



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 14 of 2019

Ibne Hassan

...Appellant

versus

Executive Director (CSD)

...Respondent

Date of Hearing: 27/02/2020

Present:

For the Appellant:

Mr. Khurram Chughtai, Counsel

For the Respondent:

- i. Mr. Amir Saleem, Joint Director (Adjudication-1)
- ii. Mr. Muhammad Anwar Hashmi, Assistant Director (Adjudication-1)

ORDER

1. This Order is passed in the matter of Appeal No. 14 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan (Commission) Act, 1997 (SECP Act) against the Order dated 21/02/19 (Impugned Order) passed by the Executive Director, Corporate Supervision Department (Respondent).
2. The brief facts of the case are that review of annual audited accounts (Accounts) of Salam Textile Mills Limited (Company) for the year ended 30/06/16 revealed that:
 - (a) The Company computed the deferred tax liability (DTL) at the rate of 8.23% on surplus of revaluation of fixed assets (as tabulated below) against the enacted tax rate which was 32% for tax year 2016 as stipulated in Income Tax Ordinance, 2001.

Particulars (Accounts-2016)	Note Ref.	Ref.	Amount Rupees
Surplus on revaluation of fixed assets- Gross	19	A	453,469,077



Securities and Exchange Commission of Pakistan

Less: Surplus relating to land (Rs. 43.733 m less Rs. 2.346 m)	5.1 and 5.1.3	B	41,387,800
Surplus excluding revaluation of land	N/A	C=A-B	412,081,277
Deferred tax liability	16 and 19	D	33,898,446
Deferred tax rate used by the Company – % age		E=D/C	8.23%

It was noted that Company computed the DTL at the rate lower than the prevailing applicable tax rate, which was in contradiction with the requirement stipulated in Para 46 of International Accounting Standard (IAS) 12. This prima facie resulted in misstatement of balance of surplus on revaluation of fixed assets as well as DTL, as on 30/06/16.

- (b) Note 16 to the Accounts 2016 showed that the Company made adjustment of Rs.13.373 million in accounts of DTL related to surplus on revaluation of fixed assets. It was observed that the Company prima facie had not taken into account the corresponding impact of Rs.13.373 million in its Accounts 2016.
- (c) Note 16 to the annual audited accounts 2015 (Accounts 2015), revealed that the Company has not taken into account the adjustment of DTL on surplus of revaluation of fixed assets, which remained unchanged at Rs.47.272 million, in the years 2015 and 2014.
- (d) Review of Note 23.2 of the accounts for the year ended 30/06/14 (Accounts 2014) of the Company revealed rectification of error with respect to non-deduction of DTL from surplus on revaluation of fixed assets as under:

Rupees in Million

Particulars Accounts-2014	Ref.	Acc. Losses SRFA		Acc. Losses SRFA	
		2013		2012	
Previously reported	A	280.219	458.451	283.400	499.141
Restated	B	219.113	397.345	222.294	438.035
Difference	C=A –B	61.106	61.106	61.106	61.606

Total assets	D	1,113,545	1,189,515
Materiality	E=C/D	5.49%	5.14%

- (e) Review of Note 23.2 of the Accounts-2014 reflects that incremental depreciation was charged by the Company on original useful life of the revalued assets instead of charging on remaining useful life of such assets. As a result, thereof, depreciation expense and loss for the respective year *prima facie* were understated.
3. In view of the aforesaid, it was construed that the Company *prima facie* did not comply with the provisions of Para 46 and 61 of IAS 12- Income Taxes and Para 50 of the IAS 16 - Property, Plant & Equipment. The non-compliance with the above said paras of relevant standards resulted in misstatement in the Accounts of the Company for the years ended 30/06/12, 30/06/13, 30/06/14, 30/06/15 and 30/06/16. UHY Hassan Naeem & Company, Chartered Accountants (Auditors) of the Company failed to appropriately highlight the above misstatements in their reports on the aforesaid accounts of the Company. Therefore, the audit reports on the Accounts from 2012 until 2016 were not in accordance with the requirements of section 255 of the Companies Ordinance, 1984 (Companies Ordinance) and International Standards on Auditing (ISAs).
4. Show Cause Notice dated 07/09/18 (SCN) was issued to the Auditors under the provisions of section 255 of the Companies Ordinance. The reply to the SCN by the Auditors was received vide letter dated 17/09/18 and hearing in the matter was held on 05/11/18. Mr. Shahid Farooq attended the hearing on behalf of the Auditors and made his submissions.
5. The Respondent dissatisfied with the response of the Auditors held that they failed to highlight the above stated non-compliances for the respective years and had not modified their opinion in the auditors' report accordingly while not adhering to the requirements of Para 6 and 8 of ISA 705 and Para A7 of ISA-705. The audits conducted were without giving due consideration to requirements of ISA. The Auditors of the Company did not exercise professional skepticism as required to be exercised by them under ISA such as ISA 200. The Auditors seemingly failed to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and that whether the financial statements





