Securities and Exchange Commission of Pakistan

SECP

BEFORE APPELLATE BENCH NO. IV

In the matter of

Appeal No. 82 of 2006

i. Hyder Ali Bhimji
ii. Shaikh Muhammad Tanvir
(Gardezi & Co)

.... Appellants

Versus

The Director (Enforcement)
SECP, Islamabad .... Respondent

Date of hearing 15/04/2015

Present:

For the Appellant:

Mr. Usman Salam, Advocate

For the Respondent

Mr. Irfan Afzal, Deputy Registrar (CCD)

ORDER

1. This Order shall dispose of Appeal No. 82 of 2006 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 22/09/2006 (Impugned Order) passed by the Respondent.

2. The brief facts of the instant Appeal are that Gardezi and Company, Chartered Accountants (auditors) audited the annual accounts of Ahmed Spinning Mills Limited (Company) for the year ended September 30, 2004 and for the period ended June 30, 2005. The auditors made their report on the accounts of the Company for the year ended September 30, 2004 on January 4, 2005 and for the period ended June 30, 2005 (accounts) on October 3, 2005. The Enforcement Department conducted an examination of the Company's annual accounts for the year ended 30th September, 2004 and observed that the Company sold all of its long-term assets i.e. Property, plant and equipment and long term investment in United Sugar Mills Limited (USML). The auditors in their report for the year ended 30th September, 2004 gave an adverse opinion and doubted the ability of the Company to continue as a going concern. The auditors also highlighted the fact that they were unable to carry out the physical verification of the long term investments as the share certificates were not made available to them. Consequently the same remained unverified. As the Company sold its assets including long term investment i.e. 673,268 shares of USML, in contravention of Section 196(3) of the Companies Ordinance, 1984 (Ordinance), a show cause notice was issued to the Chairman, Chief Executive and other directors of the Company and a penalty of Rs.100,000 each was imposed on all the directors of the Company under section 196(3) of the Ordinance, which has since been deposited by the directors of the Company. The Investment in shares of USML which was made 22 years ago stood at Rs.9.089 million as on 30th September, 2004, which constituted 61% of the total assets as per audited accounts for the year ended30th September, 2004. These shares were sold to Clearshore Limited of UK through an agreement dated November 10, 2004, which was not reported to the Karachi Stock Exchange as per their listing regulations. The agreement indicates that the price of shares so sold was to be received within six months of the agreement. The market price at the time of receipt of sale money increased to Rs.105 per share on March 29, 2005 which was further increased to Rs.333 per share during a short span of six months. The accounts of the Company for the period ended June 30, 2005 were also

examined to determine, among other things, whether auditor's report on the accounts for the period ended June 30, 2005 had been made in conformity with the requirements of Section 255 of the Ordinance. It was observed that although the auditors had issued an adverse opinion on the accounts of the Company however they failed to draw shareholders attention towards selling of the long term investment in an unlawful manner which matter was qualified in the last year audit report. The auditors, therefore, vide letter no. No. EMD/233/75/2004 dated April 19, 2006, were asked to state as to why shareholders attention was not drawn in the audit report towards selling of the long term investment by the management in the year 2005 as the matter was qualified by them in the last audit report. The reply dated May 18, 2006 to the letter was received from the auditors on May 20, 2006.

3. The Respondent dissatisfied with the reply of the auditors, issued a Show Cause Notice dated July 7, 2006 requiring them to explain, in writing, as to why action may not be taken as provided under Sub-section (1) and (2) of Section 260 read with Section 476 of the Ordinance.

4. In response to the Show Cause Notice the Appellant filed written response as well as appeared before the Respondent. However, after consideration of the facts and circumstances of the case, the Respondent concluded that the auditors have signed the audit report otherwise than in conformity with the requirements of Section 255 of the Ordinance and have committed a willful default in terms of Section 260 of the Ordinance and have made themselves liable for punishment under Sub-section (1) of Section 260 of the Ordinance. Accordingly a fine of Rs.100,000 (Rupees one hundred thousand only) under Sub- section (1) of Section 260 of the Ordinance was imposed upon Mr. Hyder Ali Bhimji, the engagement partner of the auditors.

