



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter or

Appeal No. 137 of 2020

Mr. Khan Muhammad, Engagement Partner of M/s. Kreston Hyder Bhimji & Company
(Auditor of J.A Textile Mills Limited)

..... Appellant

Versus

Executive Director/HOD, Adjudication – I, SECP

..... Respondent

Date of Hearing:

April 17, 2025

Present:

For the Appellant:

1. Mr. Khan Muhammad, Appellant
2. Mr. Syed Aftab Hameed, Authorized Representative

For the Respondent:

1. Mr. Mubasher Saeed Saddozai, Executive Director, Adjudication Division, SECP
2. Mr. Khurram Hassan, Additional Joint Director, Adjudication-I, SECP

ORDER

1. This Order shall dispose of Appeal No. 137 of 2020 filed by Mr. Khan Muhammad, Engagement Partner of M/s. Kreston Hyder Bhimji & Company (the Appellant), auditor of J.A Textile Mills Limited (the Company), against order dated September 30, 2020 (the Impugned Order), passed by the Executive Director/HOD, Adjudication-I, SECP (the Respondent), under Section 253 read with Section 249 of the Companies Act, 2017 (the Act).



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2. Brief facts of the case are that Note 16 to the annual audited financial statements for the year ended June 30, 2017 (the Financial Statements) of the Company disclosed a total loan liability of Rs. 15.111 million, comprising Rs. 4 million long-term and Rs. 11.111 million short-term loans payable to MCB Bank Limited (the Bank) and Note 26 to the accounts revealed an amount of Rs. 22.032 million recorded under "Other Income" on account of remission of mark-up/interest pursuant to a Settlement Agreement (the Agreement) with the Bank. Note 16.1 to the accounts stated that subsequent to the balance sheet date, the Company entered into the Agreement dated October 16, 2017 with the Bank, whereby the outstanding liability was agreed to be settled for Rs. 15.110 million, including a down payment of Rs. 3.111 million to be made within seven days and the balance payable in twelve equal monthly instalments of Rs. 1 million each. The Company recorded the remission of Rs. 22.032 million as income in the accounts based on the Agreement. The Securities and Exchange Commission of Pakistan (the Commission), upon review, observed that pursuant to clauses 6 and 7 of the Agreement, the remission was conditional upon the realization of the full settled amount. It was further noted that such realization occurred only in October 2018, whereas the income had already been recognized in the Financial Statements. The Commission, therefore, concluded that the remission did not meet the criteria of an adjusting event under International Accounting Standard (IAS) 10. Accordingly, the Company was obligated to retain the accrued mark-up as a liability in its Financial Statements. Furthermore, the Commission observed that the Appellant, *prima facie*, failed to identify and report this material misstatement in the audit report. As a result, the Financial Statements were *prima facie* materially misstated, and the audit report was not in compliance with Section 249 of the Companies Act and the applicable provisions of the International Financial Reporting Standards. This non-compliance attracted the provisions of Section 253 of the Act, thereby rendering the Appellant liable to regulatory action thereunder.
3. Consequently, the Respondent issued a Show Cause Notice (the SCN) dated January 2, 2019, to the Appellant. Hearing in the matter was held on September 10, 2020 where the Appellant furnished certain explanations. The Appellant denied any lapse on his part and contended that the income recognition was in accordance with IAS 10 and the related International Auditing Standards, the amount was below the materiality threshold, and all payments were made under the Agreement in due course. The Respondent found the Appellant's submissions unsatisfactory on the ground that the Company had reversed the accrued mark-up of Rs.



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22.032 million prior to finalization of the Agreement on October 16, 2017, and before realization of the full settled amount, and noted that the reversal of mark-up directly inflated the profit after tax for the year ended June 30, 2017 by 8.55 times. The Respondent concluded that the income recognition was premature, lacked legal enforceability as of the balance sheet date, and materially misstated the Company's financial position, which the Appellant failed to qualify or disclose in the audit report. Consequently, a penalty of Rs. 100,000/- was imposed on the Appellant in exercise of powers under Section 253 of the Act.

