



## The Audit Oversight Board

Before Mr. Usman Hayat, Chief Executive Officer, Audit Oversight Board

in the matter of show cause notice issued to

**UHY Hassan Naeem & Co., Chartered Accountants**

<b>Number and date of show cause notice</b>	AOB/F/061/SCN/1/2020/1 dated 28 August 2020
<b>Date of hearing</b>	29 September 2020
<b>Audit Oversight Board</b>	Mr. Usman Hayat, Chief Executive Officer
<b>AOB officials present during the hearing in Islamabad</b>	Mr. Shahid Karim, Chief Regulatory Officer Mr. Mueen Tauqir, Quality Assurance Inspector Ms. Rashk il Qamar, Intern Legal
<b>The authorized representative of UHY Hassan Naeem &amp; Co. who appeared via videolink from Lahore</b>	Mr. Naeem Akhter Sheikh, Partner Mr. Nauraiz Zafar, Manager

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## Order

1. This order shall dispose of the proceedings initiated pursuant to the show cause notice dated 28 August 2020 (the SCN) issued to M/s UHY Hassan Naeem & Co., Chartered Accountants (the Firm), under Section 36CC of the Securities and Exchange Commission of Pakistan Act, 1997 (the Act) read with Regulations 4 and 6 of the Audit Oversight Board (Operations) Regulations, 2018 (the Regulations) that have been duly notified and published in the Gazette of Pakistan.
2. AOB is the independent regulatory authority established by the parliament through the Act in 2016 to protect public interest by overseeing the quality of audit of financial statements of public interest companies (PICs). The definition of a PIC, which is notified by SECP, includes listed companies and certain non-listed companies. Stakeholders of PICs include investors, shareholders, lenders, and tax authorities that rely on audited financial statements for their financial decisions. These stakeholders place their trust in the independent assurance provided by external auditors that the financial statements prepared by the management of companies give a true and fair view of the companies' financials. Thus, it is of critical importance to the public interest that the quality of work done by external auditors meets the applicable standards and legal requirements.
3. The Firm is an "audit firm" as defined under Section 36H(b) of the Act and it is registered with AOB under Section 36T of the Act. Only the firms registered with AOB are authorized to conduct the audit of financial statements of PICs. Thus, registration with AOB holds a great deal of significance.
4. Section 36K of the Act specifies the functions of AOB, one of which is to review the work of the Quality Assurance board (QAB) and take such actions as it deems necessary.

"(c) to undertake comprehensive review and examination of the QAB work and independently assess the appropriateness of the quality control review framework and take such actions as deemed necessary;"

5. To register with AOB, a firm must first obtain a satisfactory Quality Control Review (QCR) rating under the QCR Framework. According to the QCR Framework 2015, the applicable framework for the case at hand, the objectives of the QCR Program are as follows:

"...to enhance the quality of audit report and credibility of accountancy profession in public interest by evaluating that the:

(i) audit engagements are conducted in accordance with the applicable ISAs, relevant ethical requirements and legal and regulatory requirements as applicable in Pakistan;

(ii) system of quality control has been appropriately designed and effectively implemented in accordance with the requirements of ISQC 1; and

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(iii) Firm's quality control policies and procedures have been appropriately applied so that reports issued are appropriate in the circumstances."

6. Registration of a firm with AOB is subject to the following conditions under the Regulations:

- a) Maintain satisfactory QCR rating;
- b) Comply with applicable laws and regulations, International Standards on Auditing (ISAs), Code of Ethics for Chartered Accountants (Code of Ethics) and International Standard on Quality Control;
- c) Submit Form A on an annual basis with the annual fee; and
- d) Submit a revised Form A to AOB within 15 days from occurrence of changes, if any, in the particulars of Form A.

It is the responsibility of the audit firms to comply with these conditions.

### **Prima facie violations leading to the SCN**

7. Prima facie, the Firm committed the following violations:

**a. Failure to disclose audit partner and submission of false declaration to AOB;**

Under Regulation 4 of the Regulations, it is the Firm's responsibility to submit Form A at the time of registration and then on an annual basis to AOB. Form A, inter alia, includes details of audit partners and it is submitted by a registered audit firm with the following declaration:

"The above information in Part A, B and C is updated, correct and true to the best of my knowledge and belief and it is being submitted after due authorization"

Scrutiny of Form A dated 30 August 2018, 12 July 2019 and 30 January 2020 submitted by the Firm revealed that it had failed to disclose to AOB in Form A one of the audit partners, Syed Muhammad Ali, although this disclosure is specifically required under Regulation 4(7) of the Regulations and the said audit partner signed the audit reports of nine companies.