5. The appellants aggrieved of the Impugned Order preferred the instant Appeal on the following grounds:

a. In so far as the issue of sufficiency and adequacy of the audit evidence are concerned, Paragraph 7 of ISA 500 provides that "Sufficiency is the measure of the quantity of the audit evidence. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for, or detecting misstatement in, the classes of transactions, account balances, and disclosures and related assertions. The quantity of audit evidence is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Accordingly, the sufficient and appropriateness of audit evidence are interrelated. However, merely obtaining audit evidence may not compensate for its poor quality". It may be noted that the aforesaid provision is a very general guideline and does not specify what sort of evidence is to be considered by the auditors in a particular case but rather leaves it to the judgment of an auditor to decide on a case by case basis what is and what not sufficient and what appropriate evidence is. Thus, the appellants, as auditors, were under a duty to consider all the evidence, which in their opinion was sufficient and appropriate evidence, and make a judgment on the basis of that. The appellants have shown and provided ample proof of all the evidence and factors that were taken into account before forming an opinion on the issue. Furthermore, the appellants have also provided reasonable and satisfactory explanations to all the queries/doubts raised by the Respondent. In this regards, it is specifically pointed out that all the various question/ issues that the Respondent proposed (Page 10 of the Impugned Order) the appellants should have considered were either totally unnecessary or irrelevant or the same have been duly considered by the appellants. In view whereof, it is clear that there is no contravention of the provisions of paragraph 7 of ISA 500 and the Impugned Order, being bad in law and fact, is liable to be set aside.

b. In reaching the above conclusion regarding contravention of the provisions of Paragraph 7 of ISA 500, the Respondent has formed the view, which is evident from the Impugned Order, that the transaction was illegal and unlawful and it is on the basis of the said view that the Respondent has alleged that the appellants have not collected sufficient and appropriate audit evidence and have thus contravened the provision of paragraph 7 of ISA 500. It may be noted that there is nothing on record to show that the transaction was illegal and unlawful. It is reiterated that the transaction was carried out pursuant to a legally valid Agreement and backed by a duly authorized Resolution. Furthermore and notwithstanding the fact that the same is a purely commercial matter and has no bearing whatsoever on the legality or lawfulness of the transaction, on the date of the execution of the Agreement, the market value of the shares was Rs.12 per share and the same were sold for Rs.16 per share i.e. at a profit of Rs.4 per share. It is absolutely irrelevant what the price of the said shares was after a passage of 10 or 12 months after their sale. Moreover, it is extremely difficult, if not impossible, for anyone to predict the future price of assets, particularly where the assets are shares listed on a stock exchange. With respect to the issue of applicability of Section 196 (93) of the Ordinance, it may be noted that the term 'undertaking', as defined by the superior courts, does not include all the assets of a company. The superior courts have held that where the company's business is neither to invest in shares nor even to engage in the investment in shares, the sale of such shares by the company is not the sale of the company's undertaking or even a substantial part pf the company's undertaking. In view whereof, it is clear that the shares being held by the Company in USML do not form part of the undertaking of the Company and are not relevant when determining whether the undertaking or a sizeable part thereof was sold. In other words, the provisions of section 196 (3) of the Ordinance do not apply to the sale of the said shares irrespective of what percentage of the total assets of the Company it forms. Furthermore, the Respondent in passing the Impugned Order has challenged the

opinion of the appellants as being wrong rather than pointing to any relevant piece of evidence/ factors that were not taken into account.

c. With respect to Paragraph 38 of ISA 501 (Audit Evidence), it may be noted that the reference of this paragraph is totally irrelevant as it does not belong to the sale of assets rather it is related to the valuation and disclosure of the long term investment as appearing in the financial statements, whereas in the instant sale of shares the relevant evidence as discussed in the above paragraph have been duly obtained and verified.

