



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH IV

In the matter of

Appeal No. 39 of 2015

Manzoor Hussain Mir (FCA)

M/s Kohinoor Power Co. Ltd

..... Appellant

Versus

Mr. Tahir Mahmood, Commissioner (Company
Law Division), Securities and Exchange
Commission of Pakistan

..... Respondent

Date of Hearing 11/11/15

Present:

For the Appellants:

Mr. Manzoor Hussain Mir, Chartered Accountant, Manzoor Hussain Mir & Co.

For the Respondent:

i) Mr. Ali Azeem Ikram, Executive Director (Enforcement)

ii) Ms. Amina Aziz, Director (Enforcement)

ORDER

1. This order shall dispose of appeal No. 39 of 2015 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 against the order dated 07/09/15 (Impugned Order) passed by the Respondent.

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 1 of 13

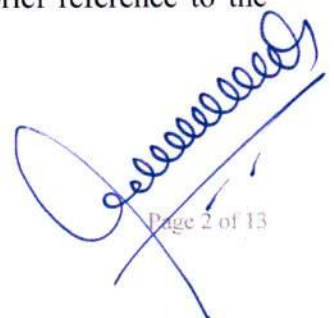


Securities and Exchange Commission of Pakistan

2. The brief facts of the case are that Mr. Manzoor Hussain Mir, Chartered Accountants (Appellant) who was auditor of Kohinoor Power Company Limited (Company) conducted the audit and signed the auditor's report dated 10/10/12 as appearing on the accounts for the year ended 30/06/12 of the Company. The said auditors' report did not appear to have been drawn out in compliance with the requirements of section 255 of the Ordinance, Form 35A of Rule 17 (C) of the Companies (General Provisions and Forms) Rules, 1985, (Rules) and International Standards on Auditing (ISAs). Further, the Appellant, prima facie, failed to adequately modify his opinion in view of the following:
- (i) The Appellant gave observations regarding discrepancies in accounting policy and accounting treatment pertaining to the determination of useful life of the plant, impairment loss, and depreciation charged provision of taxes and penalties and issue of going concern. Suggestions to the management about the accounting policies and accounting treatment were given by the Appellant.
 - (ii) The Company's sales for the year substantially decreased to Rs.282.312 million from Rs.810.519 million, Rs747.919 million and Rs737.622 million for the years ended 30/06/11, 30/06/10 and 30/06/09, respectively. Moreover, note 30 to the Accounts described that electricity purchase agreements with Lahore Electric Supply Company (LESCO) and Faisalabad Electric Supply Company (FESCO) had expired. The apparent uncertainty that existed regarding the use of going concern assumption by the Company was the fact that it lost its key customers, which was not appropriately addressed by the Appellant, who in his report only gave a very brief reference to the respective note to the Accounts.


Appellate Bench No. IV

Appeal No. 39 of 2015


Page 2 of 13

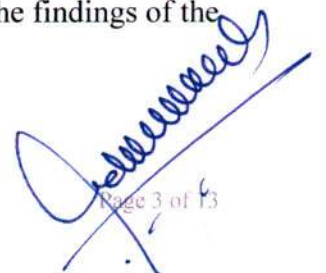


Securities and Exchange Commission of Pakistan

3. In view of the above, it appeared that the Appellant in his audit report, prima facie, failed to bring out material facts about the affairs of the Company, as per requirements of sections 255 and 260 of the Ordinance and ISA 570.
4. Show Cause Notice dated 01/01/13 (SCN) was issued to the Appellant under section 260 read with section 476 of the Ordinance. Hearing in the matter was held on 17/07/15 and the Appellant appeared before the Respondent and made verbal submissions mainly reiterating his earlier written submissions.
5. The Respondent dissatisfied with the response of the Appellant held that the Appellant in his audit report to members on Company's Accounts for the year ended 30/06/12 did not appropriately address the uncertainty that existed regarding the going concern assumption and failed to bring out material facts about the affairs of the Company. Moreover, the audit report was not in conformity with the requirements of section 255 of the Ordinance, and format provided in the Form 35A the Rules. Therefore, penalty under section 260 of the Ordinance of Rs.20,000 was imposed on the Appellant.
6. The Appellant preferred the appeal on the following grounds:
 - (a) The alleged tax liability in the opinion of the Appellant was of contingent nature that was disclosed at note 10 of the audited accounts. The Respondent has categorically stated that the Appellant's plea regarding materiality appears to be cogent but the instant proceedings are regarding the adoption of inappropriate format. The findings of the


Appellate Bench No. IV

Appeal No. 39 of 2015


Page 3 of 4



Securities and Exchange Commission of Pakistan

Respondent are very illogical for the simple reason that the Appellant has not qualified the issue as the relevant cases were subjudice before the Appellate authorities and superior courts and it was also confirmed by the 'legal advisor' vide letter dated 17/02/12 that there was likelihood of successful resolution of the matter in favour of the Company. Thus, there was no valid reason for describing such matter as qualification in Form 35A of the Rules. The matter was properly discussed in notes to the accounts as well as in the Emphasis paragraph. The objection raised is not valid and cannot be adopted for levying the penalty.

