



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. IV

In the matter of

Appeal No. 33 of 2012

Aslam Malik & Co. Chartered Accountants

.... Appellant

Versus

Head of Department (Enforcement), Securities and Exchange
Commission of Pakistan

.... Respondent

Date of hearings:

24.05.13 & 13.05.15

Present:

For Appellant:

Mr. Muhammad Khalid Aslam, Manager

For Respondent:

- i. Mr. Ali Azeem Akram, Director Enforcement
- ii. Mrs. Maheen Fatima, Director Enforcement

ORDER

1. This order shall dispose of appeal no. 33 of 2012 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 06.06.12 (the Impugned Order) passed by the Respondent under section 255 and 260 read with section 476 of the Companies Ordinance 1984 (the Ordinance).
2. The facts leading to the case are that the Respondent, while examining the annual audited accounts for the financial year ended on 30.06.10 (the Accounts) of KFW



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Factors (Pvt.) Limited (the Company), observed that Aslam Malik & Co (the Appellant) issued an unqualified audit report to the members of the Company, although the Company had failed to comply with the certain disclosure requirements of Accounting and Financial Reporting Standards for Small and Medium Sized Entities issued by ICAP ("AFRS for SMSEs).

3. The matter was inquired from the Appellant vide letter dated 03.01.12. Reply to the letter was received vide letter dated 02.02.12 wherein Appellant submitted cash flow statement, statement of changes in equity, and revised notes to the Accounts. The Respondent issued a Show cause notice dated 17.04.12 (the SCN) to the Appellant under section 255 and 260 read with 476 of the Ordinance. The Appellant replied to the SCN vide letter dated 18.05.12 and thereafter hearing in the case was held on 31.05.12. The Respondent being dissatisfied with the response of the Appellant held that the provisions of section 255 of the Ordinance have been violated therefore instead of imposing maximum fine; a penalty of Rs. 40,000 was imposed on the Appellant under section 260(1) of the Ordinance.
4. The Appellant, being aggrieved by the Impugned Order filed an appeal before the Appellate Bench and prayed to waive the penalty and set aside the Impugned Order. The grounds of appeal by the Appellant are as follows:
 - i) The Company does not fall under MSEs based on its turnover and the number of employees. It is also not an Economically Significant company. Only the total of equity crosses the minimum level figure of Rs. 25 million, for MSEs, due to undistributed profits of past years. The only source of income in the year under consideration is dividend income and profit on bank deposit. The total revenue declared is around Rs. 5 million only.
 - ii) The primary responsibility of preparation of Cash Flow Statement and Statement of Changes in Equity is of the management of the Company and not of the auditors.

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- iii) Section 234 (3) (ii) regarding contents of balance sheet and requirement of Cash Flow Statement and Statement of Changes in Equity is applicable to listed companies only. Further Section 255 (3) (iii) outlines requirement of the statements for listed companies only.
- iv) Being a private limited company doing almost no trading, non-preparation of cash flow and statement of changes in equity did not affect any of its shareholders or investors.
- v) The complete and comprehensive notes to accounts were available, so this is not true that no accounting policies were available. Notes required for all items of balance sheet and profit and loss account have been properly disclosed. The basis of preparation of financial statements has been given properly and in the required way. There is no default on this issue and the order is silent and does not highlight the violations, if any, observed by SECP. Please see note Nos. 1 to 12 attached with the financial statements.
- vi) The company is not doing any trading or manufacturing business. It is receiving income from its investments. So in this case no accounting policies are required to be disclosed as is required for a manufacturing concern.
- vii) Based on above facts and circumstances it is clear that there is no violation of section 255 so the penalty imposed is unjustified and arbitrary.
- viii) The the observations of the learned Head of Department (enforcements) are merely based upon his personal thinking which does not have any backing of law.
- ix) The imposed penalty of Rs. 40,000/- is quite, excessive, harsh and unjustified, hence liable to be deleted.