**b. Failure to rotate audit partner**

The Firm Failed to rotate the audit engagement partner every five years with respect to the PIC Jauharabad Sugar Mills Limited required under Sub-Section 290.149 of the Code of Ethics read with the applicable rotation requirement under Regulation (XXXVII)(b) of the Code of Corporate Governance (2012). An audit partner of the Firm, Mr. Ibn e Hassan, who was the engagement partner in case of Jauharabad Sugar Mills Limited, was not rotated by the Firm after five years.

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**c. Failure to disclose audit engagements for QCR**

Under clause 9.3 of QCR Framework, the Firm was required to submit to the Quality Assurance Department (QAD) of the Institute of Chartered Accountants of Pakistan (ICAP) a list of all audit engagements of all locations whose audit reports were issued during two immediate proceeding years, however, the Firm failed to disclose the following audit engagements and thereby violated Regulation 4(10) and 4(11) of the Regulations:

- i. AHM Securities (Private) Limited FY 2017
  - ii. Dalal Securities (Private) Limited FY 2017
  - iii. Muhammad Ashfaq Hussain Securities (Private) Limited FY 2017
  - iv. Oriental Securities (Private) Limited FY-2017
  - v. Q.Ain Khanani Securities (Private) Limited FY-2017
  - vi. Saya Securities (Private) Limited FY-2017
  - vii. Muhammad Salim Kasmani Securities (Private) Limited FY-2017
8. In view of the foregoing, the SCN was served upon the Firm to respond in writing and avail itself of the opportunity of being heard to explain as to why appropriate action(s) may not be taken against it under Section 36CC of the Act read with Regulation 6 of the Regulations. Because of the operational constraints posed by COVID-19, the Firm was offered the option of hearing through video and/or audio link.

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## Written response to the SCN by the Firm

9. Through its letter dated 4 September 2020, the Firm requested two more weeks to submit its response to the SCN. The Firm's request was accepted, and the hearing was rescheduled to 29 September 2020.

10. The Firm submitted its written response to the SCN dated 24 September 2020. Relevant extracts of the same are reproduced below with reference to the violations in the SCN:

### a. Failure to disclose audit partner and submission of false declaration to AOB

#### Our submissions on the matter are as under:

- i. AOB vide its letter AOB/QCRfirms180121/Reg/001/180208 dated February 08, 2018, apprised us of the registration process and the requirement thereto under Regulation 4(2) of filing of Form A, the format of which was enclosed. The enclosed Form A format in column 2 referred to Note 1 which is reproduced below for the record:

*"Include particulars of all audit partners who performed or intend to perform audit of any client. In case, any audit partner has not prepared an audit report of a PIC client during the two preceding calendar years, mention 'None' in the last two columns of Part A of Form A."*

The aforementioned text clearly states that particulars with respect to audit partners only are to be included. Therefore, we intend to clarify that Mr. Syed Muhammad Ali ceased to be the audit partner of our firm (internal memo attached as Annexure A), with effect from March 01, 2018. This is further substantiated by the fact that all the non-public interest companies (Non-PICs) listed in the notice belong to the Financial Years 2016 & 2017 and that the last audit report was signed by Mr. Syed Muhammad Ali on February 19, 2018.

- ii. We wish to duly bring to your notice that at the time of electronic filing of Form A, Mr. Shahid Farooq was the active audit partner in our Islamabad office, as Mr. Syed Muhammad Ali was discharged from performance of his duties as an audit partner. Hence, we interpreted the requirement under the pre-text that information is not to be provided for previous audit partner

of Firm in the Form A. Thus, we disclosed all the three audit partners of the Firm who were authorized and intended to perform audit engagements on the date of filing of Form A i.e. August 30, 2018.

- iii. We intend to reiterate that our disclosure of audit partners considering the aforementioned was made without any ulterior intention to discredit or disregard any process and misrepresent thereto. Therefore, the impression of false declaration to AOB may be reconsidered as it was not an absolute assurance provided with any mala fide intention but a matter of interpretation of the word 'audit partner'. Furthermore, even though considering the difference of interpretation, this subsequently entails no consequences for a regulatory body as Mr. Syed Muhammad Ali has not performed any audit since then.

