

**Before the Director (Market Supervision & Registration Department)
Securities Market Division
Securities and Exchange Commission of Pakistan**

**In the matter of Show Cause Notice Dated January 23, 2013 issued to
M/s. Avais Hyder Liaquat Nauman, Chartered Accountants**

Date of Hearing: April 4, 2013

Present at the Hearing: Syed Naveed Abbas (Partner)
M. Jamil Akhtar (Director)

Representing MSRD: Ms. Saima Shafi Rana (Deputy Director- MSRD)

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-148) SE/SMD/02 dated January 23, 2013 (“**the SCN**”) issued to M/s. Avais Hyder Liaquat Nauman, Chartered Accountants, (“**the Respondent**”) under section 22 of the Securities and Exchange Ordinance, 1969 (“**the Ordinance**”).
2. Brief facts of the case are that the Securities & Exchange Commission of Pakistan (“**the Commission**”) in exercise of its powers under Sub Section (1) of Section 6 of the Ordinance read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (the “**Inspection Rules**”) ordered an inspection of the books and records required to be maintained by M/s. First Equity Modaraba (the “**FEM**”), TREC Holder of Karachi Stock Exchange Ltd. and registered with the Commission as a broker under the Brokers and Agents Registration Rules, 2001 (“**Brokers Rules**”).
3. The report dated November 27, 2012 submitted by the Inspection Team highlighted major irregularities in calculation of Net Capital Balance (‘NCB’) of FEM as on June 30, 2012, the calculation of which was duly verified and certified by the Respondent. It appeared that NCB was not in accordance with Third Schedule of Securities and Exchange Rules, 1971 (the “**SE Rules**”) Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

***SUBJECT: SHOW CAUSE NOTICE UNDER SECTION 22 OF THE
SECURITIES AND EXCHANGE ORDINANCE, 1969 IN
THE MATTER OF FIRST EQUITY MODARABA***

WHEREAS, the Securities and Exchange Commission of Pakistan (“Commission”) in exercise of its powers under Sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 (“Ordinance”) read with Rule 3 and Rule 4 of the Stock Exchange Members (Inspection of Books and Record) Rules, 2001 (“Inspection Rules”) ordered an inspection vide order No. SMD/MS&CID-C&IW/10-1(162)/2012 dated September 24, 2012 of the books and record required to be maintained by First Equity Modaraba (“FEM”) a TREC Holder of Karachi Stock Exchange Limited (“Exchange”)



2. **AND WHEREAS**, on review of the inspection report submitted by the Inspection Team, it has been observed that the Net Capital Balance (“NCB”) of FEM as on June 30, 2012 as verified and certified by M/s. Avais Hyder Liaquat Nauman, Chartered Accountants (“Auditors”) is not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (“1971 Rules”) and following discrepancies were observed:-

- a. Trade Receivables were **understated** by an amount of Rs. 1,303,399
- b. Investments in the listed securities in the name of the company were **overstated** by an amount of Rs. 24,069,259
- c. Securities purchased for clients were **understated** by an amount of Rs. 9,375,405
- d. Total Current assets **overstated** by an amount of Rs. 13,390,455
- e. Trade payables were **understated** by an amount of Rs. 923,008
- f. Other Liabilities were **understated** by an amount of Rs. 24,271,440
- g. Total Current liabilities were **understated** by an amount of Rs. 25,194,448
- h. NCB was overstated by Rs. **38,584,903** in NCB
- i. Certificate of NCB was not prepared as per specific format

3. **AND WHEREAS**, in terms of Rule 2(d) of the 1971 Rules read with Clause 2.1 of the Regulations Governing Risk Management of the Exchange (“the Regulations”) the NCB are required to be calculated in accordance with the Third Schedule to the 1971 Rules. Further, the members of the Exchange are required to submit bi-annually a certificate from an auditor as specified in Clause 2.1 (b) of the said Regulations confirming their NCB on the format prescribed by the Exchange. The NCB is also required to be duly audited/verified in terms of Clause 2.1 (c) of the said Regulations which provides that:-

“the certificate shall specify that the Net Capital Balance calculated have been duly audited/verified by the auditor”

4. **AND WHEREAS**, prima facie it appears that the certificate of NCB of FEM as on June 30, 2012 certified by the auditors is not in accordance with the Third Schedule of the 1971 Rules and that the auditors have prima facie certified a statement and given information which it had reasonable cause to believe to be false or incorrect in material particular in violation of Section 18 of the Ordinance.

5. **AND WHEREAS**, in the light of the facts mentioned above, prima facie, it appears that the auditors are in contravention of Section 18 of the Ordinance, the contravention of which invokes penalty under Section 22 of the Ordinance.

6. **AND WHEREAS**, section 18 of the Ordinance provides:-

“No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.”

