

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

In the matter of Show Cause Notice Dated May 14, 2013 issued to
M/s. Haroon Zakaria & Company Chartered Accountants

Date of Hearing: May 31, 2013

Present at the Hearing: Mr. Muhammad Haroon (Partner)
Mr. Farhan (Partner)

Representing (MSRD): Ms. Asima Wajid (Deputy Director-MSRD)

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-138)SE/SMD/2002 dated May 14, 2013 (“SCN”) issued to engagement partner of M/s. Haroon Zakaria & Company 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 (“**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 (“**Inspection Rules**”) ordered an inspection of the books and records required to be maintained by M/s. Live Securities Limited (“**LSL**”), TREC Holder of Karachi Stock Exchange Ltd. and registered with the Commission as a broker under the Brokers and Agents Registration Rules, 2001 (“**BR Rules**”).

3. The report dated December 5, 2012 submitted by the Inspection Team highlighted irregularities in calculation of Net Capital Balance (“**NCB**”) of LSL as on December 31, 2011, the calculation of which was duly verified and certified by the Respondent. Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

“SUBJECT: SHOW CAUSE NOTICE IN THE MATTER OF INSPECTION OF BOOKS AND RECORD OF M/S. LIVE SECURITIES LIMITED – TREC HOLDER OF KARACHI STOCK EXCHANGE.”

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(124)/2012 dated July 9, 2012 of the books and record required to be maintained by Live Securities Limited (“LSL”) a TREC Holder of the Karachi Stock Exchange Limited (“the Exchange”).



2. **WHEREAS**, on review of the inspection report it has come to the notice of the Commission that the calculation of Net Capital Balance (“NCB”) of LSL as of December 31, 2011 as verified and certified by M/s. Haroon Zakaria & Co. Chartered Accountants, (“the Auditor”) is not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (“1971 Rules”) and has been overstated by Rs.414.77 million. Revised calculation is tabulated below:

	<i>As on December 31, 2011</i>	
	<i>Amount in Rupees</i>	
	<i>As submitted by LSL</i>	<i>Calculated by Inspection Team</i>
Current Assets		
Cash at Bank	3,970,314	3,970,314
Trade Receivables	42,329,707	40,027,704
Investment in Listed Securities in the name of Company	264,945	264,945
Securities Purchased for clients (overdue for more than 14 days)	261,585,265	165,519,238
TOTAL CURRENT ASSETS (A)	308,150,231	209,782,201
Current Liabilities		
Trade payables (excluding overdue for more than 30 days)	10,819,418	10,484,019
Other Liabilities	261,502,599	578,234,207
TOTAL CURRENT LIABILITIES (B)	272,322,017	588,718,226
NET CAPITAL BALANCE (A-B)	35,828,214	(378,936,025)

3. **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 is required to be calculated in accordance with the Third Schedule to the 1971 Rules.

4. **WHEREAS**, the TREC holders 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”

5. **WHEREAS**, it appears that the certificate of NCB of LSL as of December 31, 2011 certified by the Auditor is not in accordance with the Third Schedule of 1971 Rules and that the Auditor has 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.



6. **WHEREAS**, in light of the facts mentioned above, prima facie, it appears that the Auditor is in contravention of Section 18 of the Ordinance, the contravention of which invokes penalty under Section 22 of the Ordinance.

7. **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.” .

8. **AND WHEREAS**, sub-section (1) of 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.”

9. **NOW THEREFORE**, you are hereby called upon to show cause in writing by May 21, 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 May 24, 2013 at 11:00 a.m. at the SECP Headquarters, 9th Floor, NIC Building, Jinnah Avenue, Blue Area, 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 its defense and the matter will be decided ex-parte on the basis of available record.

10. 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 provision of law. Kindly acknowledge receipt of this show cause notice through return fax or courier at your earliest.

