

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

In the matter of Show Cause Notice dated April 24, 2013 issued to
M/s. M. Yousuf Adil Saleem & Company Chartered Accountants under Section 22 of the
Securities and Exchange Ordinance, 1969

Date of Hearing: May 20, 2013

Present at the Hearing: Authorized Representatives of M/s. M. Yousuf Adil Saleem & Company Chartered Accountants

1. Mr. Nadeem Yousuf Adil (Partner)
2. Mr. Shoaib Ghazi (Director)
3. Mr. Muhammad Ali (Manager)

Representing (BR&ICW): Mr. Murtaza Abbas (Deputy Director – MSRD)

ORDER

This Order shall dispose of the proceedings initiated through a Show Cause Notice No. 4/BRK-19/SE/SMD/2004 dated April 24, 2013 (“**the SCN**”) issued to M/s. M. Yousuf Adil Saleem & (“**the Respondent**”) under Section 22 of the Securities and Exchange Ordinance, 1969 (“**the Ordinance**”).

2. Brief facts of the case are that the Securities and Exchange Commission of Pakistan (“**the Commission**”) in exercise of its powers under sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 (“**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 record of M/s. IGI Finex Securities Limited (“**IGI**”), TREC Holder of the Karachi Stock Exchange Limited (“**the Exchange**”). The inspection team submitted its report to the Commission and on review of the inspection report it was noted that the Net Capital Balance (“**NCB**”) of IGI as of June 30, 2011 as verified and certified by the Respondent was not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (“**the 1971 Rules**”) and was overstated by Rs. 491.69 million. 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.


Page 1 of 7

3. Given these facts a SCN dated April 24, 2013 was issued 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 IGI FINEX SECURITIES LIMITED”

WHEREAS, the Securities and Exchange Commission of Pakistan (“the Commission”) in exercise of its powers under sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 (“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 vide order No. SMD/MS&CID-C&IW/10-1(123)/2011 dated December 9, 2011 of the books and record required to be maintained by M/s. IGI Finex Securities Limited (“IGI”) a TREC Holder of Karachi Stock Exchange Limited (“the Exchange”).

2. *WHEREAS, on review of the inspection report submitted by the Inspection Team it has come to the notice of the Commission that Net Capital Balance (“NCB”) of IGI as on June 30, 2011 as verified and certified by M/s. Yousuf Adil Saleem & Company, (“the Auditor”) is not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (“the 1971 Rules”) and has been overstated by Rs. 491.69 million.*

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, prima facie it appears that the certificate of NCB of IGI as on June 30, 2011 certified by the auditor is not in accordance with the Third Schedule of the 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**, 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 3, 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 6, 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.

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

Hasnat Ahmad
Director”

4. Pursuant to the said SCN, the Respondent requested the Commission to adjourn the hearing and accordingly the hearing was rescheduled for May 20, 2013. The Respondent appeared on the said date for hearing and also submitted its written comments before the undersigned. In its comments, the Respondent asserted that the responsibility of submitting the statement of NCB to stock exchange is


Page 3 of 7

that of the management of IGI and not the Respondent. The Respondent performed review of NCB prepared by the management of IGI in accordance with Third Schedule of the 1971 Rules and issued the report to the management of IGI. The Respondent neither prepared NCB nor submitted it to the exchange or the Commission. The review conducted by the Respondent was in accordance with International Standard on Review Engagements 2410 and accordingly the review engagement consists of procedures such as making inquiries primarily of the persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit and consequently does not enable the Respondent to obtain assurance about all the significant matters. The Respondent did not express an audit opinion and expressed only a conclusion that whether on the basis of review anything had come to its attention which caused it to believe that NCB was not prepared and presented fairly in all material aspects. The Respondent had no intention of making any statement or give any information which he knew or had reasonable cause to believe to be false or incorrect in any material aspect. The Respondent further added that the Commission in its order dated February 15, 2013 in the matter of inspection of IGI acknowledged and accepted the representations of IGI related to NCB. Given the fact that Commission is satisfied with the submissions of IGI regarding NCB, the Respondent cannot be considered to be in violation of Section 18 of the Ordinance. While explaining the difference in calculation of NCB following explanation was provided by the Respondent.

(i) Receivable against Reverse Repurchase of Securities

The amount of Rs. 114 million against the reverse repo transaction was included in the receivables due to the reasons that the amount was considered recoverable, as it was confirmed by the counterparty and also backed by securities. Further the reverse repo transaction was expiring on June 30, 2011, therefore it was not considered overdue as of June 30, 2011, i.e. the date of calculation of NCB. This practice was also followed in the past and disclosure to this effect was included in the NCB but no objection was received by the exchange or the Commission.

(ii) Unsettled Transactions made through Negotiated Deal Markets (“NDM”) of Rs. 345.85 Million

The trade receivables included amounts related to NDM transactions with certain brokers amounting to Rs. 345.85 million. IGI entered into these transactions with certain brokers in NDM where each transaction is negotiated between buyer and seller for price and terms of payment. The terms of payment were agreed between the parties and it was more than the normal settlement period of T+2. Since the Third Schedule of the 1971 Rules does not specifically address the receivable related to NDM transactions, therefore, IGI gave due consideration to the definition as provided in 1971 Rules, recoverability of the amounts, confirmations by the counter parties, security, due date and International Financial Reporting Standards. IGI also considered the fact that the amount under NDM transactions was not due on June 30, 2011 and therefore it was not considered overdue at the time of calculating NCB.