d. With respect to paragraph 13 of ISA 710 (Comparatives), the following points may be noted:

   i. firstly, as discussed above, it is neither customary nor required by law or any accounting standards to add or reproduce the previous qualifications particularly when the related matters is not carried forward/ continuing or is otherwise resolved/ settled during the period under the audit. In this regard, it may be noted that the qualification in the 2004 Report was on account of the fact that the shares were not made available for physical verification, However, in the 2005 audit, such circumstances were not-existent since the shares had been sold under a lawful Agreement duly approved by the Board of Directors and backed by the Resolution and the sale proceeds for the same had been duly received, utilized and shown appropriately in the financial statements for the year 2005. Hence, provisions of paragraph 13 of ISA 710 (Comparatives) are not applicable in the present case and there was no need to qualify the matter in the year 2005 Report;

   ii. secondly and without prejudice to the above, paragraph 13 of ISA 710 clearly states *that "when the auditor's report on the prior period, as previously issued included a qualified opinion and the matter which gave rise to the modification is resolved and properly dealt with in the financial statements, the current report does not ordinarily refer to the previous*

modification. However, if the matter is material to the current period, the auditor may include an emphasis of matter paragraph dealing with the situation." From the above, it is clear that there is no obligation on the auditor to add emphasis paragraph but the auditor may do so if adverse opinion had not been given or the transaction would not have been supported by appropriate evidence; and

iii. Thirdly and as discussed above, that Impugned Order, without any lawful basis, declares that the shares were sold at a 'throwaway' price of Rs.16 per share and makes further allegations that the same were later sold by the directors as 'Principal Shareholders' for a price of Rs.333 per share. The Impugned Order admittedly states that the same was allegedly done after the signing of the 2005 Report. At the outset, it may be noted that not only is the aforesaid allegation without proof but also the same was allegedly done after signing of the Report. Hence, the same is totally irrelevant in so far as the instant matter is concerned. Secondly, it is reiterated that at the time of the Agreement, the price was Rs.12 per share and the same were sold for Rs.16 per share i.e. at a profit of Rs.4 per share. It is absolutely irrelevant what the price of the said shares was after a passage of 10 or 12 months after their sale and the same cannot be looked into with the benefit of hindsight.

Hence, it is clear that the Impugned Order is not only bad in law and fact but has been passed on the basis of extraneous considerations and is therefore, liable to be set aside.

e. That the Respondent failed to appreciate the term *"willful"* in Section 260 of the Ordinance. It is clearly provided that penalty under Section 260 can only be imposed if the default is *willful*. The word *willful* has been used in many enactments and it has many a time been judicially interpreted. The Superior Courts have defined the term *"willful"* as *"In the ordinary dictionary sense, it means intentional or deliberate. The term,, as used in*

different statutes and judicial precedents, means deliberate and intentional and not accidental or by inadvertence. It connotes a conscious act signifying something more than a mere omission, default or inaction on the part of a person who is under a legal obligation to do or not to do a particular thing. In other words, an act done intentionally, knowingly or purposely as distinct from the one done carelessly, thoughtlessly, heedlessly or inadvertently." It is clear from the above definition that a person can only be punished under Section 260 of the Ordinance if he commits the default knowingly and with the intention to do so. In the present case, there was no default on part of the appellants as per the terms of Section 260 and there certainly was no *willful* default. In view whereof, the impugned Order is liable to be set aside.

f. That the Respondent has failed to appreciate that in so far as the judgment of an expert, such as an auditor is concerned, all that law requires is that relevant factors are taken into account before reaching an opinion. Furthermore, it is also recognized that different experts can reach different conclusions/judgment on the basis of the same evidence/facts and that the judgment of an expert can only be challenged on the basis of fraud or gross negligence. In light of the above, it is submitted that the appellants took into account the relevant factors and duly formed their opinion on the basis of those. The same was conveyed to the Respondent through the Reply, the Letter and at the Hearing. However, despite any evidence to the contrary, the Respondent challenged the expert judgment of the appellants and passed the Impugned Order. Thus, the Impugned Order is bad in law and liable to be set aside.

g. The Impugned Order is not a speaking order as various arguments/grounds raised by the appellants have not been adjudicated upon by the Respondent in the Impugned Order, the Respondent ignored the various grounds raised by the Appellants and neither addressed/considered nor

rebutted the same. In particular, the Respondent failed to appreciate and discuss the argument by the appellants in their Reply as well as the Hearing that penalty under Section 260 of the Ordinance can only be imposed if the if the requirements of the said section are satisfied. Therefore, the Impugned Order lacks judicial determination of the issues involved in the proceedings initiated and conducted by the Respondent under the Show Cause Notice. Thus, the Impugned Order is liable to be set aside.

h. The Respondent has not given due consideration to the grounds and issues raised by the appellants. In the Impugned Order, the Respondent depicted the provisions of the Ordinance in a manner, which is alien to the principles of interpretation of statutes. The Respondent failed to give rational consideration to the legal principles established by the Superior Courts.

i. That it is submitted that despite lack of any tangible evidence, the Impugned Order was passed. It is further submitted that the aforementioned finding of the Respondent notwithstanding the requirements of law as well as the authoritative pronouncements of the Superior Courts as pointed out above, makes it evident that the Impugned Order has been passed without independent application of mind and adjudication of issues but on prejudged notions and opinion of the present matter, not befitting to the Respondent and the entire proceedings under the Show Cause Notice under the Impugned Order is liable to be set aside.

