

**Before Ali Azeem Ikram, Executive Director/HOD (Adjudication-I)**

**In the matter of**

**M/s Kreston Hyder Bhimji & Co. (Auditor of J.A Textile Mills Limited)**

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Dates of Hearing

September 10, 2020

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**Order-Redacted Version**

Order dated September 30, 2020 was passed by Executive Director/Head of Department (Adjudication-I) in the matter of M/s Kreston Hyder Bhimji & Co. (Auditor of J.A Textile Mills Limited). Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated January 2, 2019
2. Name of Company	J.A Textiles Mills Limited
3. Name of Individual*	The proceedings were initiated against the engagement partner of M/s Kreston Hyder Bhimji & Co. Chartered Accountants i.e. J.A Textiles Mills Limited.
4. Nature of Offence	Violations of section 253 read with section 479 of the Companies Act, 2017
5. Action Taken	<p>Key findings were reported in the following manner:</p> <p>I am of the view that following points are relevant for the aforesaid proceedings:</p> <p>(i) The Auditor claims that for the purpose of audit; the Auditor determined materiality level at Rs 8.191 million. In this context, I would like to point out that the amount of liability reported by the Bank in its offer letter dated September 12, 2017 was Rs. 33.709 million, while the Company vide its letter dated August 17, 2017 mentioned outstanding principal amount of Rs. 15.110 million and remaining amount of Rs. 18.599 million was mark-up. As per reply of the Auditor, the Company had recorded mark-up of Rs. 22.032 million in its books of accounts. Even if taken the figure of mark-up as considered by the Bank, it was of the amount of Rs. 18.599 million and was above the materiality level of Rs. 8.191 million. Hence, the claim of the Auditor that amount of mark-up which the Bank claimed was of Rs. 6-7 million in addition to cost of funds of Rs. 1 million, is not tenable.</p>

	<p>(ii) As per Clause 11 of the Agreement wherein the Company was required to report the allowed remission to be reflected in Credit Report/CIB, It is observed that the Respondent failed to provide any evidence of such reporting. This reflects that the Company as on June 20, 2017 had not discharged of its long-term loan and was not eligible to take into account the remission of mark-up /interest as adjusting event.</p> <p>(iii) A formal agreement was not on record and just offer letter and Bank's proposals were exchanged till the date of issue of auditor's report dated October 7, 2017. Formal agreement in this regard was signed subsequent to issue of auditor's report i.e. on October 16, 2017. Therefore, in absence of formal agreement i.e. legal enforceable document, the Company was not able to record the said other income as remission of mark-up/interest.</p> <p>(iv) 12 post dated cheques of the amounts of Rs. 1 million were not paid till the date of issue of auditor's report dated October 7, 2017, as claimed by the Auditor, rather the same were handed over by the Banking Court-II Faisalabad to the attorney of the Bank as per order dated October 24, 2017. The Auditor's claim of compliance of all given terms and conditions of settlement arrangement is not acceptable.</p> <p>(v) As per offer letter dated September 12, 2017 of the Bank the financing facilities were remained to be intact till the settlement of amounts due and the mark-up was to be waived after payment of amount strictly in accordance with the repayment schedule. The Company, however, proceeded before compliance of all terms and conditions and before signing of a formal agreement dated October 16, 2017 and reversed mark-up accrued of Rs. 22.031 million in Accounts 2017, which resulted a profit after tax of Rs. 2.573 million for the aforesaid year. Had the accrued mark-up not reversed, the profit would have been lower by the same amount i.e. Rs. 22.031 million. The amount of mark-up reversed was 8.55 times of the profit after tax for the year 2017. As per available information, the Company incurred loss after tax for the years 2014, 2015 and 2016 respectively, whereas, a profit after tax of Rs. 2.573 million reported for the year 2017 was mainly recognition of other income of Rs. 22.031 million due to remission of mark-up of the same amount against long term loan of the Bank. Hence, the Company's Accounts for the year 2017 were materially misstated and the Auditor failed to modify his report to the members for the year 2017 in violation of section 249 of the Act.</p> <p>(vi) The Auditor failed to collect all related evidences in terms of para (3), para 9(a) of IAS 10 and para 16 of IAS 37 to</p>
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determine present obligation in absence of formal agreement dated October 16, 2017 which was signed between the Company and the Bank and in terms of the terms and conditions, all financing facilities were required entacted till the final payment and discharge of agreed amount of Rs. 15.111 million. The substantial conditions of adjusting event were not complied by the Company before recognizing remission of mark-up of Rs. 22.031 million, which resulted misstatement in financial statements for the year 2017.

- (vii) The matter of recovery suit of the Bank and suit of damages filed by the Company against the Bank was pending before Banking Court-II Faisalabad, and the court decided the case *sine die* and awarded decree in favour of the Bank vide order passed dated October 24, 2017. Hence, in terms of para 9(a) of IAS 10 and para 16 of IAS 37, relevant court order as evidence for adjusting event was not available till the date of issue of auditor's report dated October 7, 2017, rather the matter was subjudicie. Hence, the Auditor primarily failed to discharge his obligation to determine that in absence of settlement agreement dated October 16, 2017 and court order dated October 24, 2017, the recognition of remission of mark-up of Rs. 22.031 million in Accounts 2017 was not adjusting event. Hence, requirements of relevant requirements of IASs were not complied by the Company and Auditor failed to modify his report to the members on Accounts for the year 2017, hence, violated section 249 of the Act.
- (viii) In the instant case, the settlement agreement, which was signed on October 16, 2017 was a documentary evidence between the Company and the Bank wherein both parties agreed to settle the outstanding amount of Rs. 33.709 million. As per the aforesaid settlement agreement, the total liability amount of Rs. 33.709 million agreed, as against the offer letter dated September 12, 2017 of the Company, through which an amount of Rs. 23.341 million was communicated to the Bank. Hence, the Auditor needed to ascertain the supporting evidences in order to ascertain the adjusting event impact taken by the Company.
- (ix) As per the disclosures given in Accounts 2017, the Company reversed its accrued mark-up and recognize other income of Rs. 22.031 million, however, did not adjust principal amount despite down payment of Rs. 3.111 million made on September 25, 2017.

Hence, the Auditor based on offer letter of the Company and of the Bank did not modify the auditors' report to the members for the year ended June 30, 2017 of the Company, without any substantive evidence in support, and without compliance of the terms of settlement arrangement,

	<p>and failed to discharge his responsibilities in terms of section 249 of the Act.</p> <p>From the above discussion and after careful consideration of all the facts of this case, I am of the view that while the Respondent was not able to demonstrate justifiable grounds for basis of recognition of other income of Rs. 22.031 million due to remission of accrued mark-up of the same amount, hence, violated the requirements of section 249 of the Act, for which penalty is provided in terms of section 253 of the Act.</p> <p>Keeping in view a penalty of Rs.100,000/-(Rupees One hundred thousand) was imposed on the Respondent.</p>
6. Penalty Imposed	Penalty of Rs. 100,000 was imposed.
7. Current Status of Order	Appeal no. 137/2020 was filed against the aforesaid order.