These points were duly discussed with IGI and it was decided to include the said amount as part of receivables.

5. I have examined the facts, evidences and documents on record, in addition to written and verbal submissions made on behalf of the Respondent and the documents submitted subsequent to the hearing. Looking into the facts of the case the following four issues were framed to decide the matter:-

- 1) The responsibility of IGI with regard to submission and ensuring accuracy of NCB as provided in the regulatory framework;
- 2) The responsibility of the Respondent with regard to submission and ensuring accuracy of NCB as provided in the regulatory framework;
- 3) Issues of interpretation with regard to inclusion of reverse repo and NDM transactions in receivables; and
- 4) Role of the Respondent as statutory auditor and certification of NCB.

6. With regard to the first issue about the responsibility of IGI for submission and ensuring accuracy of NCB is concerned, Regulation 2.2 (b) requires the brokers i.e. IGI to submit bi-annually the NCB certificate from an Auditor selected from the panel of auditors prescribed by the exchange. For ease of reference the said regulation is quoted below:-

*“2.2 Capital Adequacy Procedures and Exposure Limit based thereon:
(b) The Brokers of the Exchange shall submit bi-annually a certificate from an Auditor selected from the panel of auditors prescribed by the Exchange under relevant Chapter of these Regulations Governing System Audit of the Brokers of the Exchanges confirming their NCB on the format prescribed by the Exchange on the dates and within such time as may be notified by the Exchange for this purpose;”*

This clause mentions that the duty of submitting the NCB certificate lies with IGI and not with the Respondent. However, this clause does not categorically mention about ensuring the accuracy since the next clause of the same regulation requires the NCB certificate to be duly verified/audited by the auditor.

7. As far as the responsibility of Respondent with regard to submission and ensuring accuracy of NCB certificate is concerned, regulation 2.2 (c) of the “Regulations Governing Risk Management of Karachi Stock Exchange Limited stipulates that NCB certificate shall be duly verified/audited by the auditor. For ease of reference the same is reproduced below:-

*“2.2 Capital Adequacy Procedures and Exposure Limit based thereon;
(c) The certificate shall specify that the Net Capital Balance calculated have been duly verified/audited by the auditor referred in 2(b) above;”*



This clause clearly mentions that the NCB certificate provided shall be duly verified/audited by the auditor which means that before issuing the NCB certificate the auditor shall ensure that due verification/audit process has been carried out.

8. The issues of interpretation for inclusion of Reverse Repo and NDM transactions in Receivables has been carefully evaluated in light of the facts and explanation provided by the Respondent. It is clear that reverse repo transactions and NDM transactions are not specifically covered in the Third Schedule of 1971 Rules, therefore, the decision to include or exclude these items in the calculation of NCB is open to interpretation. In the absence of any clear judgment on these issues, the benefit of doubt goes in favor of the Respondent.

9. The Respondent however has been found here negligent in performing its professional duties with regard to audit and certification. During hearing the Respondent to support its arguments provided copies of two trade confirmations obtained by it during the course of statutory audit of IGI for the year ended June 30, 2011. Perusal of the confirmations has revealed that trade confirmations pertain to M/s. Darson Securities (Private) Limited (“DARSON”) and M/s. AKD Securities Limited (“AKD”) having dated August 5, 2011 and August 9, 2011 respectively. In this regard it has been observed that:

- i. DARSON in its confirmation reply dated Aug 5, 2011 did not confirm the entire balance of Rs.168,382,089 rather it confirmed only Rs.6,872,742. (It was reported to KSE on February 11, 2011 but remained unsettled on June 30, 2011).
- ii. AKD in its confirmation reply dated August 9, 2011 did not confirm the entire balance of Rs.177,465,351 rather it confirmed the NIL balance. (NDM trade of SSGC reported to KSE on May 10, 2011 but remained unsettled on June 30, 2011).

10. It has been observed that the trade debts pertaining to Institutional Delivery System (“IDS”) remained unsettled and the corresponding parties such as DARSON and AKD did not accept/confirm their respective balances while sending confirmations to the auditors of IGI about balance which were appearing in the books of IGI on the reporting date. The difference in balance confirmations was neither reported by the Respondent in its statutory audit report nor in certification of NCB. The Respondent was also required to perform further necessary and appropriate assurance procedures which were not performed by it. Moreover, refusal by the counter parties as confirmed through confirmation received from them and refusal for settlement on their part, the question of due dates or overdue does not arise rather these circumstances raise the questions why and on what basis these receivable were booked in the books of account of IGI.

11. The Respondent being the statutory auditor of IGI was involved in audit of financial statements as well as certification of NCB since more than one year time. The annual audit of financial statements of IGI for the year ended June 30, 2011 was issued before the certification of NCB of that year. Being statutory auditor as well as auditor for certification of NCB it was duty bound to apply reasonable care and appropriate assurance procedure as well as audit procedures to enable it to confirm and verify the figures reported by IGI in its NCB. Due to negligence on part of the Respondent the overstatement of NCB remained undetected.



12. Keeping in view all the record placed before me I am taking a lenient view on the issue of interpretation of NDM and reverse repo transactions in the calculation of NCB. However, it has been noted with serious concern that being the auditor for NCB certification, the Respondent has failed to demonstrate professional conduct in performing its duty with due care, competence and diligence. Therefore, 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.

13. 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.

14. 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 July 16, 2013
Islamabad.**

