



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Specialized Companies Division

SCD-SD (Enf.)/KHI/DCML/2013/ 170

July 26, 2013

BEFORE THE EXECUTIVE DIRECTOR

**IN THE MATTER OF M/S. ERNST & YOUNG FORD RHODES
SIDAT HYDER, CHARTERED ACCOUNTANTS.**

**In Respect of Show Cause Notice under Section 282J (1) read with Section 282M of
the Companies Ordinance, 1984 for Violations of Clause 7 of Schedule V of the Non-
Banking Finance Companies & Notified Entities Regulations 2008, issued under
Section 282B of the Companies Ordinance, 1984**

No. and date of Show Cause Notice (SCN) & addendum to SCN	SCD-SD (Enf.)/DCML/2013/ dated April 29, 2013 SCD-SD(Enf.)/DCML/2013/ dated May 31, 2013
Date of 1 st Hearing:	June 13, 2013
In Attendance:	1. Mr. Omer Chughtai – Engagement Partner M/s. Ernst & Young Ford Rhodes Sidat Hyder 2. Mr. Arslan Khalid – Partner M/s. Ernst & Young Ford Rhodes Sidat Hyder. 3. Mr. Salman Talibuddin, Advocate (Kabraji & Talibuddin)
Date of 2 nd Hearing:	June 18, 2013
In Attendance:	1. Mr. Omer Chughtai – Engagement Partner M/s. Ernst & Young Ford Rhodes Sidat Hyder 2. Mr. Arslan Khalid – Partner M/s. Ernst & Young Ford Rhodes Sidat Hyder. 3. Mr. Aftab Salahuddin – Executive Director M/s. Ernst & Young Ford Rhodes Sidat Hyder 4. Mr. Salman Talibuddin, Advocate (Kabraji & Talibuddin)

ORDER

1. This order shall dispose of the proceedings initiated against M/s. Ernst & Young Ford Rhodes Sidat Hyder, Chartered Accountants (hereinafter referred as the “**External Auditors**” through a Show Cause Notice (“**SCN**”) dated April 29, 2013 and addendum to SCN dated May 31, 2013 issued under Section 282J (1) read with Section 282M of the Companies Ordinance, 1984 for Violations of Clause 7 of



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Schedule V of the Non-Banking Finance Companies & Notified Entities Regulations 2008, issued under Section 282B of the Companies Ordinance, 1984.

2. M/s. Ernst & Young Ford Rhodes Sidat Hyder, Chartered Accountants were appointed as External Auditors of Dawood Income Fund (hereinafter referred as the “DINF”), Dawood Islamic Fund (hereinafter referred as the “DISF”) and First Dawood Mutual Fund (hereinafter referred as the “FDMF”) by the Board of Directors (BOD) of Dawood Capital Management Limited (hereinafter referred as the “DCML”) in their 104th meeting held on September 07, 2011 for the year ended June 30, 2012.

3. The SCN was issued to the External Auditors encompassing the following:
 - i. The BOD of DCML in its 107th meeting held on April 28, 2012 approved full provisioning against various non-performing debt securities in the investment portfolios of DINF, DISF and FDMF, which was under discussion of the BOD since its 106th meeting dated February 21, 2012. In the Audit Committee meeting held on February 21, 2012, the External Auditors suggested to make further provisioning for non performing debt securities in the funds.

 - ii. The impact of provisioning approved on April 28, 2012 i.e. Saturday a non-business day, was reflected in the succeeding daily Net Assets Value (NAV) of DINF, DISF and FDMF on April 30, 2012 i.e. Monday, the next business day wherein the NAV of DINF, DISF and FDMF dropped overnight by 7.36%, 16.77% and 8.95% respectively.

 - iii. Prior to recording full provisions against the non-performing debt securities in DINF and DISF, the DCML and its related parties including connected persons, its CEO and her close relatives managed to get their investments redeemed prior to provisioning, and by doing so they avoided an imminent loss of Rs 18.224 million that would be incurred due to provisioning approved by DCML BOD in its meeting held on April 28, 2012. Since FDMF was a closed end scheme, hence



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no redemptions were possible. Redemptions made by the related parties/connected persons from DINF and DISF and the loss avoided by the related parties are reflected in the following table:

Date of Redemptions	Fund	Unit Holder	Relationship with DCML or its CEO	Units Redeemed	Applied NAV on Redemption per Unit (Rs.)	Total Amount Redeemed (Rs.)	Loss Avoided (Rs.)
17-Apr-12	DINF	Tara Uzra Dawood	CEO of DCML	85,220	79.7837	6,799,167	489,214
26-Apr-12	DINF	Hamida Dawood	Close relative (mother) of CEO	94,795	79.9209	7,576,088	557,185
26-Apr-12	DINF	Ayaz Dawood	Close relative (brother) of CEO	14,230	79.9209	1,137,279	83,641
		Sub Total				15,512,534	1,130,040
6-Apr-12	DISF	First Dawood Investment Bank Ltd Employees Contributory Provident Fund	FDIBL owns 2.24 million shares of DCML (major shareholder) & DCML owns 2.38 million shares of FDIBL	79,977	108.33	8,663,675	1,456,510
6-Apr-12	DISF	Hamida Dawood	Close relative (mother) of CEO	14,655	108.33	1,587,538	266,892
9-Apr-12	DISF	B.R.R. Guardian Modaraba –	Directorship on the BOD of DCML	276,778	108.49	30,028,564	5,085,149
9-Apr-12	DISF	Dawood Capital Management Ltd –	CISs Management Company	92,259	108.49	10,009,521	1,695,050
13-Apr-12	DISF	Dawood Family Takaful Ltd –DFTL	DCML owns 2.72 million shares in DFTL	470,423	108.38	50,982,120	8,590,520
		Sub Total				101,271,418	17,094,120
		Total				116,783,952	18,224,160



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- iv. As on September 17, 2012 the External Auditors of DINF and DISF presented their reports to the unit holders of the Collective Investment Schemes (CISs or Funds) on the financial statements for the year ended June 30, 2012 and expressed their opinion as follows:

Extract of the Auditors Report on the Financial Statements of DINF and DISF.

Opinion:

"In our opinion the financial statements give a true and fair view of the state of the Fund's affairs as at 30 June 2012 and of its financial performance, cash flows and transactions for the year then ended in accordance with approved accounting standards as applicable in Pakistan".

"REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

In our opinion the financial statements have been prepared in accordance with the relevant provisions of Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 and Non-Banking Finance Companies and Notified Entities Regulations 2008'.

- v. As per record, BRR Guardian Modaraba (BRRGM) which is a related party of DCML and funds under its management had two investments & two redemption transactions in DINF and one investment and one redemption transaction in DISF during the financial year 2011-2012:
- vi. Note 15 of the financial statements of DINF and Note 19 of the financial statements of DISF for the year ended June 30, 2012 do not show BRRGM as a related party/connected person despite the fact that BRRGM was a connected person as per the criteria stipulated under Non-Banking Finance companies (Establishment and Regulation) Rules, 2003 (NBFCs Rules,2003).
- vii. Further, Note 15 of the financial statements of DINF and Note 19.1 of the financial statements of DISF also do not disclose the investments and redemptions made by BRRGM.



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- viii. Para 18 of International Accounting Standard IAS 24 necessitates to disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements”. However, the financial statements for the year ended June 30, 2012 of DINF and DISF failed to disclose the necessary information regarding redemptions made by related parties/connected persons prior to the recording of provisions and these redemptions resulted in avoidance of loss to the related parties/connected persons and loss was ultimately borne by the remaining unit holders.
- ix. Furtherance, financial statements of DINF and DISF for the year ended June 30, 2012 does not appropriately disclose potential effects of all the related party transactions to the end users of the financial statements including unit holders of the funds hence, they were presented with an untrue and unfair view as of June 30, 2012.
- x. As per auditing standards applicable in Pakistan the External Auditors of DINF and DISF were expected to exercise due care in their audit assignment. Since, the Auditors are also reportable to the unit holders and their fees were charged to the unit holders’ fund hence, they were reasonably expected to perform their duties in the interest of unit holders of the funds and report to them any material fact/event which is detrimental to their interest.
- xi. The External Auditors of DINF & DISF prima facie failed to account for the impact of the following in their audit reports which is detrimental to the interest of the unit holders;
- a) Non-disclosure of related party/connected person transactions in the financial statements of DINF & DISF for the year ended June 30, 2012 and;