- (b) The second objection was regarding machinery impairment for which allegedly no provision was raised on which the Appellant should have issued qualified report and the matter reported in the prescribed Form 35A of the Rules. In this context, it was brought into the notice of the Respondent that a certificate was issued by the 'mechanical engineer' of the Company in which he confirmed that machinery was in working condition and there was no obsolescence. The findings of the Respondent that the Appellant has not qualified report on the issue of going concern are not justified. The management was confident that the Company for all intent and purpose was a going concern for the reason recorded at note 2.2.1 of the Accounts. The Appellant beyond any doubt has made a lot of efforts to obtain the audit evidence for forming opinion in respect of going concern assumption and the Respondent is not justified to draw adverse inference. All matters were carefully looked into and audit report as well as Emphasis note to audit report was issued after due application of mind taking into consideration the material facts prevailing at the material time.
- (c) The third objection is on the issue of going concern. The Company since its incorporation in August 1991 was engaged in the production


Appellate Bench No. IV

Appeal No. 39 of 2015


Page 4 of 13



Securities and Exchange Commission of Pakistan

of power energy that was supplied to associated companies up to 2007. Thereafter, as the business of associated companies was adversely affected, the Company made agreements with FESCO and LESCO for supply of power energy and agreements were renewed in routine from year to year while this matter was in process in 2012, the year under consideration. Accounts of the company as on 30/06/12 reflected the following position:

- Equity credit balance	Rs.349.510 million
- Current assets	Rs.185.564 million
- Current liabilities	Rs.47.058 million
- Stock & Spares	Rs.66.693 million
- Cash & bank balance	Rs.25.699 million

The above position shows that the business of the company was quite viable and a going concern. The Company's agreement of power supply could not be renewed. In the audited accounts for the year ended on 30/06/12, it was stated that the management was confident that the Company for all intent and purpose was a going concern as substantial evidence was submitted by the management of the company to the Appellant to show that necessary efforts were being made by it for renewal of power supply agreement and it also succeeded in getting its name included in the suppliers list of FESCO. Further, in the presence of documentation and representation of the management and note 2.2 and 2.2.1 to accounts, the Appellant was not justified to reject the representation of the management especially when admittedly, there was acute power shortage within the country and NEPRA had no alternative arrangement to satisfy the citizens of the country. The Appellant was quite justified in accepting the contention that agreement would be awarded and the Company would be a going concern. The decision of the Higher Power Board of

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 5 of 13



Securities and Exchange Commission of Pakistan

NEPRA remained unimplemented, however, but certainly not because of any error in the assessment of the Appellant. The Appellant beyond any shadow of doubt had made a lot of efforts to obtain the audit evidence for forming opinion in respect of going concern assumption and the Respondent was not justified to draw adverse inference. Attention is also invited to 'explanation' appended to section 255(f) of the Ordinance, which states "Explanation.- Where the auditor's report contains a reference to any other report, statement or remarks which they have made on the balance-sheet and profit and loss account or income and expenditure account examined by them, such statement or remarks shall be annexed to the auditor's report and shall be deemed to be a part of the auditor's report."

It is laid down in the explanation reproduced above, that any remarks or statement attached with the auditor's report shall be deemed to be a part of the auditor's report. It is a well decided proposition of law enunciated by the Supreme Court of Pakistan that one has to strictly adhere to the provision in the statute. Therefore, the findings of the Respondent that the matter referred to in the emphasis paragraph cannot be considered as a part of the audited report is not justified.

The Respondent omitted to take into consideration paragraph 2A that explains the word 'materiality' as "A2 The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. The listing is not all inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists."

The words "may cast significant doubt" shows that the word "may" is optional and of a discretionary nature.

The Respondent has not given any credence and importance to the conception of 'Difference of opinion' that normally arises between the

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 6 of 13



Securities and Exchange Commission of Pakistan

parties. The opinion of the Appellant cannot be the same on the issue as another auditor. The provisions of section 260 of the Ordinance are attracted only when there is a willful default. The observations are based only on difference of opinion and there is absolutely no untrue information and material facts are properly considered and disclosed in accounts as well as in notes to the accounts. It is submitted that all the matters were carefully looked into and audit report as well as emphasis-note to the audit report was issued after due application of mind taking into consideration the material facts prevailing at the material time.