6. The Respondent in response to the grounds of the instant Appeal vehemently denied the same and made submissions as follows:

a. The explanations put forth by the auditors in the hearing were not found satisfactory and the questions raised in the Impugned Order are all relevant and to

the point which, in fact, have never been answered by the auditors at any time. Further, the quality and appropriateness of the audit evidence was not adequate and conclusive due to the following reasons, making it necessary to be mentioned by way of emphasis paragraph in the Audit Report for the year 2005 also:

i. The sale transaction of USML shares Clearshore was a paper transaction. The ownership of USML shares were neither transferred from ASML to Clearshore in the share transfer register, nor on the share certificates.
ii. The sale proceeds were not received from U.K through remittance as Clearshore was a U.K based entity. Further, a major part of the purchase consideration was deposited through cash i.e. Rs. PKR 9.782 million out of a total value of PKR 10.772 million. The rest of the payment was originate from Dubai based 'Al Zarooni Exchange Dubai, UAE' and routed through Lloyds Bank U.K.
iii. Clearshore was a dormant company and has not reported its accounts after year 2003 to the Companies House, UK, the relevant authority.

b. The transaction of sale of shares was not only a sale of investment as it comprised of a strategic share of 22.4% shareholding which also transferred the management control of the Company. The shares were sold at Rs.16/share on November 10, 2004 and the market price of these shares at that time was Rs.12/share which rose to Rs.120/share on October 3, 2005, the date of signing of the Audit Report. This was an increase of ten times in comparison to the price on the date of sale. It may also be mentioned that the auditors failed to take notice of the fact as to why the price of the shares of USML, which was dormant for previous many years, sky rocketed immediately after the date of sale. This trend is visible to a layman's eye but it failed to trigger any interest to the auditors at the time of signing of the Audit Report and they took the sale of shares as valid and without any mala fide intention.

c. The paragraph is not only relevant but also gives the emphasis on the valuation / disclosure and importance of Long Term investments as far as the perspective of audit is considered.

d. With respect to paragraph 13 of ISA 710 (Comparatives), the contentions put forth by the appellants were refuted as follows:

   i. The share certificates remained un-verified in the year ended September 30, 2004 and the Audit Report for the year was qualified by the auditors. However, the auditors admitted that the Board Resolution for the sale of shares was concealed from them in that year. On the other hand, it is intriguing that why the auditors did not show professional skepticism despite of the fact that said Board Resolution was concealed from them and same was also admitted by the management and the matter still was regarded as bona fide sale in the preceding year and did not merit a mention in the Audit Report by way of emphasis note. In Respondent's view the stance of auditors that the para 13 of ISA 710 (Comparatives) was not applicable is incorrect as the qualification raised in the Audit Report for the year ended September 30, 2004 was regarding the Long Term Investments and it was relevant to the accounts for the period ended June 30, 2005 as the issue of concealment of sale of shares of USML to Clearshore Ltd by the directors of the Company was not fully resolved since the Company could not succeed to explain the reason of not informing the auditors regarding the sale of investment during the audit of accounts for the year ended September 30, 2004 and therefore it needed to be mentioned by way of emphasis paragraph in the Audit Report for the year 2005 also.

   ii. The auditors seem to be denying the spirit of the law in this case which clearly states that in case the matter is material to the current period as the investments sold accounted for 61% of total assets and comprised of 22% of strategic share in the total shareholding of USML. Therefore, an

emphasis paragraph had to be included in the Audit Report regarding this sale.

iii. The Audit Report was signed on October 3, 2005 and at that time the market price of the shares shot up to Rs.120/share from Rs.12/share on November 10, 2004, a tenfold increase after years of dormancy, and yet still the auditors did not notice this sharp trend and did not gather sufficient and appropriate audit evidence to support their claim that the sale transaction was valid.

