



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department- I

Adjudication Division

Before

Shahzad Afzal Khan, Director/ Head of Department

In the matter of

Premium Textile Mills Limited

Show Cause Notice No. & Date CSD/ARN/355/2016-203 dated April 08, 2024

Date of Hearing: June 03, 2024

Authorized Representative: Muhammad Waseem, FCA-Partner, Rahman Sarfraz
Rahim Iqbal Rafiq, Chartered Accountants

ORDER

Under Section 512(2) of the Companies Act, 2017 read with Regulations 36(3) & 37 of the Listed Companies (Code of Corporate Governance) Regulations, 2019

This Order shall dispose of the proceedings initiated by the Securities and Exchange Commission of Pakistan (the Commission) through Show Cause Notice dated April 08, 2024 (the SCN) issued under Section 512(2) of the Companies Act, 2017 (the Act) read with regulations 36(3) & 37 of the Listed Companies (Code of Corporate Governance) Regulations, 2019 (the Regulations) to Mr. Muhammad Rafiq Dosani, FCA - Partner Rahman Sarfaraz Rahim Iqbal Rafiq (the Auditor), auditor of Premium Textile Mills Limited (the Company).

2. Brief facts of the case are that:
- i. The Company in its Extra Ordinary General Meeting (the EOGM) held on February 11, 2021 elected following directors for a period of three (3) years:
- 1) Mr. Mohammad Tufail (Independent)
 - 2) Mr. Mohammad Aslam
 - 3) Mr. Mohammad Yasin Siddik
 - 4) Mr. Abdul Kader Adam
 - 5) Mrs. Lubna Asif Balagamwala (Independent)
 - 6) Mr. Tanzeel Abdul Sattar
 - 7) Mr. Mohammad Ali Jaliawala (Independent)

As per record, the Company has three independent directors on its board, two of whom namely Mr. Mohammad Ali Jaliawala and Mr. Mohammad Tufail have served



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on the board of the Company for more than three consecutive terms in contravention to the requirements of section 166(2)(g) of the Companies Act, 2017 (**the Act**) which states that a person is deemed not to be independent if he has served on the board of the Company for more than three consecutive terms from the date of appointment thus were ineligible to be elected as independent directors of the Company. Moreover, Mr. Tufail, being ineligible to act as independent director, was also made chairman of the Audit Committee (**AC**) contrary to the mandatory requirement prescribed under regulation 27 of the Regulations. Further, the third independent director, namely Ms. Lubna Asif was not registered with the databank of independent directors maintained by Pakistan Institute of Corporate Governance (**PICG**) at the time of her election and was subsequently registered with PICG.

- (ii) The Auditor of the Company failed to disclose the aforesaid non-compliances by the Company in its Review Report on Company's Statement of Compliance with the Regulations for the years 2021 and 2022 (**SoCs**).
- (iii) The Commission vide letter dated February 22, 2024 directed the Auditor to provide comments on the aforesaid non-compliances of the Company and for not highlighting the said non-compliances in its review reports for the years 2021 and 2022. The Auditor vide reply dated February 28, 2024 submitted that (relevant extract):

"Due to Adjudication proceedings through SCN 28-Dec-2022, Mr. Muhammad Tufail on 17-Jan-2023 resigned from the directorship of the Company and the appointment of independent director from the databank of independent directors was concluded. There had been a misunderstanding of the independence requirement of a Director on the part of Company. At the time of review of the statement of compliance for year 2021 and 2022, we were provided by the Company the consent letters signed by the said directors in which they had represented that they were independent directors. We remained unable to highlight as per Regulation 36 of CCG Regulations the non-compliance of Regulation-27(ii)."

- (iv) The auditors review report is issued under Auditors (Reporting Obligations) Regulations, 2018 (**the Reporting Regulations**) which require auditors to specifically report that:
 - a) Auditor's responsibility is to review whether the Statement of Compliance reflects the status of the Company's compliance with the provisions of the regulations;
 - b) Highlight any non-compliance with the requirements of the Regulations;
 - c) Inquires of the Company's personnel and review of various documents prepared by the Company to comply with the Regulations;
 - d) As a part of audit of the financial statements, auditor's are required to obtain an understanding of the accounting and internal control systems
- (v) The Company was required to disclose any non-compliance with the mandatory regulations as required by regulation-36(1) of the Regulations. However, the Company



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in its SOC stated that it has complied with all the requirements of mandatory Regulations (3, 6, 7, 8, 27, 32, 33 and 36) whereas, the Company was not compliant with the provisions of regulations 6, 27(2)(a) & 36 of the Regulations for the year 2021 and 2022.

