



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 32 of 2014

Muhammad Asif Raza, FCA,

....Appellant

Asif Associates, Chartered Accountants

Versus

Head of Department (Enforcement)

Securities and Exchange Commission of Pakistan

....Respondent

Date of Hearing

03/12/14

### ORDER

Present:

Appellant

Mr. Muhammad Asif Raza, FCA, Asif Associates, Chartered Accountants

For the Respondent:

1. Ms. Maheen Fatima, Director (Enforcement)
2. Mr. Alishah Ali Raza, Deputy Director (Enforcement)

1. This order is in appeal No. 32 of 2014 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 27/05/14 (the "Impugned Order") passed by the Respondent.

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2. The brief facts of the case are that Asif Associates, Chartered Accountants (the “Auditor”) audited the annual financial statements of Prime Foundation (the “Company”) for the year ended 30/06/12 (the “Financial Statements”) and issued an unqualified audit report (the “Report”) dated 20/10/12. The Enforcement department (the “Department”) of the Commission while examining the Financial Statements observed that the “Statement of Changes in Fund” was not annexed to the Financial Statements of the Company; and the Auditor of the Company neither gave an opinion on the missing statement nor modified the Report thereon. Furthermore, Note 2.1.2 of the Financial Statements of the Company states the depreciation policy in accordance with which full year’s depreciation was charged on additions while no depreciation was charged on items disposed off during the year. The disclosure given in Note 2.1.2 of the Financial Statements indicated prima facie that the Company has not complied with the provisions of para 3.33 of section: 3 “Property, Plant and Equipment” of the Accounting and Financial Reporting Standards (the “AFRS”), as an incorrect depreciation policy has been used in the Financial Statements of the Company on charging depreciation on assets acquired and disposed off during the year. In the presence of the aforesaid non-compliance of the AFRS the Auditor’s opinion that the financial statements conform to “approved accounting standards as applicable in Pakistan” do not appear to be appropriate and well-founded. Moreover, the form and content of the Report to the members was not modified in a manner which was required to give user appropriate understanding of the Report. The depreciation policy in the Financial Statements was contrary to the provisions of AFRS and prima face, the Auditor failed to perform the audit of the financial statements of the Company as per the standards and guidelines provided in International Standards on Auditing (the “ISAs”) and the opinion that the Financial Statements give a “true and fair view” was not correct.



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Moreover, the Auditor failed to highlight the above-referred facts in his Report to the members of the Company.

3. Show Cause Notice dated 21/03/14 (“SCN”) was issued to the Auditor of the Company under section 260 read with section 255 and 476 of the Companies Ordinance (the “Ordinance”). The Auditor submitted its response vide letter dated 10/04/14 and hearing on the matter was conducted the same day. The Respondent found the submissions of the Auditor in respect of revision of the Financial Statements of the Company and his report untenable.
4. The Respondent dissatisfied with the submissions of the Appellant held that the Auditor had failed to comply with the provisions of section 255(3) of the Ordinance by presenting a Report which does not highlight Company’s non-compliance of Para 3.33 of AFRS and missing ‘Statement of Changes in Fund’. Therefore, the provisions of section 255 of the Ordinance have been violated which attracts penal provisions of section 260(1) of the Ordinance. However, keeping in view the assurance given by the Auditor that the default will not recur in future, a token penalty of Rs. 7,000 was imposed on the Appellant
5. The Appellant has preferred to file the instant appeal against the Impugned Order. The Appellant argued that:
  - (a) the responsibility for filing of financial statements is of the Company and not of the auditor as established by Circular No. 7 of 2013 dated 23/05/13 and section 468 of the Ordinance. The auditor’s responsibility is limited that is to express opinion on the financial statements in the form of audit report. The audit report submitted to the Company in the first instance do not include of the “Statement of Changes in funds” due to a clerical



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mistake on part of our staff, however, subsequently a revised audit report was submitted to the Company. The revised audit report was acknowledged by the Company vide their letter dated 18/02/2014; and

- b) in accordance with paragraph 50 read with para 55 of the International Accounting Standards (IAS), depreciation is not a policy but an estimate. As per the current practice of the Company, full year depreciation is charged in the year of purchase and no depreciation is charged in the year of sale/disposal. The Appellant was not required to modify reports as the impact of charging full year's depreciation was not material to the financial statements.