7. The Respondent rebutted the arguments as follows:

- a) The Impugned Order at para 6(f) states that *with regard to observations regarding levy of taxes and penalties the respondent's plea regarding materiality appears to be cogent*. It is pertinent to note that this observation is only in respect of levy of taxes and penalties, which is just a small part of overall issues that have led to issuance of SCN. The Appellant has tried to generalize this observation given by the Respondent. However, there were other issues adequately disclosed in the Impugned Order which led to imposition of penalties. Other issues adequately disclosed in the order were material both in terms of nature and amount. Therefore, non-compliance with the prescribed format of report and materiality of issues led to imposition of penalties.
- b) It is relevant to mention that it is auditors' responsibility to clearly state that whether his report to members in respect of the issues highlighted in the report, is qualified or not. In respect of the issues regarding discrepancies in accounting policy and accounting treatment

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 4 of 13



Securities and Exchange Commission of Pakistan

pertaining to the determination of useful life of the plant, impairment loss and depreciation charged, the Appellant gave generalized suggestions to the management in the report and failed to record if his opinion was qualified or not in respect of such issues (clause (f) of audit report). The audit report is not meant for giving suggestions to the management but it is a report to the members of the Company. There were generalized suggestions and the Appellant failed to follow the requirement to properly record his opinion. The Appellant's claim that the report was not qualified and only emphasis-note was added, therefore, as per Form-35A no details were needed, is not tenable. It was not mentioned in the audit report that the report in respect of impairment loss and recalculation of depreciation rate was not qualified. Moreover, in terms of applicable ISAs, Section 255 and 260, the Appellant must have brought out material facts including the quantified impact on the financial statements.

- c) The Impugned Order at paragraph 6 clearly describes the requirements of the Ordinance and ISAs in respect of auditors' responsibilities regarding going concern assumption. The preparation of financial statements is responsibility of the management and it is the auditor's responsibility to express an independent opinion on the financial statements. Any information contained in the notes to the financial statements is a part thereof and cannot be construed as auditor's opinion even though any reference to such notes will be treated as part of the report, in terms of section 255(3) of the Ordinance. Mere reference to disclosure of certain facts in the Accounts does not absolve the auditor of his responsibility to express opinion on the prescribed format. Moreover, in terms of section 255(4), in case of any qualifications, the auditor is, inter alia, required to state reasons thereof.

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 8 of 13



Securities and Exchange Commission of Pakistan

It is clear beyond doubt that the auditor, in all cases, has to follow the requirements of the law and ISAs. Generalized 'attention notes' given in the audit report without following the form and mode prescribed by the law and the ISAs cannot be considered as sufficient discharge of auditor's responsibility. Paragraph (g) of the Appellant's audit report to members on Accounts is reproduced below for ready reference:

"The management is confident that Company for all intents and purposes is a going concern for the reasons recorded at note 2.2.1."

The above referred para of the audit report is not an opinion by any standards. It is just a referral to a note in the Accounts. The Auditor can only discharge his duties if he expresses the opinion while remaining compliant to the requirements of the law and the ISAs. In terms of ISA 570 it is auditors' responsibility to remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and evaluate management's assessment of the entity's ability to continue as a going concern. If the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, then the auditor is required to determine whether adequate disclosure has been made in the Accounts. In case of inadequate disclosure, the auditor is required to qualify the report. In case of adequate disclosure in the Accounts, the auditor must add an emphasis of the matter paragraph in his report to highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and (ii) draw attention to the note in the financial statements that discloses the matters. The Appellant in the instant case clearly failed to follow the requirements.

