



Securities and Exchange Commission of Pakistan

Securities Market Division

Through Courier

Before The Director / HOD (MSRD)

In the matter of Show Cause Notice issued to Parker Randall - A.J.S, Chartered Accountants

Date of Hearing:

January 21, 2014

Present at the Hearing:

Representing Parker Randall - A.J.S, Chartered Accountants

(i) *Mr. Faisal Iqbal Khawaja*

Partner

(ii) *Mr. Fazal Mahmood*

Authorized Representative

Assisting the Director/HOD (MSRD)

(i) *Ms. Najia Ubaid*

Deputy Director

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(6) SMD/MSRD/C&IW dated December 16, 2013 ("SCN") served to Parker Randall - A.J.S, Chartered Accountants ("**Respondent**") under Section 22 of the Securities and Exchange Ordinance, 1969 ("**Ordinance**").

2. Brief facts of the case are that the Securities and 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 of Darson Securities (Private) Limited ("**DSL**"). DSL is trading Right Entitlement Certificate Holder of the Karachi Stock Exchange Limited ("**KSE**") and registered with the Commission as a broker under the Brokers and Agents Registration Rules, 2001 ("**Brokers Rules**"). The Respondent was the auditor of DSL.

3. The inspection team submitted its report ("**Inspection Report**") on September 6, 2013 which highlighted major irregularities in calculation of Net Capital Balance ("**NCB**") of DSL.

SECURITIES & EXCHANGE
COMMISSION OF PAKISTAN
NIC Building, 63 Jinnah Avenue,
Islamabad, Pakistan





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as on December 31, 2012 and it appeared that NCB was not calculated in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("Rules 1971").

4. The Inspection Report highlighted following discrepancies in calculation of the NCB of DSL as on December 31, 2012:

- a) Understatement of cash in hand by Rs.1.081 million;
- b) Overstatement of Trade Receivables by Rs.79.421 million;
- c) Non-inclusion of Securities purchased for clients of Rs.18.15 million;
- d) Understatement of other liabilities by Rs.22.09 million;
- e) Misclassification of Rs. 20 million payable to M/s. Paramount Commodities (Pvt) Limited as trade Payables.

5. The Commission, in light of the Inspection Report, served a SCN to the Respondent under Section 22 of the Ordinance. Hearing in the matter of aforesaid SCN was scheduled for December 27, 2013. However, the Respondent vide letter received on December 20, 2013 requested for change in hearing date to any other suitable date in the 2nd week of January 2014. Acceding to the request of the Respondent, hearing was rescheduled for January 14, 2014 at the Commission's Head Office and the Respondent was required to submit its written response within the stipulated time. However, the Respondent communicated its un-availability on the said date and requested for further extension in the date of hearing. Accordingly, hearing in the matter was re-scheduled for January 21, 2014.

6. The Respondent's written response to the SCN was received in the Commission on the date of hearing. Mr. Faisal Iqbal Khawaja, partner of the Respondent and Mr. Fazal Mahmood, authorized representative of the Respondent ("Representatives") attended the hearing on behalf of the Respondent. The following arguments were put forward by the Respondent in its written response to the SCN and by the Representatives of the Respondent during the hearing held on January 21, 2014:

a) **Trade Receivables:** The Respondent in its written response stated that:

"We have been provided with a detail by the client as finalized by the enquiry officer as under.... Your good self will appreciate that the said working has been based on clarification issued by Securities and Exchange Commission of Pakistan on July 03, 2013 which was not available at the time we were issuing this Net Capital Balance Certificate to our client which is dated March 13, 2013. At that time, the only





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clarification available was Rule 2(d), Third Schedule of Securities and Exchange Commission Rules, 1971, which explained the method of calculating various figures to be included in the Net Capital Balance Certificate as under..... We verified debtors amounting to Rs. 132,579,196 before issuance of this Net Capital Balance Certificate as detailed as under..... From the examination of above you can easily trace that all the moving debtors were considered as trade receivable for the purpose of this certificate as per Rule 2(d).....We also obtained subsequent ledgers of debtors to confirm the mobbing debtors which is exactly in line with guidelines provided in this respect and according to prevailing practices.....we have verified all the debtors according to clarification as given in Third Schedule of Securities and Exchange Rules, 1971. Thus the matter is not of overdue debtors but only difference of interpretation of the Rule."