**We therefore, request you to please review the contention and apprehend in the light of aforementioned facts and circumstances; thus, withdraw the above allegation.**

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## b. Failure to rotate audit partner

### Our submissions on the matter are as under:

It is submitted that the relevant provisions in the SECP Act, 1997 with regard to AOB were introduced in August 2016 and the AOB (Operations) Regulations, 2018 ("the AOB Regulations") were notified in January 2018. Before you consider our reply to your referenced query, please take into consideration, which, among others, are: (1) the referenced Show Cause Notice and these

proceedings are coram non judge; and (2) if the act(s) of the Firm prior to the AOB Regulations came into force are considered not to be in full conformity with the AOB Regulations in the opinion of AOB, especially when such act(s) were taken by the Firm with all bona fides, the same act(s) cannot be judged on the basis of the AOB Regulations.

Without prejudice to the above, we reply:

- i. To reiterate, our firm strictly believes in following all applicable laws and regulations and this is a first such instance where we have been alleged to be in violation of any such law and regulation. However, we seek the opportunity to clarify to your good self that this was based on a difference of opinion rather than a deliberate attempt to non-comply with the applicable laws and regulations and the pre-conditions for registration with AOB.
- ii. We may kindly bring to your notice that a Show Cause Notice has already been issued to Mr. Ibne Hassan by the Institute of Chartered Accountants of Pakistan (ICAP) with regards to rendering of services beyond the lapse of a period of five (5) years. In response to this, a detailed reply has been submitted thereto explaining in detail the basis of the decision-making process and the professional judgment exercised in light of the applicable Code of Ethics. It is, however, pending adjudication.

We wish to submit that the Code of Ethics has been issued by the Institute of Chartered Accountants of Pakistan (ICAP) and they are the primary regulator responsible for the enforcement of the same. Since, the matter is under active consideration of the Investigation Committee of ICAP, therefore, raising the same contention and probing the same would tantamount to duplicity of proceedings and would be arbitrary and illegal. Thus, we hereby request you to please withdraw this objection and wait for the decision by Investigation Committee of ICAP.

- iii. Without prejudice to the above, we also wish to apprise you of the response submitted to ICAP. A summary of the same has been reproduced below for reference:

The issue relates to the non-compliance of Code of Ethics (2008 and 2015) read with regulation (xxxvii)(b) of the Code of Corporate Governance (CCG)-2012, which deals with all listed companies other than those in the financial sector, wherein it is required to rotate the engagement partner after every 5 years.

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An irregularity has been highlighted in case of audit of financial statements of Jauharabad Sugar Mills Limited (Formerly known as 'Kohinoor Sugar Mills Limited'), which is a listed company and where Mr. Ibne Hassan remained an engagement partner from September 30, 2009 to September 30, 2017. It has been alleged as follows:

*"AND WHEREAS, the Firm failed to rotate the audit engagement partner after every five years as required under sub-section 290.149 of Code of Ethics for Chartered Accountants (Revised 2015) read with regulation 34(2) of Listed Companies (Code of Corporate Governance) Regulations, 2017 in respect of audit of financial statements of the Jauharabad Sugar Mills Limited for which the audit reports were issued by one of the audit partners of the Firm, Mr. Ibne Hassan, exceeding five years period, and thereby violated the conditions of registration as stated in paragraph (1) above issued under the Regulation 4(10) and 4(11) of Regulations."*

The facts of the case are as follows:

- A. It may be noted that the above issue became relevant for the first time in audit of the year ended, 30<sup>th</sup> September 2014, as Mr. Ibne Hassan's tenure of five years, as engagement partner, was completed after the audit of year ended, 30<sup>th</sup> September, 2013. During the years 2013 and 2014, some unique events happened in the above-named client, which resulted in change of ownership, management and control of the Company including its Board of Directors, top executives and financial management which have been detailed as follows:

The Firm then provided details of the changes to the shareholding, board of directors, and the management.

Keeping in view the above circumstances and principles laid down in the Code of Ethics (2008), as applicable at that time, and based on our evaluation of the above directives. According to our

best professional judgement his independence was not impaired, and the familiarity and self-interest threats did not exist on account of unique circumstances of that particular client. The conclusion was based on the following considerations which were emanating from the applicable Code of Ethics 2008 as adopted by ICAP:

- i. It may be noted that Code of Ethics for Chartered Accountants, both 2008 and 2015, provide guidance principles to the professional accountants, as how to identify the threats while doing the professional work, how to evaluate these threats and apply safeguard to either reduce them to an acceptable level or completely eliminate them. It may be noted that these directives are mere principles and not rule based. Therefore, entail exercise of judgement in different circumstances.

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It may also be noted that this conceptual framework does not cover all the possible circumstances that a chartered accountant may come across while discharging his professional work. These set of principles have to be applied to all unique circumstances by exercising judgement, to come to a right conclusion.