4. The Appellant preferred the instant appeal *inter alia* on the grounds that the Impugned Order is liable to be set aside as it is contrary to the facts, law, and record of the case, and fails to consider the detailed written submissions, oral representations, and supporting documents duly furnished by the Appellant during the proceedings. The Appellant contended that identical responses submitted by the Company regarding the remission of markup and adjustment of loan liabilities were accepted by the Commission without any adverse action, and therefore, penalizing the Appellant on the same issue constituted discriminatory treatment in violation of the principles of equity. The Appellant further submitted that the Respondent failed to duly consider the legal implications arising from the unauthorized conversion of the loan and the unlawful imposition of compound markup by the Bank, which according to the Appellant, have been condemned by the Hon'ble Supreme Court of Pakistan in multiple authoritative judgments. The Appellant submitted that the markup was consistently disclosed in the company's Financial Statements since 2008 and that the remission of Rs. 22.032 million, as recognized in the Financial Statements, was in fact only Rs. 6.951 million after adjusting the cost of funds, which was well within the materiality threshold of Rs. 8.191 million set by the Appellant, thus having no impact on the audit opinion. The Appellant submitted that the Respondent wrongly relied on an incorrect amount of Rs. 33.709 million mentioned in the Bank's letter dated September 12, 2017, an amount that was neither part of the Bank's legal pleadings nor raised in the SCN or during the hearing, therefore, making such reliance an afterthought and legally flawed. The Appellant further stated that the Agreement dated October 16, 2017 simply confirmed the terms already outlined in the Bank's earlier letter of September 12, 2017, and that all settlement terms including the down payment and submission of twelve post-dated cheques were fully complied with before the audit report was signed by the Appellant on October 07, 2017. The Appellant emphasized that there was no misstatement in the Financial Statements as all



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conditions of the Agreement were fulfilled in letter and spirit, and that the delay in issuance of the NOC and vacation of charge by the Bank was due to routine regulatory formalities, unrelated to the audit process. The Appellant also denied that there was any failure on the part of the Appellant to collect or verify evidence in accordance with IAS 10 and 37, and that all professional responsibilities were discharged diligently and in compliance with Sections 249 and 253 of the Act. The Appellant thus prayed that the Impugned Order may kindly be set aside.

5. In response to the Appellant's submissions, the Respondent *inter alia* submitted that the Appeal is devoid of merit and unsupported by any admissible documentary evidence. The Respondent contended that the Appellant failed to amend the audit report for the year ended June 30, 2017, which resulted in initiation of proceedings under Section 253 of the Act. The Respondent submitted that the Appellant failed to obtain sufficient appropriate audit evidence, as required under paragraph 9(a) of IAS 10 and paragraph 16 of IAS 37, to determine the existence of a present obligation as at the reporting date. Furthermore, the Appellant's failure to modify the audit opinion, particularly in light of the premature recognition of Rs. 22.032 million as "Other Income" on account of remission of mark-up, constituted a material misstatement in violation of Section 249 of the Act. The Respondent stated that the Bank's letter dated September 12, 2017 reflected total liability of Rs. 33.709 million, including Rs. 18.599 million as mark-up, an amount well in excess of the materiality threshold of Rs. 8.191 million as set by the Appellant himself, while the Company had recorded an even higher mark-up in the amount of Rs. 22.032 million. The Respondent refuted the Appellant's contention that only Rs. 6.951 million of mark-up along with Rs. 1 million as cost of funds was waived, and termed it misconceived as the amount settled as per Agreement was Rs. 15.111 million which was well above the materiality level. The Respondent asserted that the recognition of remission of markup as "Other Income" was premature and not in accordance with the terms of the Agreement dated October 16, 2017, which had not been executed prior to the issuance of the audit report on October 07, 2017, resulting in a distorted representation of profits in the Financial Statements, which would otherwise had disclosed a significant loss. The Respondent further contended that the Appellant failed to appropriately draw the attention of shareholders to the premature reversal of the mark-up.