6. The department's representatives argued that:

- a) the revised audit report was not issued as per the guidelines and requirements outlined in International Standards on Auditing (ISA)-560 "Subsequent Events" which establishes non-compliance of the requirements of ISA 560. Further it was noted that the revised audit report has the same date as was mentioned on the initial audit report i.e. October 20, 2012 which suggests that the revision is being used as measure to conceal the irregularities committed by the Appellant. The Appellant has made reference to letter dated 18/02/14 from the Company which states that the Financial Statements submitted with the Registrar have been superseded by the revised audit report. However, such a letter from the Company does not exonerate the Appellant from his statutory duty of withdrawing the previous 'Audit Report' to be superseded with the revised 'Audit Report' as per ISA 560; and

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- b) submission made by the Appellant on the issue of materiality of inappropriate depreciation policy of the Company is not factually correct. The Company has not charged any depreciation on deletions and in case of addition, even if the asset was purchased in the end of financial year, impact of full years depreciation has been accounted for which could have a material impact on the financial statements. It is pertinent to mention Para 6 of ISA 320 “Materiality in Planning and Performing an Audit which provides that, “...*the materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.....the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements.”*”

Further in the case of Sandhu & Co., Chartered Accountants vs. Commissioner (Enforcement & Monitoring) SEC, Appeal No. 57 of 2003, it was held that the arguments of the auditor on the materiality of the issue would not be considered acceptable since the auditors are required by law to report on the accounts of the company prepared according to the IAS as applicable in Pakistan and as such a failure to report to the shareholders that the statements do not give the information as required by the law and standards and also do not give a true and fair view as required under section 255 of the Ordinance will be considered a default on part of the auditor.

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7. We have heard the arguments. Section 255(3) and 260 of the Ordinance, Para 50 read with para 55 of the International 3.33 Accounting Standards (IAS) and Para 6 and Para 7 of ISA 705 “Modification to the Opinion in the Independent Auditor’s Report” are reproduced for reference:

### ***Section 255(3) of the Companies Ordinance, 1984***

*(3) The auditor shall make a report to the members of the company on the accounts and books of accounts of the company and on every balance-sheet and profit and loss account or income and expenditure account and on every other document forming part of the balance-sheet and profit and loss account or income and expenditure account, including notes, statements or schedules appended thereto, which are laid before the company in general meeting during his tenure of office, and the report shall state—*

- (a) whether or not they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of the audit;*
- (b) whether or not in their opinion proper books of accounts as required by this Ordinance have been kept by the company;*
- (c) whether or not in their opinion the balance-sheet and profit and loss account or in the income and expenditure account have been drawn up in conformity with this Ordinance and are in agreement with the books of accounts;*
- (d) whether or not in their opinion and to the best of their information and according to the explanations given to them, the said accounts give the information required by this Ordinance in the manner so required and give a true and fair view—*
  - (i) in the case of the balance-sheet, of the state of the company’s affairs as at the end of its financial year;*
  - (ii) in the case of the profit and loss account or the income and expenditure account, of the profit or loss or surplus or deficit, as the case may be, for its financial year; and*
  - (iii) in the case of the statement of changes in financial position or sources and application of funds of a listed company, of the changes in the financial position or the sources and application of funds for its financial year;*
- (e) whether or not in their opinion-*



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- (i) *the expenditure incurred during the year was for the purpose of the company's business; and*
- (ii) *the business conducted, investments made and expenditure incurred during the year were in accordance with the objects of the company ; and*
- (f) *whether or not in their opinion zakat deductible at source under the Zakat and Usher Ordinance, 1980 (XVIII of 1980), was deducted by the company and deposited in the Central Zakat Fund established under section 7 of that Ordinance.*