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- b) Non-disclosure of necessary information of related parties/connected persons transactions having potential effect on the financial statements of DINF & DISF for the year ended June 30, 2012.
4. In response to the SCN initiated, the External Auditors vide their letter dated May 16, 2013 contended that;
- i. They were engaged to audit the financial statements of DINF, DISF and FDMF for the year June 30, 2012 and to perform limited scope review of their condensed interim financial statements for the half year ended December 31, 2011.
 - ii. The audit and limited scope review were conducted in accordance with the international standards on auditing and applicable financial reporting framework in Pakistan.
 - iii. They as an External Auditors suggested the management of DCML to evaluate the provisioning in the funds in the light of provisioning policy of DCML, prevailing regulatory framework and connected economic realities.
 - iv. During the course of annual audit of DINF, DISF & FDMF which was carried out after the year end, they noted from the minutes of the DCML BOD meeting held on April 28, 2012 that the BOD performed a detailed review of provisioning against impaired debt securities based on the factors laid down in the provisioning policy and decided to account for additional provisions over and above the minimum levels required under the regulatory requirements and in their view this action of the BOD was in line with the applicable financial reporting framework and the same was fully disclosed in the financial statements of respective CISs.
 - v. As regards to the redemptions of investments by DCML and its related parties, the scope of their audit and review did not require them to perform



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an examination of the extent and timing of the various issuance and redemptions of units during the course of the year by the CISs and accordingly they did not, nor they were required to, undertake any procedures to determine the specific motives behind such transactions based on the NAV changes in the CISs.

- vi. With reference to the non-disclosure of related parties and connected person transactions pertaining to BRRGM in the financial statements of DINF & DISF for the year ended June 30, 2012, in their view BRRGM did not fit in as related party as per the definition of connected person given in Clause 2 (1) (XV) of NBFC Rules 2003. Further, there are three major criterion laid down in the said definition i.e. (a) BRRGM did not hold directly or indirectly hold ten percent or more of the units of DINF or DISF at any time during the year, (b) BRRGM is not a fund manager, trustee or custodian for DINF or DISF and (c) BRRGM is not interconnected with DINF and DISF as member of same "Group" in terms of Group definition mentioned in NBFC Rules. Therefore, they were of the view that BRRGM, DINF and DISF were not connected to each other in any manner in terms of the definition of "Connected Person" in the NBFC Rules and as a result specific disclosure of the transactions, between BRRGM, DINF and DISF was not mandatory to be reported/disclosed in the financial statements. Further, as per International Accounting Standards (IAS) 24, BRRGM could not be considered as a related party therefore, specific disclosures under the provisions of the applicable legal and financial reporting framework were not required.
- vii. As per NBFC Rules & Regulations and IAS 24 the aggregate transactions between related parties are disclosed for the period covered by the financial statements and not on specific point of time period during a financial year or prior to taking or not taking any actions by the managements, such as provisions made in nonperforming debt securities (the subject matter of the SCN).





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- viii. All the related parties relationships as well as information about the transactions and balances with “Related Parties” and “Connected Persons” were properly disclosed in the financial statements of DINF and DISF for the year ended June 30, 2012 as per the requirement of Schedule V of NBFC Regulations 2008 and IAS 24.
5. During the course of deliberations in the Hearings, the representatives of External Auditors argued that;
- i. The management of DCML did not disclose BRRGM as related party/connected person and they as an External Auditors relied on and agreed to it in the light of definition of connected person provided in the NBFC Rules.
- ii. For clarity in terms of their understanding on connected person, the External Auditors were referred to sub clause (a) of Clause 2 (1) (XV) of NBFC Rules 2003 for the definition of connected person given in the NBFC Rules which read that “*any person or trust beneficially owning, directly or indirectly, ten percent or more of capital of the NBFC or the collective investment scheme*”. The External Auditors further contended that if any person holds ten percent or more capital in NBFC is a connected person of such NBFC, whereas, if any person holds ten percent or more of the units/certificate holdings of the CIS is a connected person of such CIS. Since it is a matter of interpretation of law and in any manner NBFC and CIS could not be mixed up in this definition.
- iii. As per their record, during the FY 2011-12, BRRGM in any point in time did not hold more than ten percent of the unit holding in DINF or DISF; therefore BRRGM was not a connected person of DINF or DISF.