The Firm then drew AOB's attention to clauses 100.2 and 100.3 of the Code of Ethics for Chartered Accountants (2008) followed by clauses 100.5, 100.6, 100.7, and 100.9, reproducing the same in its written response.

It is apparent from plain reading of the above paragraphs of Code of Ethics and principles provided therein that the threats have to be evaluated under each and every circumstance, specifically and all general principles cannot be applied in specific circumstances. This will be especially true for the unique circumstances in his case that are not covered under the Code.

We wish to submit that in such circumstances due to the change in ownership, Board of Directors and the executive management of the client, the familiarity threat was very low keeping in view paragraph 290.155. The paragraph 290.156, also talks about this familiarity threat and the safeguard to be applied in such situation to bring the threat to an acceptable level and then it draws attention to take *cognizance* of Code of Corporate Governance provided under the Listing Regulations. However, the point is to be noted that cognizance of these rules shall only come into account when a familiarity threat exists. In case if there is no familiarity threat, then reference to the Code of Corporate Governance is of no consequence.

- v. It may also be noted that the one way provided to reduce the familiarity threat, in such circumstances is rotation of engagement partner which, when juxtaposed with the unique situation, was of insignificant relevance while considering the complete change of management, owners and members of the board on the client.
- vi. It may also be noted that our assertion and conclusion on the interpretation of the Code of Ethics (2008) was further confirmed with subsequent change in the revised Code of Ethics (2015) whereby a change of client's management was added as an important factor for determining the familiarity threat. Reference is made to para 290.148 of the Code of Ethics (2015).

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Therefore, keeping in view the provisions of the Code of Ethics quoted above, and the unique circumstances that existed in this case, to the best of our knowledge, belief and professional judgement, arrived at the conclusion that the familiarity threat was significantly reduced. Therefore, there is no need to rotate the engagement partner in such circumstances as suggested in Code of Ethics.

- B. The Code of Ethics compulsorily requires rotation of the engagement partner after five years as envisaged under Regulation (xxxvii) (b) of the Code of Corporate Governance (CCG) 2012, therefore, its compliance was mandatory. We wish to submit that in addition to the arguments already made as supra, we may also draw your attention towards the following two facts:
- i) The Code of Corporate Governance is a part of Listing Regulations and is a mandatory requirement applicable to the companies and does not apply directly to the Chartered Accountants.
  - ii) The compliance of regulation (xxxvii)(b) of Code of Corporate Governance, 2012 only comes to play for the Chartered Accountants with reference to the Code of Ethics (2008) and more specifically provided in paragraph 290.156 as narrated above.

It may be noted that this clause cannot be interpreted in isolation and has to be read along with the entire Code of Ethics in general and the section dealing with the independence of auditors in particular.

- i. We wish to submit that preamble of the above paragraph (290.156) instructs the auditors in practice to take "cognizance" of the requirements of Code of Corporate Governance 2012 pertaining to the engagement partner for addressing the familiarity threat:

*" Accordingly, in respect of the financial statement audit of listed entities the chartered accountants in practice shall take cognizance of the following requirements of the Code of Corporate Governance."*

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The Firm then mentioned the principle of substantial compliance.

The Authority would appreciate that in the unique circumstances before us, there was no familiarity threat as explained in detail as supra, therefore, in substance and spirit, our act was in compliance with both the Code of Ethics read with Code of Corporate Governance. Therefore, the non-compliance if any can be to the extent of specific form or procedure only, and does not pertain to the actual intent.

Reference is drawn towards the principle of "substantial compliance" with regards to the requirements of directory law, which is accepted by the Supreme Court of Pakistan. Reference may kindly be made to the term "substantial compliance" explained hereunder:

Definition of 'substantial compliance' in Merriam-Webster's Dictionary of Law: (Edition: 1996)	
Substantial Compliance (n)	<u>Compliance with the substantial or essential requirements of something (as a statute or contract) that satisfies its purpose or objective even though its formal requirements are not complied with.</u>
Definition of 'substantial-compliance rule' and 'substantial performance doctrine' in Black's Law Dictionary: (Deluxe 10th Edition)	
Substantial Compliance Rule	See substantial performance doctrine
Substantial-Performance Doctrine	The rule that if a good-faith attempt to perform does not precisely meet the terms of an agreement or statutory requirements, the performance will be considered complete if the essential purpose is accomplished.

The superior court of Pakistan has held that the doctrine of substantial compliance is a doctrine in equity. It states that if a good faith attempt was made to perform the requirement of a law, but failed to exactly meet the specifics, and if the essential aim of the law has been met, the law will still be considered as having been complied with the essential requirement that satisfies its purpose or objective despite of the fact that its formal requirements are not met.