- (vi) It appears from the aforesaid, that the Auditor failed to highlight the Company's non-compliances with regulation 6, 27 & 36 of the Regulations, thus, *prima facie*, contravened the provisions of regulation 36(3) of the Regulations.

3. In order to take cognizance of the aforesaid contraventions, the SCN was served upon the Auditor seeking justification for the aforesaid violations. The Auditor vide letter dated April 22, 2024, *inter-alia*, submitted that (relevant extracts):

- No penalty is attracted as I did not at any stage failed or refused to comply with regulation 3, 6, 7, 8, 27, 32, 33 and 36 of the Regulations nor had any willful intent to contravene any of the said regulations;
- Ms. Lubna Asif was elected as independent director on February 11, 2021 and was subsequently registered with PICG and the said non-compliance was duly highlighted in our Review Report for the year 2021 in accordance with Regulation 36.
- The non-compliance relating to other two independent director was not highlighted due to limited inquiry made by us in respect of independence of the said directors and reliance placed on assertion made by the Board in its SoC, consent letters and PICG certification were obtained, both of which confirmed that the said Directors were independent. A chain of events including replacement of Regulation 2017 with Regulation 2019 and then Covid 19 epidemic that had continued beyond the year ended 31st December 2021 (most of staff including engagement partner were effected) also caused our reliance on the documentary evidence submitted by the directors.
- It later transpired that the company became aware of the actual requirement of section 166(g) of the Act on receipt of a show cause notice by the Commission in respect of these non-compliances. In Review Report for 2020 we highlighted a non- mandatory compliance with regards to the requirement of the number of independent directors to be either two or one third of the strength of Board against which Board's explanation appeared in paragraph 18 of their Statement of Compliance.
- The Commission had in an earlier Order passed in the same matter against the Company in which, a token penalty of Rs. 25,000/- was imposed and warning was issued for ensuring compliance in future. The Company while admitting the default also cited the same reason that the non-compliance was caused due to misunderstanding of the requirement on its part. Hence the Company was responsible for said non-compliances.



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- In Review Reports for the years 2020 and 2021 on SoC, we highlighted a non-mandatory non-compliance in the year 2020 and a mandatory non-compliance in the year 2021. Further, in case of Review Engagements, the responsibility of the Auditor is limited primarily to inquiries of the company's personnel and review of the various documents prepared by the company for complying with the Auditors (Reporting Obligations) Regulations 2018 read with Regulation 6.

4. In order to provide opportunity of personal representation, hearing in the matter was fixed for June 03, 2024 wherein Mr. Muhammad Waseem, FCA-Partner, Rahman Sarfraz Rahim Iqbal Rafiq being Authorized Representative (**Representative**) appeared and while reiterating his response to SCN stated that auditor's responsibility was to review compliance based on gathered information, not to conduct an audit. Due to Covid-19 pandemic, reliance was placed on the consent and declaration by independent directors and the same was considered as basis for the Company's compliance. He further requested a lenient view, stating that the default was not willful or intentional.

5. Subsequent to the hearing, the Auditor vide letter dated June 06, 2024 submitted the list of actions/requisite measures taken aimed at improving the quality of the fieldwork in an engagement to review the SOC with the Regulations.

6. Relevant provisions of the Regulations and the Act are reproduced as under:

"The Regulation:

36. Compliance Statement and Auditor Review. - (3) *It is mandatory that the statutory auditor of company shall highlight any non-compliance with these Regulations in their review report.*

37. Penalty. - *Whoever fails or refused to comply with, or contravenes regulation 3, 6, 7, 8, 27, 32, 33 and 36 of these Regulations, shall be punishable with penalty as provided under sub-section (2) of section 512 of the Act.*

The Act:

512. Power to make regulations. - (2) *Any regulation made under sub-section (1) may provide that a contravention thereof shall be punishable with a penalty which may extend to five million rupees and, where the contravention is a continuing one, with a further penalty which may extend to one hundred thousand rupees for every day after the first during which such contravention continues."*

7. I have gone through the facts of the case, considered both the written and verbal submissions submitted by the Representative and Auditor in the light of the applicable legal provisions and available record before me. At this juncture, it is imperative to address the following:



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- (i) **Whether the Auditor's assertion that no penalty is attracted because there was no willful intent to contravene the Regulations absolves him of responsibility under regulation 36(3) of the Regulations?**

No, regulation 36(3) of the Regulations explicitly requires the statutory auditor to highlight any non-compliance with the Regulations in their review report. Auditor's assertion that there was no willful intent to contravene the Regulations does not absolve him of responsibility under regulation 36(3) of the Regulations. Regulation 36(3) typically relates to the responsibilities and duties of auditors in ensuring compliance with the regulations and under the applicable regulatory frameworks, including the Regulations, auditors are held to certain standards of professional conduct and responsibility regardless of intent and are expected to uphold high standards of professional conduct and diligence in their work, which includes detecting and reporting non-compliance with applicable regulations.