The Representatives of the Respondent during the hearing emphasized that they calculated the trade receivable based on the market practice, however, in future they shall ensure that calculation is done in light of the guidelines issued by the Commission.

- b) **Securities purchased for clients:** The Respondent in its written response stated the following:

"Your good self will appreciate that as per detail provided to us by the client regarding this amount concerning sample selected by Inquiry Officer from Securities and Exchange Commission of Pakistan for inspection. Your good self will appreciate that, as according to our opinion the clients mentioned by the Enquiry Officer as overdue, according to our interpretations were not overdue. They were all alive clients having a lot of movements in their accounts. Thus the question of showing these securities as securities purchased for client does not arise as per our interpretation. This is also an issue of interpretations of working out/calculating of amount of debtors for purpose of Net Capital Certificate and nothing else....From the examination of the data your good self will appreciate that only two parties Muhammad Rashid Siddiqui and Rashida Bano are dormant parties having no movement and securities relating to both of them are Rs. 1,262,370 and Rs. 14,294 respectively. If we include these balances they will have a positive effect on Net Capital Balance position which we previously were not allowing our clients being a prudent approach.....Again we will state that we have not done anything wrong and the same is the matter of interpretation.....Therefore, in the name of justice, we request to your honor to withdraw this shoe cause notice under section 22. ."

The Representatives of the Respondent during the course of hearing reiterated the stance taken by the Respondent and assured that they shall ensure compliance in future.

- c) **Other liabilities and trade payables:** The Respondent in its written statement regarding trade payables and other liabilities submitted that:





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"The inquiry officer pointed out two discrepancies under this head. One is the balance of Paramount Commodities (Private) Limited of Rs. 20 million, which according to the inquiry officer should have been classified as other liabilities not trade payables. Paramount Commodities as per details provided to us by client is a trade payable and cannot be classified as other liability in accordance with accounting principles relating to the same. This creditor according to our working was overdue for more than thirty days and we rightly deducted the creditor from total creditors as per Third Schedule working pattern mentioned in our reply earlier. Here we would like to state that there is no explanation in the Third Schedule which could explain that an overdue creditor shall be shown as part of other liabilities. Another important fact is that there is no clarification in the Third Schedule regarding calculation of other liabilities which only says that same may be calculated according to generally accepted accounting principles. In absence of such explanation regarding other liabilities our calculation cannot be termed as wrong.....Your good self will appreciate that all the figures as at December 31, 2012 as made available to us are based on management accounts which were unaudited. Hence the same was overlooked by the client and there is no fault on our part. In absence of specific provision of such figures by the client same is very difficult for the Auditor to trace due to unaudited nature of Accounts. However, the amount of accrued markup is an immaterial figure which does not affect the overall capital adequacy position."

The Representatives of the Respondent communicated that the difference in value of other liabilities appearing on the NCB certificate was because of failure to incorporate the accrued markup figure by DSL which was accounted for by them after preparation of NCB certificate.

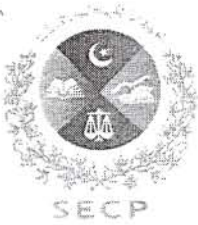
d) Non recording of Rs. 2.21 million pledged shares in DSL books of account:

The Respondent in its written response stated that:

"We have examined this point in depth and have made inquiries from client as well. Complete detail of shares were accounted for as provided by client and confirmed by him in the Management Representation Letter obtained. Any un-recording on part of client could be an error in his back office record, as the same would result in an increase in Net Capital Balance and would not have any adverse effect on net capital balance position. We performed verification on test basis and our sample is representative of majority population in the sample. The figure as shown in this point is immaterial and does not affect overall position of Net Capital balance. In fact will have a positive effect on the same."

The Representatives of the Respondent avowed its above stance during the hearing and communicated that recording of pledged securities in the books of accounts is the responsibility of DSL and not of their auditors. The





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Representative of the Respondent further asserted that they have not performed the audit and only issued review report in this context.

e) **Overstatement of Net Capital Balance of Rs. 82.63 million:** Written response of the Respondent clarified that:

"The calculation of Net Capital Balance on our part is made in accordance with provision of Third Schedule as enumerated in detail earlier in this reply and figure of Net Capital Balance as shown by us is perfectly legal and there is no overstatement on our part."