7. **AND WHEREAS**, Section 22 of the Ordinance provides that:

“ If any person refuses or fails to furnish any document, paper or information which he is required to furnish by or under this Ordinance; or refuses or fails to comply with any order or direction

of the Commission made or issued under this Ordinance; or contravenes or otherwise fails to comply with the provisions of this Ordinance or any rules or regulations made thereunder, the Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding fifty million rupees as may be specified in the order and in the case of continuing default, a further sum calculated at the rate of two hundred thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.”

8. ***NOW THEREFORE***, you are hereby called upon to show cause in writing by February 8, 2013, as to why action as provided under Section 22 of the Ordinance may not be initiated for violation as indicated above. You are further directed to appear in person or through an authorized representative (with documentary proof of such authorization), on ***February 12, 2013*** at 3:00 p.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you may consider necessary for clarification or in your defense. This notice sufficiently discharges the Commission’s obligation to afford an opportunity of hearing in terms of Section 22 of the Ordinance. In case of your failure to appear on the stated date of hearing it will be deemed that you have nothing to say in your defense and the matter will be decided ex-parte on the basis of available record.

9. Please note that this show cause is being issued without prejudice to any action, which may be taken or warranted for the above said or any other default under the above referred or any other provisions of law. Kindly acknowledge receipt of this show cause notice through return fax or courier at your earliest.

Sd/-
Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for February 12, 2013 was adjourned on the request of the Respondent. The Respondent submitted a written response vide its letter dated April 1, 2013. The hearing dated April 2, 2013 was attended by a local partner duly authorized by the engagement partner. The following arguments were put forward by the Respondent in its written response and during the hearing held on April 2, 2013:

a) **Understatement of Trade Receivables:** In this connection, the Respondent in its written response stated as follows:

“...The schedules provided by the management of the Modaraba during the audit showed trade receivables as Rs. 39,458,692. Inquiry was made from the client and we were informed that aging reports are not generated from the system, as an alternate procedure we took the breakup of the receivables as on June 30, 2012 June 16, 2012 and May 31, 2012 from where we were able to identify the amount of receivables which were overdue for more than 14 days. As at that time, annual audit was in progress therefore we also performed tests of details for customers /receivables selected on a random sampling basis, the procedures were as follows:

- Confirmation circulation for confirming the amount receivable from the customer selected.
- Detailed verification for transactions carried out during the year.
- Subsequent clearance for checking whether the amounts are received subsequent to year end.

The analysis of all these customers showed that the amounts due from them were more than 14 days old. We then based on our above procedure concluded that the management's statement as regards to receivable was appropriate."

- b) **Overstatement of Investment in Listed Securities:** In this connection, the Respondent in its written response stated as follows:

"Investments in listed securities are classified as Short term and Long term as per the Framework provided in International Financial Reporting Standards, whereas the nature of investments held by the Modaraba are short term because during the year sales and purchases are being made from the long term portfolio as well which indicates the fact that the classification is only made for better presentation of the financial statements. The breakup of investments in listed securities as per the audited financial statements is as follows of which 85% is taken in the NCB:

<i>Long term investments</i>	<i>28,298,775</i>
<i>Short term investments</i>	<i>26,918,313</i>
<i>Total</i>	<i>55,217,088</i>
<i>85% taken in NCB</i>	<i>46,934,525</i>

The objection raised by the Securities and Exchange Commission of Pakistan (SECP) indicated that the investments are overstated by Rs. 24,069,259, whereas there is no overstatement as depicted from the break up given above."

- c) **Understatement of Securities Purchased for Clients:** In this connection, the Respondent in its written response stated as follows:

"Inquiry was made from the client regarding the securities purchased for the client and held by the member where payment has not been received within 14 days and in response we were informed that no securities were held by the member. However, replying on the response received and non-availability of other evidences that could indicate a misrepresentation we did not perform detailed testing regarding it"

The Respondent was inquired whether it checked the CDS statement of the clients whose Trade Receivables were overdue for more than 14 days. The Respondent replied that it only relied on the response of the company.

- d) **Understatement of Trade Payables:** In this connection, the Respondent in its written response stated as follows:

"The schedules provided by the management of the Modaraba during the audit showed trade payables as Rs. 4,841,489. Inquiry was made from the client and

we were informed that aging reports are not generated from the system as an alternate procedure we took the breakup of the payables as on June 30, 2012 and May 31, 2012 from where we were able to identify the amount of payables which were overdue for more than 30 days. As at that time, annual audit was in progress therefore we also performed tests of details for certain parties/payables selected on a random sampling basis, the procedures were as follows:

- Confirmation circulation for confirming the amount payable to the party selected.
- Detailed verification for transactions carried out during the year.
- Subsequent clearance for checking whether the amounts are paid subsequent to year end.