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- iv. Since BRRGM was not a connected person of DINF and DISF, therefore there was no disclosure requirement for BRRGM transactions in the financial statements of DINF or DISF.
- v. The External Auditors further stressed upon that the financial statements of DINF and DISF for the year ended June 30, 2012 that these reflected true and fair view of affairs of the fund and for the sake of argument even if the transactions of BRRGM as related party were not disclosed even then, the financial statements were giving true and fair view.
- vi. Thereupon, the External Auditors were referred to sub clause (g) of the definition of connected person given in the NBFC Rules that *“any member of the group of which that person, or trust forms part”* and further the definition of *“Group”* was also referred which stated that Group means persons, whether natural or legal, if one of them or his close relatives, in case of a natural person, or, its subsidiary or associated company, if it is a legal person, have control or hold substantial ownership interest or have power to exercise significant influence over others, whereas *“significant influence”* explained as *“the management control of the company or the ability to participate in financial and operating policies, either exercised by representation on the Board of Directors, through partnership or by statute or by agreement in the policy making process”*. The External Auditors were referred to following facts corroborating the above view about the *“Group”* to which DCML/its CISs belongs to:
- a. DCML and BRR Investments (Pvt.) Limited -BRR I (the management company of BRRGM) were associated companies of First Dawood Investment Bank Limited (FDIBL) as per financial statements of FDIBL for the year ended June 30, 2012 and FDIBL held 15% stake in DCML and 41.63% in BRR I.
- b. As of June 30, 2011 and June 30, 2012 BRRGM held 12.93% shareholding in DCML and had nominee director on the board of

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- DCML, namely Mr. Nazimuddin Feroz (re-elected on March 22, 2010 and subsequently resigned in November 2012).
- c. The CEO of DCML (Ms. Tara Uzra Dawood) is a sister of Mr. Ayaz Dawood (CEO of BRR Investment Pvt Ltd) and daughter of of Mr. Rafique Dawood, who happens to be Chairman of BRR and FDIBL.
- vii. In response the External Auditors explained that though BRRGM had nominee director on the board of DCML but it had no significant influence on the affairs of the company. They further stated that Asset management Company has different legal status while managing funds in the capacity of service provider as per the agreement of management of assets of funds.
- viii. The External Auditors were also referred to point 6.5 of the annual audited accounts of DISF for the year ended June 30, 2012 wherein BRRGM was mentioned as related party. Moreover, the External Auditors were also referred to page 41 of the annual audited accounts of FDMF for the year ended June 30, 2012, wherein BRRGM was mentioned as related party and the accounts were audited by the same engagement partner of the External Auditors which undertook the audit assignment of DINF and DISF. The representative of the External Auditors stated that it might be due to a typographical mistake/error on part of the management of funds as the financial statements were prepared by the management of CISs and not by the External Auditors and their job was to provide true and fair view on the statements.
- ix. Further, annual audited accounts of BRRGM for the year ended June 30, 2012 were also referred to the External Auditors wherein both the funds were mentioned as related parties and their transactions were also disclosed as related party transactions and the accounts were audited by the same External Auditors i.e. E&Y. In response, the representative reasoned that the management of BRRGM had disclosed the CISs as their related parties and the respective



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engagement partner of their firm might have agreed to it. The reasons might be different as compared to in the subject matter of SCN.

- x. The External Auditors were referred to the financial statements of DINF and DISF for the year ended June 30, 2011 (audited by another audit firm i.e. M/s. M. Yousuf Adil Saleem & Co. Chartered Accountants) wherein BRRGM was shown as related party/connected person in the financial statements and its transaction were appropriately disclosed in the financial statements.
- xi. The External Auditors were also referred to financial statements of Alfalah GHP Alpha Fund for the half year ended December, 2012 which were reviewed by the same engagement partner of External Auditors, which undertook the audit assignment of DINF and DIF; wherein Bank Alfalah Limited was shown as related party/connected person to the fund on the basis of shareholding in the management company of the fund.
- xii. During the course of hearing, the External Auditors stated that related party disclosures (other than BRRGM) in the matter of redemptions were disclosed in the financial statements of DINF and DISF in accordance with the requirements of IAS 24. The External Auditors were then referred to the Paragraph 8 of IAS 24 which clearly stipulates that "if an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements", which was not observed in the case matter and large redemption by related parties prior to the provisioning resulted in avoidance of imminent losses, which were then ultimately borne by the remaining unit holders. The said piece of information was of prime importance and of critical nature having impact on decision making of the existing and potential unit holders.



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6. The External Auditors maintained that they performed their audit in accordance with International Auditing Standards (ISA). In view of the redemption by the related parties, the scope of their audit limits, require performing an examination of the extent and timing of various issuances and redemptions of units and accordingly they were not required to undertake any procedure to determine the specific motives behind such transactions based on the NAV changes in the funds. In this regard, the External Auditors were referred to various paragraphs of International Auditing Standards (ISA) which specifically requires auditors to extend the scope of their work and to recognize fraud risk factors arising out of related party relationship and transactions as in the matter of SCN wherein the related parties redeemed their investments prior to provision made in DINF and DISF.