The superior courts while insisting on the compliance of rules in accordance with their provisions as well as the parent law; have also by and large accepted the rule of substantial compliance with a view to see that they are not applied and operated as stumbling blocks instead of stepping stones. They should also not be used simply to trap people by technicalities of the rules instead of advancing the purpose for which they are framed.

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The Firm then made reference to 1989 PLD 222 and 1975 PLD 678 in order to elaborate on its argument regarding the doctrine of substantial compliance.

It may be noted that the Code of Ethics is a direction of the Council of Institute of Chartered Accountants of Pakistan and not a statutory law, therefore, in light of above judgements of Supreme Court of Pakistan, substantial compliance of the Code will be considered to be made in substance by fulfilling the purpose and objective for which particular directive have been issued even though its formal requirements are not complied with. The principle laid down in the above cases equally apply to our case, since the "substance" or "essence" of rotation of engagement partner was fully served i.e. familiarity threat was substantially reduced consequent to the change in client's ownership, management and control after year 2013. Therefore, the requirement for rotation of engagement partner was not relevant for audit of the client for a period of next 5 years starting from year 2014.

**c. Failure to disclose audit engagements for the purpose of QCR**

Our submissions on the matter are as under:

- i. Keeping in view the aforementioned reservation we wish to apprise you that it is on account of an inadvertent error on our part that the referred clients were not included in the list furnished

to the Quality Assurance Department (QAD) of the Institute of Chartered Accountant of Pakistan (ICAP).

- ii. Without prejudice to the above, you would appreciate the fact that at the time of filing of Form A dated 12 July 2019 (*Annexure C*), we did mention the names of these clients. This confirms that the filing with QAD of ICAP was an oversight without any guilty intent.

We sincerely apologize for the inconvenience caused due to our inadvertent mistake and assure you that appropriate steps will be undertaken to avoid such a discrepancy in future i.e. all audit engagements will be reported to QAD, as and when required.

Furthermore, to the satisfaction of the competent authority, should you require, we wish to offer the record of entities whose names were inadvertently excluded, for inspection by the QAD, at any time of their convenience.

The Firm stated that it had come up with an action plan to ensure compliance with all applicable laws in the future.

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### Action Plan for Future

Keeping in view the issues and inconsistencies highlighted, we have devised an internal strategy and issued memos to ensure compliance of all applicable laws, regulations and conditions. Your good self may consider the positive of the matter that this is the first time that we have been alleged on any such professional non-compliances. Thus, a lenient view may be undertaken.

### **Oral submissions by the Firm during the hearing**

11. The Firm availed itself of the opportunity of being heard on 29 September 2020. As requested by the Firm, AOB organized the hearing via videolink. Mr. Naeem Akhter Sheikh, a partner of the Firm, and Mr. Nauraiz Zafar, a manager of the Firm, (the Firm's Authorized Representatives) appeared on behalf of the Firm through video link from Lahore.
12. **Regarding violation (a) in the SCN** pertaining to non-disclosure of an audit partner in Form A, the Firm's Authorized Representatives explained as follows:
  - 12.1. The Firm has filed Form A with AOB three times, 2018, 2019, and 2020.
  - 12.2. Syed Muhammad Ali, who was and is still a partner of the Firm, signed auditors report for nine companies, most of which were done in 2016 and 2017, and two were done in 2018.
  - 12.3. The Firm submitted details of its audit partners in the Form A filed with AOB in 2018, at the time Syed Muhammad Ali was not an audit partner of the Firm.
  - 12.4. The Firm made a mistake in filing Form A in 2019 and did not report Syed Muhammad Ali as an audit partner. The Firm's failure to disclose the requisite information regarding Syed Muhammad Ali was an inadvertent mistake resulting from the Firm's own 'understanding' and there was no motivation or intention of not reporting the said partner to AOB.
  - 12.5. Filings with QAD for the purposes are QCR and AOB are different in nature.
13. **Regarding violation (b) in the SCN** pertaining to rotation of audit partner in case of Jauharabad Sugar Mills, the Firm's Authorized Representatives explained as follows:
  - 13.1. Mr. Ibn e Hasan remained the auditing partner for Jauharabad Sugar Mills from 2009 till 2013, when AOB had not been established, and therefore, the matter falls outside the ambit of AOB;