The analysis of all these payables showed that the amounts due to them were more than 30 days old. We then based on our above procedure concluded that the management's statement as regards to payables was appropriate..."

e) **Understatement of Other Liabilities:** In this connection, the Respondent in its written response stated as follows:

.. "The unclaimed dividend amounts from 2003 onwards have been taken, as the net capital certificate is related to brokerage business, therefore the liability is taken from there onwards and not before as the brokerage business was started by the Modaraba. Creditors included amounts payable to Premier Financial Services (Pvt) Limited, management company of the Modaraba for the expenses incurred by them on behalf of the Modaraba during the normal course of business and the management fee payable to them. Management fee is taken as a percentage of annual profit and the accrual of the management fee is made after the financials are approved and therefore the 'figure of the creditors was changed as per the net capital certificate and the financial statements. Further, the amount of the provision for taxation was adjusted by the Modaraba against the advance tax paid during the whole year. While finalization of the financial statements the adjustment of the provision for taxation was made and both the accounts were disclosed accordingly."

f) **Format of Certificate:** In this connection, the Respondent in its written response stated as follows:

"Following the past history and policy of the firm, the certificate of NCB was prepared as per the same format as is issued to other clients. The format followed by our firm of NCB certificate is also available on the websites of Lahore and Islamabad Stock Exchanges. No format of NCB certificate was found on the website of the Karachi Stock Exchange and if there is any format we ensure that in future the NCB certificates will be in accordance with the specified format.."

5. I have examined the written and verbal submissions made on behalf of the Respondent. It has been observed that the Respondent has failed to perform its professional duty with due

care and showed negligence in verifying the calculation and certifying the NCB. The amount of securities purchased for clients appearing in NCB was required to be verified with sufficient appropriate evidence such as verification of respective CDC Balance Statements of relevant period. The Respondent has failed to obtain sufficient evidence; therefore, contentions of the Respondent have no merit and it stands established that the securities purchased for clients have not been calculated properly and this fact has not been reported by the Respondent in certificate of NCB.

6. It is evident that the Respondent verified Trade Receivables and Trade Payable on the basis of overall position rather than individual transaction basis. It is clarified that Third Schedule of the SE Rules clearly provides for consideration of Trade Payables and Trade Receivables, separately and netting of Trade Receivables and Trade Payables should be allowed in the case of same client only.

7. With regards to 'Investment in Listed Securities'; the Third Schedule of SE Rules considers only Current Assets and Current Liabilities. Accordingly Long Term Investments cannot be made part of NCB. Regarding the Respondent's observation concerning "Other Liabilities", it is clarified that according to Third Schedule of the SE Rules all Current Liabilities, irrespective of their aging, should be included in calculation of the Net Capital Balance. Hence the Respondent's argument that the FEM's Liabilities prior to the date of obtaining membership of the stock exchange cannot be considered for calculation of NCB does not hold any merit.

8. It is further observed and evident from the discussion held during the meeting that the Respondent is not aware about the format of the NCB certificate. It may be clarified that certification of Net Capital Balance is an Assurance Engagement and appropriate assurance procedures should have been performed to enable the auditor to issue the required certificate. International Standard on Assurance Engagements 3000 requires that the Practitioner should obtain sufficient appropriate evidence on which to base the conclusion. Moreover, the Respondent being a firm of Chartered Accountants is required to comply with the Code of Ethics for Chartered Accountants issued by The Institute of Chartered Accountants of Pakistan which requires that a Chartered Accountant should perform professional services with due care, competence and diligence and all professional services are required to be carried out in accordance with the relevant technical and professional standards. Moreover, KSE Notice dated August 29, 2002 clearly requires a firm of Chartered Accountants to perform an audit while certifying the Net Capital Balance.

9. I have examined the facts, evidences and documents on record, in addition to written and verbal submissions made on behalf of the Respondent. It is evident from perusal of the record that if NCB was verified in strict compliance with the requirements of SE Rules; the NCB verified by the Respondent would have been given a different picture. It is further evident that Respondent did not apply the necessary prudence in certifying the NCB and was not aware about the significance of NCB, the relevant Rules and Regulations, methods of certification and the systemic risk involved as a result of overstatement. Although I am of the opinion that the difference in calculation of NCB by FEM was primarily because of peculiar nature of the business of Modaraba and its regulatory structure, still I am of the considered opinion that a firm of Chartered Accountants certifying the Net Capital Balance statement should be well versed with the relevant Rules and Regulations, its significance for the securities business and adhere to professional conduct; which in this particular case was not found.

10. Therefore, although I am taking a lenient view on the difference in calculation, which was not highlighted by the Respondent in the NCB Certificate. However, on account of professional misconduct and negligence in performing the said duty with due care, competence and diligence and in exercise of the powers under Section 22 of the Ordinance, I, hereby, through this Order, impose a penalty of sum of Rs. 20,000 (Rupees Twenty Thousand Only) on the Respondent. The Respondent is further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

11. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty in the bank account of the Commission being maintained in the designated branches of MCB Bank Limited not later than thirty (30) days from the date of this Order and furnish copy of the deposit challan to the undersigned.

12. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.


Hasnat Ahmad
Director (MSRD)

**Announced on May 6, 2013
Islamabad.**