e. Reference is made to the decision of the Appellate Bench in the case of Shaikh Jalaluddin F.C.A vs. Commissioner (Enforcement) which was upheld by the Hon'ble High Court in appeal. There too the auditor who was penalized argued that his default was not willful although he had failed to comply with the provisions of the law and applicable auditing standards. The Appellate Bench while holding that his default was indeed willful observed as follows:

"In the case of City Equitable Fire Insurance Co. Ltd. Re, 1925 Ch 407 , it was held that a default, in case of breach of duty, will be considered 'willful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent. Simply put, if the Appellant admits to know the auditing standards and claims to have followed them when in reality, as proven above he has not, then keeping in view his status as a professional and his duty as a fiduciary he should be held to be willfully in default."

f. The auditors remained the external auditors of the Company and USML during the relevant period i.e. in the years 2004 and 2005. In the same period 5 out of 7 directors of USML including Shaikh Abdul Wahid, Shaikh Muhammad Saeed, their wives Mrs. Nasreen Wahid and Mrs. Abida Saeed and their mother Mrs. Qaiser Begum were also directors of the Company. These common directors directly and beneficially owned 16.5% and 36% shares respectively in USML by virtue of which they were exercising control over USML. However they did not choose to sell their own shares but sold those held by the Company. This pattern

of shareholding was in the knowledge of auditors being simultaneously the auditors of both these listed companies. The auditors have not taken into account important factors as discussed in the Order. They seem to have failed in exercising due professional care and diligence which also amounts to a breach of trust which the society in general and statute in particular has reposed in them.

g. The Order is based on facts and also strongly supported by mandatory legal provisions of the law.

h. All arguments put forth by the auditors have been duly considered before the passing of the Order.

i. The Order is not based on pre-judged notions and is well thought out and a speaking Order.

7. We have heard the parties and taken into consideration written submission by the Appellant and the Respondent. We have also perused the case law submitted at the hearing by the counsel for the appellants, cited as ***"1992 (2) BomCR 429",*** which to our understanding is not attracted in the instant matter. The relevant provisions of the Ordinance which have been referred above have been considered. We have observed as follows:

i. The main contention of the appellant as stated in the ground of appeal along with others is that the default if any is not willful. Here we would like to quote the remarks made by our predecessors in an Order in "Appeal No. 57 of 2003 titled as Shaikh Jalaluddin F.C.A vs. Commissioner (Enforcement) (cited as 2005 CLD 333)" wherein it was noted as follows; *"In the case of City Equitable Fire Insurance Co. Ltd. Re, 1925 Ch 407 , it was held that a default, in case of breach of duty, will be considered 'willful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent. Simply put, if the Appellant admits to know the auditing standards and claims to have followed them when in*

reality, as proven above he has not, then keeping in view his status as a professional and his duty as a fiduciary he should be held to be willfully in default."

Accordingly the Honorable Bench held that the auditor has committed a breach of his fiduciary duty with knowledge and intent.

ii. Having stated the above, it may be noted that the appellants have failed to bring to the attention of the shareholders of the Company the non-transparent sale of shares by the management of the Company which resulted in loss to the shareholders who would, had the appellants been performing their duties in accordance with the mandatory obligations of the Ordinance, profited from their shareholdings held in the Company.

iii. Most importantly, since the Company being a public listed company had interests of the general public therefore, the appellants should have been more cautious and diligent while discharging their duties as auditors of the Company.

iv. The proceedings held before the Respondent and Impugned Order reflects that the Respondent has been vigilant and has addressed the essential concerns which are of essence concerning the instant Appeal. The Impugned Order does not reflect lack of independence nor pre-judged notions as alleged by the appellants.

8. Having stated the above, it has been noted as per communication made by the Appellant's Counsel that Mr. Hyder Ali Bhimji (the engagement partner) has expired in the year 2013. Henceforth, in exercise of powers under Section 33 of the SECP

Act, 1997 the demise of the Appellant has forced us to take a lenient view in the matter and accordingly the Impugned Order is set aside.

9. In view of the foregoing the instant Appeal stands disposed of. Parties to bear their cost.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SCD)

Announced on: 26 AUG 2015