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6. It was further submitted by the Respondent that Clause 11 of the Agreement mandated reporting of the remission in the Credit Information Bureau (CIB) by the Company, and the Appellant failed to produce any evidence of such reporting. The Respondent pointed out that the Agreement was executed on October 16, 2017 and the Banking Court's decree was passed on October 24, 2017, both subsequent to the date of the audit report and thus, any reliance on these post-balance-sheet events to justify the reversal of mark-up as an adjusting event was contrary to the requirements of IAS 10 and IAS 37. The Respondent further submitted that the twelve post-dated cheques relied upon by the Appellant were delivered on October 24, 2017, thereby rendering them irrelevant for assessing the financial position of the Company as on June 30, 2017, consequently, the recording of the remission of markup in the Financial Statement was based on an unexecuted Agreement, and the Appellant's failure to highlight this material misstatement and to modify the audit opinion constituted a non-compliance with the duties imposed under Section 249 of the Act. The Respondent further contended that the remission was contingent upon full compliance with all operative clauses of the Agreement, and that the premature reversal resulted in an inflated profit after tax for the year ended June 30, 2017 by 8.55 times. According to the Respondent, this constituted the recognition of income without the requisite legal enforceability of the Agreement as on the balance sheet date, thereby resulting in a material misstatement of the Company's financial position.
7. The Appellate Bench (the Bench) has heard the parties at length and perused the record with due care and caution. The prime issue for determination is whether the Appellant, in conducting the audit of the Company's Financial Statements discharged his professional obligations in accordance with the applicable statutory and regulatory framework, particularly under Section 249 of the Act and the relevant international accounting standards, or if the premature recognition of remission of mark-up amounting to Rs. 22.032 million constituted a material misstatement that necessitated modification of the audit opinion. The Bench notes that the remission of mark-up was recorded in the Company's accounts based on the Agreement, the formal execution of which occurred after the balance sheet date i.e. on October 16, 2017 and full realization of which occurred even later, in October 2018. The remission was therefore contingent and conditional as per clauses 6 and 7 of the Agreement. The said clauses are reproduced below for ease of reference:

"6. That upon realization of the entire settled/agreed amount i.e. Rs. 15.111 Million, strictly in accordance with above payment schedule mentioned above, the bank shall:



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waive-off the remaining outstanding liability.

"7. That all remissions given/offered under this settlement agreement shall only accrue upon realization of entire settled/agreed amount as per terms and conditions set out therein."

8. The Bench observed that under paragraph 9(a) of IAS 10 and paragraph 16 of IAS 37, a present obligation or adjusting event requires the condition to exist as on the balance sheet date. Since the relevant conditions had not been fulfilled by June 30, 2017, the recognition of Rs. 22.032 million as "Other Income" was evidently premature and lacked legal enforceability. The Appellant's failure to qualify or appropriately modify the audit opinion in view of this material misstatement is found to be a serious lapse, undermining the reliability and accuracy of the Financial Statements. The Bench further notes that the reversal of accrued mark-up resulted in an 8.55 times inflation in the reported profit after tax, thereby rendering the impact of the misstatement as significant and well beyond the materiality threshold of Rs. 8.191 million. The Bench also finds no merit in the Appellant's contention that the remission amount was only Rs. 6.951 million, as the Company had recognized the full amount of Rs. 22.032 million, and the record does not support the purported adjustments. Additionally, reliance by the Appellant on the post-dated cheques, the Agreement, and the Banking Court's decree executed or delivered after the issuance of the audit report on October 07, 2017 cannot retrospectively validate the recognition of income in the Financial Statements as of June 30, 2017. Such reliance is inconsistent with the provisions of IAS 10 governing adjusting and non-adjusting events. Furthermore, the Bench is of the view that the Appellant's assertions regarding the unauthorized conversion of the loan and the alleged imposition of compound mark-up by the Bank are not relevant to the issues under adjudication in the present matter and thus do not merit further consideration.
9. Additionally, the Bench finds no substance in the Appellant's plea of discriminatory treatment vis-a-vis the Company, as the role and responsibilities of an external auditor are distinct and independent, and any acceptance of the Company's submissions does not exonerate the Appellant from his duty to adhere to international accounting standards. The primary responsibility of the external auditor is to express an independent opinion on whether the Financial Statements present a true and fair view in accordance with the applicable financial reporting framework, including applicable International Accounting Standards/International Financial Reporting Standards. Furthermore, pursuant to Section 249



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of the Companies Act, 2017, the auditor is under a statutory obligation to report to the members of the company on whether the Financial Statements present a true and fair view, are in compliance with the applicable financial reporting framework, and whether the company has maintained proper books of account. The Appellant's failure to highlight the material uncertainty surrounding the remission and to issue a modified audit opinion amounts to professional negligence, attracting liability under Sections 253 of the Act.

10. In view of the foregoing, the Bench finds no reason to interfere with the merit of the Impugned Order, therefore, the Appeal is dismissed without any order as to cost.

(Akif Saeed)
Chairman/Commissioner

(Zeeshan Rehman Khattak)
Commissioner

Announced on: 02 JUN 2025