5. Respondent replied to the appeal through para wise comments and rebutted the grounds of appeal and arguments of the Appellants against the Impugned Order. The

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Respondent reiterated the arguments stated in the Impugned Order and prayed to dismiss the appeal as follows:

- i) In accordance with the classifications of non-listed companies provided in S.R.O. 860 (I)/2007 dated August 21, 2007, now replaced with SRO-23 (I)-2012 dated January 16, 2012, the Company falls under that ambit of Medium Sized Entities ("MSEs"). The Auditor has also referred to the Company's equity of Rs. 571.173 million due to which the Company has to follow the MSE's reporting standards. In view thereof, the Company was required to follow the Accounting and Financial Reporting Standards for Small and Medium Sized issued by ICAP ("AFRS for SMSEs") as required under the aforementioned notifications.
- ii) This is factually correct that management of the Company is responsible for preparation of the financial statements. But Auditor is required to give an opinion on the financial statements. In this case the Auditor gave an unqualified opinion inspite of the fact that certain disclosure requirements were not complied with.
- iii) The AFRS for SMSEs have been notified by the Commission in exercise of its power under Section 234 of the Ordinance. Therefore, it is obligatory for the non-listed companies falling under these classifications to prepare their accounts in accordance with the requirements of AFRS for SMSEs. Section 255(3) of the Ordinance clearly requires the auditor to report to the members of the Company on accounts and on every balance sheet and profit and loss account or income and expenditure account, including notes, statements. Furthermore, Section 255 (4) of the Ordinance requires the auditor to report non-compliance of the provisions of the Ordinance with a qualification. Auditor may not be exonerated from its statutory duty of highlighting the Company's non-compliances of applicable reporting standards. It is also pertinent to note that Para 1.1 of AFRS for SMSEs requires companies to prepare cash flow statement and statement of

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changes in equity along with the accounts. However, the Company did not prepare these statements and the Auditors have not highlighted the fact in the Auditor Report.

- iv) Auditor's reference to Para 234 (3) (ii) is inappropriate and irrelevant. The Company was required to prepare cash flow statement and statement of changes in equity in accordance with the requirements of Para 1.1 of AFRS for SMSEs. The Auditor referred para 234 (3) (ii) which list downs the requirement of cash flow statement and statement of changes in equity for listed companies. However, the referred provision of the Ordinance never discussed or acquits the non-listed companies from the preparation of cash flow statement and statement of changes in equity and in the capacity of an MSE the company had to abide by the Para 1.1 of AFRS for SMSEs as stated above. Therefore, he may also be directed to remain vigilant of the statutory duties and roles to perform higher quality of audit in the future.
- v) This is an inappropriate and irrelevant reference as Section 255 (3) (iii) does not exist in the Ordinance. The Company, as MSE, was required to prepare cash flow statement and statement of changes in equity in accordance Para 1.1 of AFRS for SMSEs. The Auditors was liable under sub-section 3(c) of section 255 of the Ordinance to adjudge the compliance of the Company with the provisions of the Ordinance. However, the Auditor did not highlight the non-compliances of AFRS for SMSEs in his report as a result of which proceedings were initiated under Section 260 of the Ordinance.
- vi) The Company was required to follow the law.
- vii) The accounts of the Company for the year ended June 30, 2010 were examined. It may be noted that the issue of non-compliances of AFRS for SMSEs and non-compliance of provisions of the Ordinance was inquired from the auditor vide letter dated January 3, 2012. The Auditor responded on February 2, 2012 and provided accounts wherein revised notes to the Accounts, cash flow statement

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and statement of changes in equity were duly added. It may be seen that submission of revised accounts shows that the Auditor failed to comply with the provisions of the Ordinance while preparing and filing the Accounts with the Commission. This fact was further corroborated from company's response dated February 9, 2012 wherein it was stated as follows:

"Reference to your letter No. EMD/242/P/71/11-4 dated January 3, 2012, this is to intimate you that we have gone through our subject financial statements and have found that the deficiencies pointed out by you have been overlooked on our part. However we would like to ensure you that in future submission of financial statement of SECP, we will comply with all the requirements of AFRS for MSE and the Companies Ordinance, 1984,"

In the appeal the auditor has taken a completely contradicting stance in comparison to earlier submissions and stated that comprehensive notes to the Accounts were available. It may also be observed from perusal of accounts annexed with the appeal that the notes are not in compliance with AFRS for MSEs. In addition to non-preparation cash flow statement and statement of changes in equity, it may be observed that notes to the Accounts do not provide basis of preparation of accounts, accounting policies and date of authorization of financial statements. Para 2, 3, 6 and 7 of the Order explicitly discuss violations of AFRS for SMSEs in detail, therefore, Auditor's stance in this regard may be considered unjustified.

- viii) Para 1.33 of AFRS for SMSEs explicitly requires MSEs to prepare accounting policies for better understanding of Accounts. In this context, it was binding on the Company to prepare and attach its accounting policies in accordance with the requirements of AFRS for SMSEs and the Auditor was required to report on the status of conformity of applicable reporting standards by the Company.
- ix) The SCN proceedings were initiated against the Auditor after observing the probable default of provisions of the law by the auditor. The Auditor was duly

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provided with an opportunity to appear before the Commission wherein it may be noted that the Auditor admitted the default. The Order provides the detailed background of the case and furnishes the pattern of actions taken in the matter. Para 6 and Para 7 of the Order clearly discuss the Auditor's failure to observe the compliance of the relevant provisions of the Ordinance. Arguments submitted by the Auditor were appropriately addressed in these Para and his contravention of law was also explicitly discussed. In addition, relevant provisions of the Ordinance and notification issued in this regard were also highlighted to the Auditor for consideration. The order also discusses the auditor's duty to present opinion on the Accounts and highlight non-compliances of law and reporting standards, which in the case in hand the Auditor failed to perform. Considering the aforementioned facts, the decision was reached to penalize the Auditor.

- x) The Penalty was imposed on the Appellant after giving due consideration to the default of the Ordinance and quality of audit report and opinion formulated by the Appellant. The Appellant made blatant violations of the Ordinance and admitted the default during the course of hearing. Considering these facts and acceptance of default by the Appellant, instead of imposing maximum fine, the Respondent took lenient view and imposed penalty of Rs. 40,000 on the Appellant. Therefore, request for leniency in this matter is not justified as the Appellant failed to comply with the provisions of the Ordinance in true letter and spirit. It is also pertinent to note that in order to take further leniency from the Bench; The Appellant has altered his earlier stance during the hearing in which he admitted the default before the Respondent.
6. We have heard the parties i.e. Appellant and Respondent at length and perused the relevant record with the able assistance of the parties.
7. The Appellant in its capacity as an Auditor has failed to discharge its duty in accordance with section 255 of the Ordinance by issuing an unqualified opinion on

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accounts which did not include cash flow statement and statement of changes in equity as required by the MSE's reporting standards.

8. The Company has admitted the fact that cash flow statement and statement of changes in equity as required by the MSE's reporting standards has not been included in the accounts and the same will be complied in future. The Auditor response on February 2, 2012 of providing accounts wherein revised notes to the Accounts, cash flow statement and statement of changes in equity were duly added is itself an admission of the fact that he has failed to discharge his duty which he attempted to hide by providing yet another false statement as the management of the Company has not intended to file revised accounts.
9. In the light of above stated facts which came on record through pleadings and submissions made before the Appellate Bench by the parties it has been established that the Appellant has violated the section 255 of the Ordinance and the Respondent has rightly imposed the penalty on the Appellant. Therefore, no case of appeal against the Impugned Order has been made out by the Appellant. In view of the aforesaid, there being no reason to interfere with the Impugned Order dated 06.06.12, hence, the appeal is dismissed.
10. Parties to bear their own cost.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SM)

Announced on:

06 JUL 2015