The Representatives of the Respondent during the course of hearing contended the above stance and added that they shall prepare the NCB in light of the guidelines issued by the Commission in future.

f) **Clause 2.1 of Regulations Governing Risk Management of the Exchange:** The Respondent in its written response communicated:

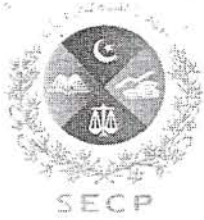
"Your good self will appreciate that this certificate has been issued on the basis of figures which are unaudited. Only audited accounts can attract audit word in reports. We have issued a review report exactly in line with Auditing Practices in Pakistan where even in the case of listed companies auditor issues a review report giving a low level assurance regarding unaudited half yearly accounts.....It was a general practice prevailing in the market at that time to issue review report for half yearly accounts which are unaudited. Same has been discussed also in various clarifications as issued by Securities and Exchange Commission of Pakistan in July to December 2013 that there were different formats in field."

The Representatives of the Respondent during the course of hearing communicated that they only issued review report/certificate and not the audited certificate. They further added that it is not possible for the auditors to perform complete audit and accordingly the phrase mentioned in the referred regulation is not included in the NCB certificate issued by the Respondent.

7. I have heard the arguments presented by the Representatives of the Respondent at length during the hearing. Additionally, I have perused the available record and the written response filed by the Respondent. Accordingly, my findings on the arguments and assertions made by the Respondent to the issues raised in the SCN are as follows.

a) The Representatives of the Respondent during the course of hearing, with regard to non-inclusion of securities purchased for client in the calculation





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communicated that they based their opinion on the principle of prudence. In this context, it is pertinent to note that the rationale behind prudence is that one should not recognize an asset at a value that is higher than the amount which is expected to be recovered from its sale or use. Conversely, liabilities of an entity should not be presented below the amount that is likely to be paid in its respect in the future. However, prudence does not require deliberately overstating its liabilities and expenses or understating its assets and income. The application of prudence should eliminate bias from financial statements but its application should not reduce the reliability of the information. Accordingly the figure pertaining to the securities purchased for clients whose payment on transaction to transaction basis is overdue should have been included in the NCB calculation.

- b) The Respondent with reference to the understatement of other liabilities stated that the liabilities were not accounted for by the Respondent at that time and was not their responsibility. However, the auditor issuing the NCB Certificate is responsible to ensure that complete and correct amounts have been accounted for in NCB calculation.
- c) The Representatives of the Respondent stated that it is the responsibility of DSL to ensure that all the events are recorded properly in the books of accounts and is not the responsibility of the auditor issuing NCB Certificate to verify the values from the books of accounts. However, the Respondent was responsible to verify the figures and ask for any difference in the value from the DSL, which the Respondent failed to do.
- d) With regard to the clause 2.1 (c) of the Regulations governing Risk Management of the Exchange the Respondent and the Representatives of the Respondent communicated that they issued review report and not the audited NCB certificate. It is pertinent to mention here that use of word 'review report' does not absolve the Respondent from preparation of NCB with complete and accurate values.

8. The Representatives of the Respondent during the course of hearing stated that in light of the guidelines recently issued by the Commission, they will ensure that the NCB and the Certificate issued is in strict compliance with the applicable laws, rules and regulations.





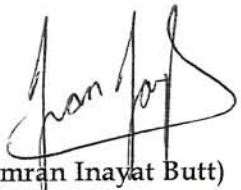
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9. After a detailed and thorough perusal of the facts, evidence/information available on record, contentions and averments made by the Representatives of the Respondent during the course of the hearing, it is evident that the Respondent did not apply the necessary prudence in certifying the NCB. The Respondent is responsible to ensure that the amounts/numbers used to arrive at the NCB value depict completeness and accuracy and is also expected to give a statement to the same effect in the NCB Certificate. An auditor should be perceived as professional that is beyond reproach and it should perform its functions in a fair, proficient and impartial manner.

10. The violation of the Rules and Regulations is a serious matter. However, on this occasion taking a lenient view, the Respondent is strictly warned to comply with the directions of the Commission in future failing which appropriate action will be taken against it. This Order is issued without prejudice to any other action that the Commission may initiate against the Respondent in accordance with law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.




(Imran Inayat Butt)
Director/HOD (MSRD)

Announced on February 06, 2014
Islamabad.