Sd/-
Hasnat Ahmad
Director (MSRD)”



4. Thereafter, the hearing fixed for May 24, 2013 was adjourned on the request of the Respondent. The Respondent submitted a written response to the SCN on May 24, 2013. The following arguments were put forward by the Respondent in its written response and during the hearing held on May 31, 2013:

(a) *Overstatement of Trade Receivables*: In respect of this, the Respondent in its written statement stated as under:

“Difference between Rs.42.3 million and 40 million of Rs.2.3 million represents markup on clients’ outstanding balance which we have already deducted from our working. Your team worked on sample basis whereas our work is on total population which also may be the reason for difference of Rs.2.3 million in net capital working. Further this difference may be on account of different interpretation.”

(b) *Overstatement of Securities Purchased for Clients*: The Respondent in its written statement stated as under:

“Various securities of different clients has been ignored by your team in its working and amount of securities of one customer is wrongly calculated in your working. After correction revised securities as per your working comes to Rs.262,909,708/-”

(c) *Overstatement of Trade Payable*: The Respondent in its written statement stated as under:

“Difference of Rs.335,400/- between your and our working is immaterial and may be due to different interpretation. Further difference is not material and amount taken by us give no benefit to the Company as our calculation of trade payable is higher than your team working, thereby, net capital is reduced accordingly.”

(d) *Understatement of Other Liabilities*: The Respondent in its written statement stated as under:

“Difference in other liabilities of Rs.316,731,608/- are overdue creditors as per our working and Company has provided us account opening form on sample basis for major client. Therefore, this difference in other liabilities could be regarded as difference in interpretation.”

4. I have examined the facts, evidences and documents on record, in addition to the written and verbal submissions made on behalf of the Respondent. With regard to the overstatement in trade receivables, it is stated that the Inspection Team performed the aging of trade receivables based on outstanding day’s criteria as prescribed in Third Schedule of the Securities and Exchange Rules, 1971 (“**1971 Rules**”) whereas LSL’s calculation was based on nature of receivables. Moreover, with regard to securities purchased for the clients, since the LSL held the client’s securities in its House Account therefore, the value of securities as per LSL’s back office record was taken. The Respondent relied only on the figures provided by the LSL and failed to verify the LSL’s accounts with due diligence.




5. Moreover, with regard to understatement of Other Liabilities the Respondent was informed that as per requirement of Third Schedule of 1971 Rules, all current liabilities, other than those reported under trade creditors, were required to be reported under the head of Other Liabilities. It has been observed that the Respondent verified certain loan accounts as Trade Creditors overdue by more than 30 days rather than Other Liabilities (as no trading in said accounts was witnessed for more than a year). Other Liabilities were therefore, understated, resulting in overstatement of the NCB. The above shows a severe negligence on part of the Respondent. Therefore, the Respondent's submission that the difference in Other Liabilities was due to difference in interpretation is not tenable.

6. It is evident from perusal of the record that if NCB was calculated in strict compliance with the requirements of the 1971 Rules; the NCB verified by the Respondent would have been negative. It is evident that the Respondent did not apply necessary prudence while certifying the NCB certificate which resulted in misrepresentation and overstatement. It is further evident that the Respondent had not applied the necessary prudence in certifying the NCB and was not aware about the significance of NCB and the systemic risk involved as a result of overstatement. Therefore, it stands established that the NCB as certified by the Respondent is not in accordance with the Third Schedule of 1971 Rules and the Respondent has provided a statement which it had reasonable cause to believe to be false or incorrect in material in violation of Section 18 of the Ordinance.

7. Although, the violation of the Ordinance, rules and regulations is a serious matter; however, considering that the violations have been noted for the first time; therefore, taking a lenient view, in exercise of the powers under Section 22 of the Ordinance through this Order, I hereby impose a penalty of Rs.5,000/- (Rupees Five Thousand Only) on the Respondent to be deposited in the 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. Please furnish copy of the deposit challan to the undersigned. The Respondent is further directed to be vigilant and in future fully comply with the Rules, Regulations and directions of the Commission.

8. 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 January 24, 2014
Islamabad.