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- 13.2. The same matter has been taken up by the ICAP's investigation committee, AOB should wait till the matter is concluded by ICAP, and a plethora of case law suggests that two regulators cannot take cognizance of the same matter.
  - 13.3. The Firm has provided detailed arguments in the matter to ICAP's investigation committee and a brief version has been submitted to AOB as a part of the Firm's written reply to the SCN.
  - 13.4. The shareholders, directors, and management of Jauharabad Sugar Mills, formerly known as Kohinoor Sugar Mills, had changed during 2013-14, there was no longer any familiarity threat to the independence of the audit partner, therefore the Firm did not rotate the partner.
  - 13.5. The Firm had nothing to gain financially by not rotating the engagement partner and another partner of the Firm could have easily stepped in to meet the rotation requirement.
  - 13.6. There was no violation of the Code of Ethics because it is a principles-based framework where judgement needs to be exercised in view of unique circumstances of the case and the Firm took cognizance of the matter and judged that there was no familiarity threat.
  - 13.7. The Firm may not have complied in form, but it had complied in substance under the doctrine of substantial compliance as stated in the Firm's written reply.
  - 13.8. This is an isolated incident, there is no other case where the Firm did not rotate the partner as required.
14. **Regarding violation (c) in the SCN** pertaining to the list of engagements provided to QAD for the purpose of QCR, the Firms Authorized Representatives explained as follows;
- 14.1. The seven engagements that not reported to QAD in 2018 were from the Firm's Karachi office, however, these seven cases were reported to AOB through Form A in 2018, there was no ill-intent on the Firm's part.
  - 14.2. Non-disclosure of these engagements to QAD was an inadvertent filing error on behalf of the Firm.
  - 14.3. Non-disclosure of these engagements to QAD did not affect the Firm's QCR rating.
  - 14.4. The Firm has formulated an action plan to ensure that such a lapse does not occur in the future and under this action plan the Firm will conduct internal quality reviews in each office of the Firm every three months, periodically and these internal quality reviews will be signed by the Firm's audit partners.

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- 14.5. The Firm is willing to open its records to AOB's inspectors to conduct an audit of the seven engagements.
- 14.6. The Firm apologizes for its mistake.

### **AOB's analysis of violation (a): Failure to disclose audit partner and submission of false declaration to AOB**

15. Regarding non-disclosure of audit partner and submission of false declaration to AOB, our analysis is as follows:

- 15.1. Only the firms registered with AOB are authorized to audit the financial statements of a PIC. The firms registered with AOB are required to report their audit partners through Form A. The non-disclosure of a partner who is conducting audits of PICs is against public interest.

- 15.2. As stated earlier, audit firms registered with AOB are required to file Form A at the time of registration and then annually. Form A, inter alia, includes audit partners of a firm and it is filed with AOB with a solemn declaration that the information being furnished is updated, correct, and true. It is thus clear that the filing of Form A to AOB is indeed a serious matter and has to be done with due care and diligence.

- 15.3. AOB letter AOB/QCRfirms180121/Reg/001/180208 dated 8 February 2018 which was sent to the Firm had a note which stated the following about reporting the audit partner in Form A:

“Note-1: Include particulars of all audit partners who performed or intend to perform audit of any client. In case, any audit partner has not prepared an audit report of a PIC client during **the two preceding calendar years**, mention ‘None’ in the last two columns of Part A of Form A.” (emphasis added)

- 15.4. Syed Muhammad Ali had signed auditor's reports on behalf of the Firm during 2016, 2017, and 2018. Therefore, the Firm had to report him as an audit partner through Form A in each of the three years, 2018, 2019, and 2020.

- 15.5. AOB's registration fee is charged to the registered firm based on the number of audit partners. This fee is specified in Schedule III of the Regulations. Because the Firm had not reported Syed Muhammad Ali as an audit partner, the Firm did not pay a portion of the applicable fee. The payment of this fee is a requirement to maintain registration of the Firm with AOB under Regulation 4(2)(d) of the Regulations, which is reproduced below:

“(d) In order to maintain registration with AOB, an audit firm shall file Form A along with annual Fee as specified in Schedule 3 for each calendar year by 31 January of the current year. Failure to pay the annual Fee along with Form A by the due date shall make the

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audit firm liable to pay surcharge at the rate of 1.5 per cent (one and a half per cent) per month or part thereof, until payment and such firm may also be subject to actions by AOB under section 36CC of the Act.”