Securities and Exchange Commission of Pakistan

are prepared, in all material aspects, in accordance with the applicable financial reporting framework. Furthermore, the Auditors should have indicated the weaknesses identified during the course of audit in the auditors' reports. The Auditors apparently also did not design and perform substantive procedures for material and important transactions during the audit. The Auditors have failed to comply with the requirements of section 255 of the Ordinance by not bringing out material facts about the affairs of the Company in their reports on the Accounts of the Company for the years ended 30/06/12, 30/06/13, 30/06/14, 30/06/15 and 30/06/16. Therefore, the Auditors were in contravention of section 255 of the Companies Ordinance and a penalty of Rs.50,000 was imposed by the Respondent on Mr. Ibne Hassan, Engagement Partner of the Auditors (Appellant) under the provisions of section 260 of the Companies Ordinance. The Auditors were further warned to ensure strict compliance of the law and all the applicable standards in the future.

6. The Appellant preferred the appeal on the following grounds:

- (a) The audit reports issued were in accordance with all requirements of ISAs and International Financial Reporting Standards (IFRS). Reasonable assurance was obtained during the financial years under discussion and misstatements including omissions during the course of audit are considered for adjustment if they are material. The financial impact of issues pointed in the Impugned Order was below materiality level for each year respectively. Deferred tax on incremental depreciation was calculated by using applicable future tax rate for the year ended 2016 i.e. 32%, however, incremental depreciation was inadvertently charged to surplus on revaluation of fixed asset with amount of Rs.29.77 million instead of gross amount. However, related deferred tax asset was reflected correctly under deferred tax liability account and its corresponding effect was charged to balance of revaluation surplus. Deferred tax is an estimate, which has to be adjusted against the company's profit in future years, therefore, immaterial difference in recognition of deferred tax did not affect the overall financial position of the Company. The materiality level was separately determined for respective years under examination based on the assessment of circumstances of the Company and factors determined in ISA 320 para A4. Since the deferred taxation impact for the year, under discussion, was below the materiality level ascertained for the said year i.e. Rs.14.93 million, therefore, deferred taxation impact for the year on revaluation surplus was not considered for verification. The aforementioned error was subsequently corrected by the Company in the



Securities and Exchange Commission of Pakistan

financial statements of the year ending 2018. Furthermore, since deferred tax on revaluation surplus was recorded outside profit and loss, therefore, error in recording the deferred tax liability had no impact on profit after taxation and EPS and had no significant bearing on the economic decisions of users. Therefore, no omission or error relating to deferred tax and revaluation surplus exceeds the materiality level for each year, which would require the Appellant to modify the opinion. Furthermore, professional skepticism has been exercised and all audit procedures were applied which are also evident from the replies made by the Appellant. Furthermore, the Appellant has given qualified opinion on financials for the year ending 30/06/16 on matters, which were material and may have affected the decisions of users of financial statements, which is also prima facie evidence that the Appellant while giving audit opinion on financials of the said entity has exercised professional skepticism. Furthermore, ISA 320 para 4 provides that, *"The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users make reasonable economic decisions on the basis of the information in the financial statements."* Furthermore, ISA 200 para 6 provides that, *"...the auditor is not responsible for the detection of misstatements that are not material to the financial statement as a whole."*

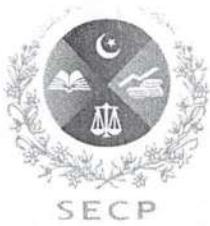
- (b) The imposition of fine must be based on any cogent and concrete grounds. Therefore, the Impugned Order is a nullity in the eyes of the law. The Appellant was neither part of the Company nor did he gain any personal benefit from the said Company and followed the ISA as well as all the relevant laws while preparing the audit report. It is important to note that the Respondent while passing the Impugned Order has ignored the basic and fundamental principle of Audi Alteram partem as the Appellant was not afforded an opportunity to argue and explain the relevant facts in the matter. The Respondent while passing the Impugned Order has bypassed relevant laws by ignoring the relevant material and details given in all written replies and passed a non-speaking order. It is of utmost importance to note that receipt of the notices by Appellant and the submission of replies did not prove that the Appellant was given ample opportunity in the matter. Furthermore, during the investigation/proceedings no concerns were raised by the Respondent with regards to the Appellant in his personal capacity.