7. During the course of 2nd hearing, the representatives of External Auditors stated that this is purely a matter of interpretation of definition of Connected Person given in the NBFC Rules which they interpreted the other way and as result of which they unintentionally and not willfully overlooked to mention BRRGM as Connected persons in the financial statements of DINF and DISF for the year ended June 30, 2012. As a result of which, the transactions of BRRGM with DINF and DISF remained undisclosed in the said financial statements. The representatives of External Auditors requested a lenient view in the matter of SCN due to their negligence and overlook on the subject matter of the SCN.

8. After the 2nd hearing the External Auditors vide their letter bearing No. AC3/213/2013 dated June 19, 2013 further submitted as under;
 - i. "We would also like to acknowledge that the aforesaid hearing was interactive and provided us an opportunity to take note of certain guiding factors for conducting our future audit assignments, in particular, the interpretation you have given as a regulator with regard to clause (a) of the definition of "Connected Person" which implies that where an entity holds



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directly or indirectly 10 percent or more equity in a Collective Investment Scheme or its Asset Management Company, the said entity should be treated as a "Connected Person" in the context of asset management company as well as the Collective Investment Scheme and need for conducting meetings with its trustees. However, your aforesaid interpretation of the definition of "Connected Person", is different from our understanding based on our plain reading of the text of the above referred provisions of the regulation. We assure you that moving forward, we shall apply definition of "Connected Person" as explained by you as a guideline while conducting our future audit assignments of such collective investment schemes. For this purpose, we intend to issue instructions to all our audit partners through our internal technical communications so as to ensure that such inadvertent negligence, on our part, though unintentional, is not committed in future.

- ii. As we submitted during the course of the hearings that our understanding on this matter was based on an honest interpretation of the provisions of the law. While discussing the same with yourself, it was given to understand that our understanding is not consistent with the interpretation as you have explained to us. We acknowledge our inadvertent misinterpretation of the definition of the "Connected person" as provided in the relevant laws but we would request you to appreciate that on our part, it was unintentional and not willful overlook and the same was without any malifide intent.
- iii. We have also taken note of the extent of diligence and auditing procedures that are expected from an auditor by the regulators to protect the interest of the unit holders/minority shareholders while conducting the audit assignments. We have received your guidance very positively, particularly with reference to the need for conducting meetings with the trustees as a matter of routine to know the independent views and observation of the trustees during the course of the audit.



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- iv. We undertake to make best endeavors for briefing our audit teams engaged in the audits of asset management industry so that all the audit executives and staff exercise and reinforce due professional care and remain more alert in the future to the risk of transactions with "Related Party"/"Connected Person".
- v. In the light of our foregoing submissions, we request your good self to kindly favorably consider the matter, take a lenient view of the mater overlooked by us and conclude the proceedings by condoning our conduct being unintentional and not willful.”
9. I have considered the explanations submitted by the External Auditors vide their letters and hearing opportunities given to them, in light of the relevant provisions of the Ordinance, the NBFC Rules & Regulations and applicable International Accounting/Auditing Standards. I have also reviewed the record placed before me and have come to the conclusion that the External Auditors failed to account for the impact of the following in their audit reports to the unit holders;
- i. Non-disclosure of related party/connected person transactions in the financial statements of DINF and DISF for the year ended June 30, 2012.
- ii. Non-disclosure of necessary information of related parties/connected persons transactions for user to understand the potential effect of these transactions in the financial statements of DINF and DISF for the year ended June 30, 2012.

The External Auditors were well aware of the requirements of prevailing regulatory framework and International Accounting & Auditing Standards which requires auditors to recognize fraud risk factors arising out of related party relationship and transactions and report to the user of the report. Whereas in the matter of SCN wherein the related parties redeemed their investments prior to recording of provisions in the non performing debt securities portfolio of in DINF and DISF, the



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External Auditors failed to account for the same. Para 9 of ISA 550 states objectives of auditors that;

- a) *Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:*
- i. *To recognize **fraud risk factors**, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and*
 - ii. *To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:*
 - a) *Achieve fair presentation (for fair presentation frameworks); or*
 - b) *Are not misleading (for compliance frameworks); and*
- b) *In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.”*

Given the requirement of above, the External Auditors were required to recognize fraud risk factors arising from related party transactions in DINF and DISF. Further, “fraud risk factors” are defined in Para 11(b) of ISA 240 as “*Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.*” Whereas fraud is defined as “*An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.*” in Para 11 (a) of ISA 240.