- 15.6. The Firm disclosed Syed Muhammad Ali for the purposes of QCR but did not disclose him to AOB.
- 15.7. The Firm’s last QCR report by QAB shows that there were two engagements by Syed Muhammad Ali that were reviewed for the purposes of QCR and found satisfactory. However, the QAB in its report concluded that two out of the three engagements performed by Mr. Ibn e Hasan were not in accordance with the applicable requirements. This was stated in the QAB’s report dated 19 July 2019 as follows:

“The Quality Assurance Board (QAB) in its 96<sup>th</sup> meeting held on July 04, 2019 concluded the audit was carried out and audit report issued by the firm in respect of reviewed client was **not in accordance** with ISAs and legal and regulatory requirements as applicable in Pakistan” (page 6; page 12)
- 15.8. Under the QCR Framework, the Firm was assigned a satisfactory QCR rating because the overall conclusion pertaining to two thirds of the Firm’s three partners was satisfactory. That is, the work performed by Syed Muhammad Ali directly contributed to the Firm’s Satisfactory QCR rating, which is a necessary precondition for the Firm’s registration with AOB. However, the Firm did not disclose Syed Muhammad Ali as an audit partner to AOB.
- 15.9. It is pertinent to note that the Firm has accepted its non-compliance regarding disclosure of its audit partner, Syed Muhammad Ali, to AOB through Form A.

### **AOB’s analysis of violation (b): Failure to rotate audit partner**

16. AOB is the independent and apex regulator of audit profession established under the Act. AOB registers audit firms and regulates audit firms under the Act and regulations made thereunder. ICAP is a professional body that regulates its members, that is Chartered Accountants, who are individuals, under the Chartered Accountants Ordinance, 1961. The mandates and functions of AOB and ICAP as stated in the laws establishing the two organizations are different. Therefore, it is an invalid argument that because ICAP has initiated proceedings against its member, Mr. Ibn e Hasan, therefore, AOB cannot proceed against the Firm.
17. AOB was established in 2016 and the Firm was deemed registered with AOB with effect from 06 August 2016. The same date is stated on the certificate of registration issued by AOB to the Firm. The auditor’s report for Jauharabad Sugar Mills were signed by the Firm’s partner, Mr. Ibn e Hassan, on 29 December 2017. That is, the argument that AOB is applying the Act on the Firm retrospectively is without merit.

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18. The requirement for rotation as stated in the Code of Ethics read with the requirement for rotation in the Code of Corporate Governance do not leave an extensive room for judgement and interpretation as argued by the Firm.

18.1. Sub-section 290.149 of Code of Ethics is as follows:

“In respect of an audit of a public interest entity, an individual **shall not be** a key audit partner for more than seven years unless the law prescribes a shorter period in which case the requirement of the law shall prevail for such specific entities. After such time, the individual **shall not be** a member of the engagement team or be a key audit partner for the client for two years.” (emphasis added)

18.2. The concept of “Engagement Partner” as defined in Code of Ethics and International Standard on Auditing 220 “Quality Control for an audit of financial statements” includes engagement partner. It is reproduced as follows:

“The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor’s report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.”

18.3. The applicable rotation requirement as stated in the Code of Corporate Governance is as follows:

“All listed companies other than those in the financial sector **shall**, at the minimum, rotate the engagement partner **after every five years.**” (emphasis added)

18.4. The requirement of the Code of Corporate Governance as stated in regarding the appointment of external auditor is as follows:

(xxxiii) “No listed company **shall** appoint as external auditors, a firm of auditors which or a partner of which is non-compliant with the International Federation of Accountants’ Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan.” (emphasis added)

18.5. Reading the Code of Ethics with the Code of Corporate Governance make it clear that the engagement partner was, at the minimum, required to be rotated every five years. The use of “shall” in the provisions quoted above leaves no doubt that this is a mandatory requirement.

18.6. The Code of Corporate Governance specifies a five-year rotation period as a “minimum” requirement without providing any room for exception, whereas the Firm, acting on its own, extended this period to 10 years. This is clearly against the letter and spirit of the Code of Ethics and the Code of Corporate Governance.

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- 18.7. At no stage did the Firm or Jauharabad Sugar Mills provide any disclosure through the company's annual reports, from 2014 to 2018, that the requirement to rotate audit engagement partner was not being met.
- 18.8. Instead of complying with the requirement or disclosing the non-compliance, the Firm and the Jauharabad Sugar Mills provided absolute assurances to the readers of the company's annual reports regarding compliance with the Code of Ethics and Code of Corporate Governance.
- 18.9. In the annual report 2017 of Jauharabad Sugar Mills, the statement of compliance with the Code of Corporate Governance stated the following:

“19. The statutory auditors of the Company have confirmed that they have been given a satisfactory rating under the quality control review program of the ICAP, that they or any of the partners of the firm, their spouses and minor children to not hold shares of the Company and that **the firm and all its partners are in compliance with International Federation of Accountants (IFAC) guidelines on code of ethics as adopted by ICAP.**” (p. 54) (emphasis added)

- 18.10. In the annual report 2017 of Jauharabad Sugar Mills, review report by the Firm to the members on the statement of compliance of the company with the Code of Corporate Governance stated the following:

“Based on our review, **nothing has come to our attention** which causes us to believe that the Statement of Compliance does not appropriately reflect the Company's compliance, in all material respects, with the best practices contained in the Code as applicable to the Company for the year ended September 30, 2017” (p. 55) (emphasis added)

The Firm was fully aware that the Jauharabad Sugar Mills did not comply with the Code of Corporate Governance because the Firm did not rotate the audit partner after five years.