Appellate Bench No. IV

Appeal No. 39 of 2015

Page 9 of 13



Securities and Exchange Commission of Pakistan

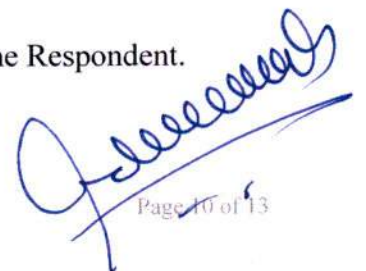
The Appellant added the emphasis of matter paragraph in the review report dated 28/03/13 on half yearly accounts for 31/12/12, at a time when the Company's petition for including FESCO as its customer had been accepted by NEPRA. This further demonstrates that as at 30/06/12 when there was no such decision in Company's favour, the Appellant should have addressed the issue of going concern appropriately. The Company had lost its major customers i.e. LESCO and FESCO and sales declined manifold during the year ended 30/06/12, and there was significant doubt about going concern assumption and the Appellant was responsible to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. Further, the Respondent reviewed the NEPRA's decision dated 12/12/12 whereof the Company's petition was accepted and FESCO was allowed as one of the power purchasers of the Company. However, no documentation had been provided to substantiate execution of any agreement by the Company with FESCO for purchase of power. During the relevant time i.e. year ended 30/06/12 and at the time of signing of audit report, there was no evidence or documentation to substantiate that the Company had been able to retain its key customers or secured any alternative customers. Moreover, the Company was not able to enter into agreement with FESCO or any other key customers subsequently. As per information available in the file, there had not been any agreement of the Company with FESCO even after elapse of considerable time since the NEPRA's decision. Therefore, the default was made knowingly and penalty on the Appellant, therefore, has been rightly imposed under the provision of section 260(1) of the Ordinance.

8. We have heard the parties i.e. the Appellant and the Respondent.



Appellate Bench No. IV

Appeal No. 39 of 2015



Page 10 of 13



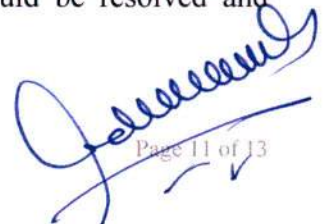
Securities and Exchange Commission of Pakistan

9. 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 stated that the matter of going concern was duly and adequately addressed stating the positive equity, current assets exceeding current liabilities etc. Further, the Company was almost debt-free with potential to earn profit due to electricity demand in the country and was, therefore, a going concern. However, we have noted that the Company's sales had decreased significantly and the electricity purchase agreements with LESCO and FESCO had expired and there was uncertainty of renewal of these agreements. Due to this it was probable that the Company may not be able to continue as a going concern. Further, the Appellant gave generalized suggestions to revise the depreciation rate and writing off the impairment loss, without quantifying the possible impact on the Accounts in violation of ISAs and the Ordinance. The Appellant has stated that emphasis of matter paragraph was added and significant doubts about going concern were adequately addressed in the Review Report dated 28/02/13 issued for half year accounts for the period ended December 31, 2012. However, the Appellant has not been able to justify the change in circumstances which led to addition of emphasis of matter paragraph in Review Report as the same circumstances were prevalent at the year-end i.e. June 30, 2012. Further, the Appellant has failed to discharge responsibility as auditor of the Company by issuing a report which is not in compliance with law.

10. The Appellant has argued that the management was confident that issues relating to power purchase agreement would be resolved and


Appellate Bench No. IV

Appeal No. 39 of 2015


Page 11 of 13



Securities and Exchange Commission of Pakistan

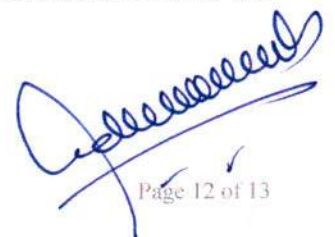
subsequently FESCO was allowed by NEPRA vide its decision dated 12/12/12 as one of the power purchasers of the Company. However, at the time of the submission of the accounts dated 30/06/12, there was no documentation to substantiate that Company would be able to retain its key customers or secure alternative customers. Further, there has not been any agreement of the Company with FESCO since NEPRA's decision. We are of the opinion that Appellant had relied heavily on the statement of the Company without independently ascertaining the facts. We concur with the Respondent that there was significant doubt about going concern assumption and the Appellant was responsible to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. The Appellant failed to conduct 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 making a truthful report to the members of the Company. The audit report for the year ended 30/06/12 is, therefore, not in conformity with the requirements of section 255 of the Ordinance and failed to bring out the above-mentioned material facts about the affairs of the Company.

11. The argument of the Appellant that the default was not "willful" holds little merit as even there may not be knowledge or intent, the Appellant did not exercise the due skill and care required of them as auditors. The word "willful default" has been defined in Oxford Dictionary of Law Fifth Edition as "The failure of the person to do what he should do, either intentionally or through recklessness." The default, therefore, would be considered as willful. Therefore, the penalty was rightly imposed on the Appellant by the Respondent under section 260 of the Ordinance.



Appellate Bench No. IV

Appeal No. 39 of 2015



Page 12 of 13



Securities and Exchange Commission of Pakistan

12. In view of the foregoing, the Impugned Order is upheld. The appeal is dismissed with no order as to costs.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SCD)

Announced on: **10 DEC 2015**