The absence of willful intent does not negate the Auditor's duty to report non-compliance as stipulated by regulation 36(3). The Regulations imposes an objective standard of reporting, which means that the auditor's obligation to disclose non-compliance exists regardless of intent or awareness.

- (ii) **Whether the Auditor's reliance on the Company's statements and documentation adequately justifies their failure to highlight non-compliance regarding the independence of the directors in their review report?**

No, the Auditor's duty to report non-compliance with independence requirements as stipulated by regulations remains paramount, regardless of the challenges posed by regulatory changes and the COVID-19 pandemic. While the Auditor may rely on the Company's assertions and documentary evidence to some extent, he is expected to conduct sufficient independent inquiry to verify the accuracy of such assertions and placing reliance solely on information provided by the Company without conducting its own assessment and verification cannot be considered appropriate grounds for non-compliance.

Auditors play a crucial role in providing assurance to stakeholders, including investors, about the accuracy and reliability of financial and governance-related disclosures, therefore, highlighting non-compliance with independence is crucial for maintaining investor confidence and ensuring transparency in corporate governance. Moreover, the transition between regulations and external disruptions do not relieve the Auditor from his responsibility to apply professional judgment and diligence in assessing and reporting compliance issues, including director's independence.



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- (iii) **Whether the Auditor's stance that the Company is responsible for these non-compliances due to its misunderstanding of the requirements of the Act holds merit?**

No, though the primary responsibility for compliance with legal and regulatory requirements lies with the company, it is the responsibility and role of the auditors to provide assurance regarding the company's compliance with laws and regulations after conducting independent assessment regarding company's compliance with regulatory and legal requirements. Auditors are expected to exercise professional judgment and skepticism in their assessments and to communicate their findings clearly in their audit reports and highlight any resulting non-compliance.

The Auditor was responsible to independently verify Company's compliance with the applicable legal and regulatory requirement and to disclose any instances of non-compliance in their reports. He, therefore cannot absolve himself from his responsibilities by attributing non-compliance solely to Company's misunderstanding and was required to clearly highlight the flaw in Company's understanding of legal requirements may be flawed or inadequate.

- (iv) **Whether the Auditor's claim that in review engagements they are constrained and primarily rely on personnel and review of the various documents of the Company, holds merit?**

No, Review engagements are less extensive and provide limited assurance than audits but the Auditors are required to exercise professional judgment, maintain skepticism and perform appropriate analytical procedures to identify any material misstatements or inconsistencies. The auditors are responsible to identify and report material misstatements or non-compliance with applicable regulations that come to their attention during the review process. They cannot entirely absolve themselves from their professional responsibilities by claiming constraints inherent in the nature of review engagements.

Moreover, regulation 6 of the Reporting Regulations explicitly mandates Auditors to report on any identified non-compliance with the Regulations. Therefore, the Auditor's approach should ensure a thorough assessment that accurately identifies and reports all relevant non-compliances in accordance with the requirements of the Regulations.

8. In view of the aforesaid, the contravention of regulation 36(3) of the Regulations at the relevant point of time, has been established. I, therefore, in exercise of powers conferred under regulation 37 of the Regulations read with section 512 of the Act, hereby conclude the



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proceeding initiated through the SCN by imposing a penalty of **Rs. 25,000 (Rupees Twenty-Five Thousand only)** on the Auditor and advise him to ensure compliance with the relevant provision of the law in future, in letter and spirit.

9. The Auditor is hereby directed to deposit the aforesaid amount of penalty in the designated bank account maintained in the name of the Securities Exchange and Commission of Pakistan with MCB Bank Limited within thirty (30) days of the date of this Order and furnish receipted bank challan, evidencing payment of the same, to the Commission forthwith. In case of failure to deposit the penalties, the proceedings under Land Revenue Act, 1967 will be initiated for recovery of the fines as arrears of land revenue.

10. Nothing in this Order may be deemed to prejudice the operation of any provision of the Act providing for imposition of penalties in respect of any default, omission, violation of the Act.

(Shahzad Afzal Khan)
Director/HOD
Adjudication Department-I

Announced:

Dated: July 15, 2024

Islamabad