- 18.11. As stated earlier, stakeholders of PICs include investors, shareholders, lenders, and tax authorities that rely on audited financial statements for their financial decisions. These stakeholders place their trust in the independent assurance provided by the external auditor that the financial statements prepared by the management of companies give a true and fair view of the companies' financials. The facts of the case clearly show that by failing to rotate its audit engagement partner, the Firm did not comply with the Code of Ethics and provided false and misleading statement of compliance in the annual reports of Jauharabad Sugar Mills.

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## **AOB's analysis of violation: (c) Failure to disclose audit engagements for Quality Control Review (QCR)**

19. By failing to disclose all the audit engagements, the Firm has not followed the letter and spirit of clause 9.3 the QCR Framework, 2015, which is reproduced below:

“9.3 The Firm shall submit to QAD, at least one month before the date of QCR visit, a list of **all audit engagements** on the prescribed format of all locations whose audit reports were issued during two immediate preceding years.” (emphasis added)

20. The Firm's submission that despite the non-disclosure of the seven engagements its QCR rating was not affected is incorrect because reduction of a population inevitably affects the sample selection from the population and the results derived from the analysis of the sample.
21. The list of engagement submitted under Clause 9.3 of the QCR Framework, 2015 was on with a specific declaration:
- “The above information is updated, correct and true to the best of my knowledge and belief and it is being submitted after due authorization.”
22. The fact that the list of all engagements is to be submitted through such a clearly and strongly worded declaration underscores the importance of engagement selection for the QCR rating. An obvious reason is that a firm can influence its QCR rating by not disclosing those engagements that are unlikely to lead to a satisfactory QCR rating.
23. It is pertinent to note that the Firm has accepted its non-compliance regarding disclosure of all audit engagements for the purposes of QCR.

## **Conclusion**

24. Based on the foregoing, AOB has come to the conclusion that:
- the Firm failed to disclose in Form A that Syed Muhammad Ali was an audit partner to AOB and submitted a false declaration and thereby violated 4(2)(d) of the Regulations and the conditions of its registration with AOB;
  - the Firm failed to comply with the Code of Ethics regarding rotation of the audit partner and thereby violated the IAS and QCR Framework whereas a satisfactory QCR rating is a necessary precondition for the Firm's registration with AOB; and
  - the Firm failed to disclose all audit engagements for the purpose of QCR and submitted a false declaration to QAD whereas a satisfactory QCR rating is a necessary precondition for the Firm's registration with AOB.

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25. AOB has taken into consideration that:
- the Firm has accepted its non-compliance with respect to violation (a) and (c) in the SCN and tendered an apology;
  - the Firm has reported that neither the Firm nor any partner has any prior history of a disciplinary action by a regulatory authority; and
  - the Firm has reported that it has implemented an action plan for compliance in future.
26. The actions available to AOB under Section 36CC of the Act include deregistration, suspension, imposition of a financial penalty, issuance of a reprimand or a warning.
27. Accordingly, in exercise of the powers conferred under Section 36K, 36AA 36CC of the Act, to protect public interest in audit quality, AOB hereby:
- issues a warning to the Firm;
  - bars the Firm from assigning any audit engagement of a PIC to its partner Mr. Ibn e Hasan and/or no auditor's report of a PIC is to be signed on behalf of the Firm by Mr. Ibn e Hasan for two years from the date of this order; and
  - directs the Firm to submit within 30 days of the date of this order an action plan comprising substantive measures to ensure there is no recurrence of the same violations listed in this order.

This order be placed on AOB's website with immediate effect.

  


Usman Hayat  
Chief Executive Officer

Announced: 22 October 2020

**Copy for information and necessary action, if any:**

1. Governor, State Bank of Pakistan
2. Chairman, Securities and Exchange Commission of Pakistan
3. President, The Institute of Chartered Accountants of Pakistan
4. Managing Director, Pakistan Stock Exchange Limited
5. Chairman, Quality Assurance Board