### **Section 260 of the Companies Ordinance, 1984**

*(1) If any auditor's report is made, or any document of the company is signed or authenticated otherwise than in conformity with the requirements of section 157, section 255 or section 257 or is otherwise untrue or fails to bring out material facts about the affairs of the company or matters to which it purports to relate, the auditor concerned and the person, if any, other than the auditor who signs the report or signs or authenticates the document, and in the case of a firm all partners of the firm, shall, if the default is wilful, be punishable with fine which may extend to 2[one hundred] thousand rupees.*

### **Para 50 and 55 of IAS 3 "Property, Plant and Equipment"**

*50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.*

*55 Depreciation of an asset begins when it is available for use, i.e .when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Depreciation of an asset ceases the date when the asset is derecognized. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.*

### **Para 6 and 7 of ISA 705 "Modification to the Opinion in the Independent Auditor's Report"**

*"6. The auditor shall modify the opinion in the auditor's report when: (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement: or (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.*



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7. *The auditor shall express a qualified opinion when: (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.*”

Emphasis Added

- a) the aforementioned provisions of the law are clear and unambiguous. It was necessary for the Appellant to consider the validity of provisions under section 1 “Presentation of Financial Statements” and Para 50 read with para 55 of IAS 3 “Property, Plant and Equipment”. The auditors being the ultimate watchdog of the shareholders interest are required to give a report on the Financial Statements and books of account after conducting the audit in accordance with the prescribed procedures and requirements of the Ordinance, International Accounting and Auditing Standards. In case any misstatement / omission is found, which has a material impact on the financial statements, the auditor is required to issue a modified report.

In the instant case, the Appellant has admitted their mistake that they have not identified the title of “Statement of Changes in funds” due to a clerical mistake on part of their staff and consequently submitted a revised audit report to the Company. The revised report was required to be submitted as per the guidelines outlined in International Standards on Auditing (ISA)-560 “Subsequent Events” which have not been compiled by the Appellant.

The fact that the Company had acknowledged the revised report has no bearing on the Appellant does not relieve him of his statutory responsibility to follow the guidelines and requirements of ISA; and





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- b) section 255 of the Ordinance requires auditor to express an opinion to the best of their information and according to the explanations given to them which gives a true and fair view relating to the affairs of the Company. The Appellant has argued that the audit opinion does not have to be modified as charging full year's depreciation was not material to the financial statements. In this connection, the department has argued that impact of full years depreciation has to be accounted for which could have a material impact on the financial statements. Para 6 of ISA 320 "Materiality in Planning and Performing an Audit states, *"...the materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.....the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements."*

The Appellant has admitted that deprecation policy adopted by the company was not in line with the IAS and advised the Company to change their deprecation policy. In compliance the Company has changed their deprecation policy in the subsequent financial statements for the year ended June 30, 2013.

The above depicts that the depreciation policy adopted by the Company was not appropriate and the auditor being Appellant has failed to discharge statutory responsibility.

In view of the foregoing, we are of the view that the Appellant has failed to give an audit report in accordance with the provisions of section 255(3) of the Ordinance and

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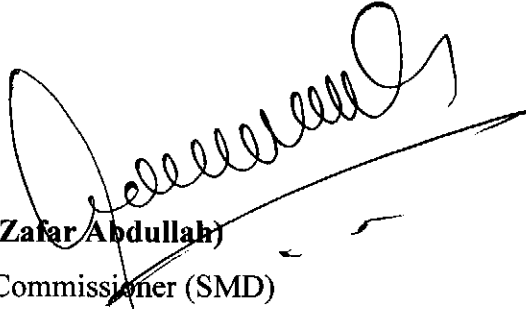
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the penalty, therefore, was rightly imposed on the Appellant. The Impugned Order is upheld with no order as to costs.

  
(Zafar Abdullah)  
Commissioner (SMD)

  
(Tahir Mahmood)  
(Chairman)

Announced on: 08/12/14