7. The Respondent rebutted the arguments of the Appellant on the following grounds:



Securities and Exchange Commission of Pakistan

- (a) The Impugned Order is a speaking order based on the facts of the case. The Appellant was the statutory auditor of the Company. The auditor being the ultimate watchdog of the shareholders' interest is required to give a report on the accounts and books of account after conducting the audit in accordance with the prescribed procedures and requirements of the Companies Ordinance and IFRS. Accounts audited by them carry weight and are relied upon by various authorities and stakeholders. The statutory financial statements of companies are required to be prepared in accordance with the approved accounting standards comprising IFRS/IAS, as applicable in Pakistan. Furthermore, provisions of IAS 12 and 16 are clear and explicit and any non-compliance with the provisions of IFRS/IAS will lead to misstatement in the financial statement, which can be misleading for the users of financial statements. The Company deducted the related DTL of Rs.33.898 million, which could not be arrived at by applying the enacted tax rate for the year i.e. 32%. Furthermore, no supporting working have been mentioned under the respective Note to substantiate the computation of the DTL. Therefore, the Company had not computed the DTL on surplus on revaluation of fixed assets in accordance with the provisions of IAS 12. The deviation from IAS 12 resulted in material misstatement in the closing balance of surplus on revaluation of fixed assets as well as the balance of DTL in the Accounts of 2016. The Appellant admitted that the management of the Company did not account for DTL for the year 2015 and further stated that financial statement for the year ended 30/06/18 were corrected to that extent. Furthermore, with regard to incremental depreciation, this cannot be charged on the original life and the Company was required to charge the incremental depreciation on remaining life of the revalued asset. The Appellant was required to bring out this fact to the knowledge of the shareholders and is responsible in his personal capacity for failing to highlight any deviations by the Company from the applicable laws or accounting standards that are included in his scope.
- (b) Hearing in the matter was held on 05/11/18, which was duly attended by authorized representative of the Appellant. Furthermore, a written response to the SCN was submitted, for which extension of time was allowed. The Impugned Order has properly covered the response of the Appellant to the SCN and provided adequate rebuttal before concluding the proceedings. The mistakes in the accounts alleged in the SCN were material and the auditor is required to highlight it in accordance with accounting standards. Qualifications given on some matters in the audit report does not exonerate the auditor from failing to highlight other material deviations. The Appellant chose to be represented by an authorized representative



Securities and Exchange Commission of Pakistan

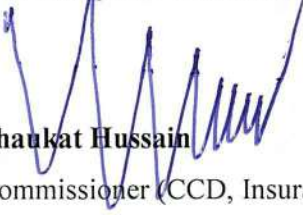
instead of attending the hearing himself and was given proper hearing opportunity as per the standard procedure of the Commission in adjudication proceedings.

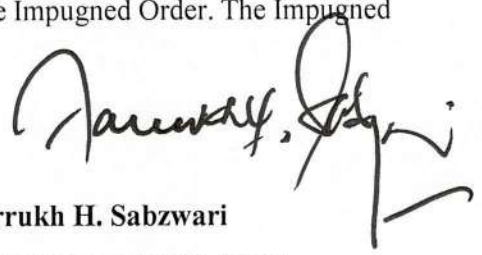
8. We have heard the parties i.e. the Appellant and the Respondent. Section 260 of the Companies Ordinance clearly states that if any document of a company is signed or authenticated and which is otherwise untrue or fails to bring out material matters to which it purports to relate, the auditor who signs or authenticates such a document is liable to a fine that may extend to one hundred thousand rupees. Para 46 of the IAS-12 provides that, *"Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period."* Furthermore, Para 50 of the IAS-12 provides that, *"The depreciable amount of an asset shall be allocated on a systematic basis over its useful life."* In the instant case, the Company had not computed the DTL on surplus on revaluation of fixed assets at the applicable tax rate in accordance with the provisions of IAS. Furthermore, the Company charged incremental depreciation on original useful life of the revalued assets instead of charging it on remaining useful life of such assets, which has resulted in understatement of loss in Accounts of the year ended 2014. While it is correct that in terms of ISA 320, materiality is a matter of professional judgment of the auditor, we are of the view that in the instant case, the information was material which no reasonable auditor would have failed to highlight and, therefore, deviation from IAS 12 resulted in material misstatement which in turn impacted the decisions of users of the financial accounts. Para 8 of ISA-705 states that, *"The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate evidence concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial statements."* It is the responsibility of the auditor, therefore, to disclose complete facts and material information. The Auditors failed to highlight the complete facts and perform the audit of the financial statements of the Company as per the standards and guidelines provided in the auditing framework and have not discharged his responsibilities in terms of section 255 of the Companies Ordinance in making a truthful report to the members of the Company. The audit reports for the years ended 2013, 2014, 2015 and 2016 are, therefore, not in conformity with the requirements of section 255 of the Companies Ordinance. Therefore, we are of the view that penalty was rightly imposed on the Appellant under section 260 of the Companies Ordinance.



Securities and Exchange Commission of Pakistan

9. In view of the foregoing, we see no reason to interfere with the Impugned Order. The Impugned Order is upheld with no order as to cost.


Shaikat Hussain
Commissioner (CCD, Insurance)


Farrukh H. Sabzwari
Commissioner (SCD, AML)

Announced on: **21 MAY 2020**