It is pertinent to mention here that the management of DCML had the prior information regarding imminent significant provisioning to be made in DINF and DISF and had an opportunity to obtain unjust advantage which resulted in transactions by DCML, its related parties and its connected persons. This should have been the red flag for the External Auditors to recognize fraud risk factors arising from related party transactions as they themselves had suggested the Audit Committee of DCML in the meeting held on February 21, 2012 to write down the values of investments in defaulted companies.



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Further Para A-2 of ISA 550 states that *“In the context of a fair presentation framework, related party relationships and transactions may cause the financial statements to fail to achieve fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the financial statements. For instance, fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend.”*

Similarly, Para A3 of ISA-550 states that, *“In the context of a compliance framework, whether related party relationships and transactions cause the financial statements to be misleading as discussed in ISA 700 depends upon the particular circumstances of the engagement. For example, even if non-disclosure of related party transactions in the financial statements is in compliance with the framework and applicable law or regulation, the financial statements could be misleading if the entity drives a very substantial portion of its revenue from transactions with related parties, and that fact is not disclosed”*

In view of the requirement of Para 23 of ISA 550, the External Auditors were also responsible to consider the business rationale of related parties' transactions just before the impact of provisioning on net assets of DINF and DISF which requires;

“For identified significant related party transactions outside the entity's normal course of business, the auditor shall:

- (a) *Inspect the underlying contracts or agreements, if any, and evaluate whether:*
- (i) *The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;*
 - (ii) *The terms of the transactions are consistent with management's explanations; and*
 - (iii) *The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; “*

Moreover, Para A-39 of ISA 550 specifically requires the External Auditors to view the related party transactions from the perspective of related party in order to understand the economic reality of transaction, which requires *“The auditor may also seek to understand the business rationale of such a transaction from the related party's perspective, as this may help the auditor to*





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better understand the economic reality of the transaction and why it was carried out. A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

In addition to the above Para 15 of ISA 200 requires that; *"The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that causes the financial statements to be materially misstated."* Whereas Professional Skepticism is defined in Para 13 of ISA 200 *"An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence."* And Para A18 of ISA 200 substantiates Professional skepticism as:

- *Audit evidence that contradicts other audit evidence obtained.*
- *Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.*
- *Conditions that may indicate possible fraud.*
- *Circumstances that suggest the need for audit procedures in addition to those required by the ISAs.*

10. Prima facie, the requirements of above mentioned ISA were not adhered with during the course of their audit. The External Auditors failed to highlight the risk of related party transactions which were indicative of possible fraud on the part of management. Redemption of units amounting to Rs. 116.783 million in DINF and DISF by related parties/connected persons prior to provisioning amounting to Rs.78.811 million and thereby avoidance of material loss amounting to Rs 18.224 million which got transferred ultimately to the remaining unit holders, were information of critical nature having impact on decision making of the existing and potential unit holders and therefore requiring External Auditors to consider the issue in their audit for the year ended June 30, 2012.

11. The External Auditors were responsible to the unit holders and their fees were charged to the funds. Therefore, they were reasonably expected to perform their duties in the interest of unit holders of the funds and report to them any material fact/event which is detrimental to their interest.

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12. After careful consideration of the facts and in view of the admitted default and honest submissions made by the External Auditors, I am hereby inclined to take a lenient view, resultantly no penalty is imposed on the External Auditors in pursuance of the subject show cause notice and addendum thereto. However, the External Auditors are hereby strictly warned to be cautious in future and to ensure that all the related parties/connected persons and their transactions are disclosed appropriately in the financial statements stringently in line with the requirements of prevailing regulatory and reporting framework applicable in Pakistan as given in para 9 above and to perform their duties in the interest of unit holders of the CISs and report to them any material fact/event which may be detrimental to the interest of the unit holders, or having impact on the decision making of users of financial statements, to avoid any expropriation of the CISs' assets by the related parties/connected persons.
13. This order is issued without prejudice to any action, which may be taken or warranted for the above said defaults under any other provision of the law.


(Shahid Nasim)

Executive Director

Announced: 26th July, 2013
Karachi.