

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

In the matter of Show Cause Notice Dated May 11, 2012 issued to M/s. First National Equities Limited, Member Karachi Stock Exchange (Guarantee) Limited

Date of Hearing: June 5, 2012

Present at the Hearing: Authorized Representatives of First National Equities Ltd.

1. Mr. Ali A. Malik (Chief Executive Officer)
2. Mr. Ijaz Mahmood Ch. (Legal Counsel)
3. Mr. Asif Mumtaz Mian (Company Secretary)

Representing (BR&ICW): 1. Ms. Saima Shafi Rana (Deputy Director (BR&ICW))

ORDER

This Order shall dispose of the proceedings initiated through a Show Cause Notice No. 4/BRK-176/SE/SMD/2004 dated May 11, 2012 (**“the SCN”**) issued to M/s First National Equities Limited (**“the Respondent”**), under section 22 of the Securities and Exchange Ordinance, 1969 (**“the Ordinance”**).

2. Brief facts of the case are that the Respondent is a member of the Karachi Stock Exchange (G) Ltd. and is registered with the Securities & Exchange Commission of Pakistan (**“the Commission”**) as a broker under the Brokers and Agents Registration Rules, 2001. 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 the Respondent. The report dated January 17, 2012 submitted by the inspection team highlighted major deficiencies in the calculation of Net Capital Balance (**“NCB”**) of the Respondent as on June 30, 2011. The findings of the report were duly forwarded to the Respondent on January 30, 2012 and an opportunity of hearing in terms of rule 7(i) of the Inspection Rules was also provided to the Respondent on April 13, 2012.



3. The Respondent, in its written comments and during the hearing held on April 13, 2012, failed to submit satisfactory response to the observations highlighted in the inspection report, therefore the SCN dated May 11, 2012 was issued 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. FIRST NATIONAL EQUITIES LIMITED - MEMBER KARACHI STOCK EXCHANGE (GUARANTEE) LIMITED.

WHEREAS, M/s. First National Equities Limited ('FNEL') is a member of the Karachi Stock Exchange and registered as a broker with the Securities and Exchange Commission of Pakistan (the 'Commission') under the Brokers and Agents Registration Rules, 2001 (the 'Rules').

2. *WHEREAS, 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. SECP/SMD-CW/(91)/2011 dated July 19, 2011 of the books and records required to be maintained by FNEL. The inspection team submitted the inspection report to the Commission on January 17, 2012 which was forwarded to FNEL in accordance with rule 7 of the Inspection Rules on January 30, 2012. The opportunity of hearing in terms of rule 7 (i) of the Inspection Rules was also provided to FNEL on April 13, 2012.*

3. *WHEREAS, on review of inspection report it has come to the notice of the Commission that the calculation of Net Capital Balance ('NCB') of FNEL as on June 30, 2011 certified by M/s. Ilyas Saeed & Company, Chartered Accountants, has the following irregularities:*

(a) Overstatement of Current Assets:-

- i. Trade receivables overstated: - A sum of Rs. 165 million was included as trade receivables from Mr. Mohammad Shoaib Rais however, no documentary evidence in support thereof was provided by FNEL. Further as per the ledger of Mr. Shoaib Rais an amount of Rs. 281.562 million was appearing as receivable however the same was overdue by more than 14 days.*
- ii. Securities purchased for clients overstated:- A sum of Rs. 242.111 million was included in current asset as "Securities purchased for clients" out of which an amount of Rs. 128.979 million was selected by inspection team for verification. On scrutiny of the CDC Balance Report as on June 30, 2011; the inspection team observed that shares of the clients which were appearing in share balance report were not appearing in respective CDC Balance Report in total of*

partial. In this regard overstatement of Rs. 113.797 million was observed as per sample selected for inspection.

- iii. **Investment overstated/duplicated:-** “Investment in listed securities in the name of the company” has been reported as Rs. 70.901 million which includes an amount of Rs. 54.647 million (discounted at 15%) representing shares that were appearing in CDC Sub Account in the name of M/s. Sindh Industrial Trade Limited (“SITE”). Scrip wise break up of shares of SITE Limited are as under:

Scrip's name	No. of shares	Value of shares (Rs. in millions)
<i>Bankislami Pakistan Limited</i>	3,200,000	10.88
<i>Pioneer Cement Limited</i>	6,010,000	33.115
<i>SME Leasing Limited</i>	1,353,000	20.295
Total	10,563,000	64.29

The shares appearing in CDC Sub-Account of SITE which has been included in “investment in listed securities in the name of the company” at discount price of 15% stated above, has again been included in “value of securities purchased for clients” for Rs. 64.29 million at gross value resulting in duplication.

- (b) **Understatement of current liabilities:** Total current liabilities of the FNEL as on June 30, 2011 as per audited financial statements were Rs. 717.648 million out of which only Rs. 475.931 million were reported in NCB. Thus current liabilities were understated by Rs. 241.717 million.

Current Liabilities	Rs. in million
<i>Accrued expenses</i>	24.293
<i>Unclaimed Dividends</i>	2.544
<i>Other liabilities</i>	10.873
<i>Short term finances</i>	415.531
<i>Accrued Mark up</i>	1.989
<i>Current portion of long term financing</i>	248.719
<i>Loan from director</i>	13.700
Total Current Liabilities as reported in audited Financial Statements as on June 30, 2011	717.648

4. **WHEREAS**, after incorporating the aforementioned adjustments, the NCB is showing a negative balance of Rs. 508.765 million as depicted below:-

Net Capital Balance (NCB)		
As on June 30, 2011		
	Rs. in million	
	As submitted in KSE	Adjusted NCB
CURRENT ASSETS		
Cash at bank	2.461	
Trade receivables	172.209	
Investment in listed securities in the name of company	70.901	
Securities purchased for clients (overdue for more than fourteen days)	242.111	
TOTAL CURRENT ASSETS (A)	487.682	208.883
CURRENT LIABILITIES		
Trade payables (excluding overdue for more than thirty days)	21.945	
Other liabilities	453.986	
TOTAL CURRENT LIABILITIES (B)	475.931	717.648
NET CAPITAL BALANCE (A – B)	11.751	(508.765)

5. **WHEREAS**, in terms of rule 3 of the Securities and Exchange Rules 1971 (“1971 Rules”) it is a duty of every member of the exchange to maintain at all time a NCB as calculated in accordance with the Third Schedule of the 1971 Rules. Further section 18 of the Ordinance provides that:-

“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.”

6. **WHEREAS**, Prima facie, it appears that the NCB as calculated by FNEL is not in accordance with the Third Schedule of the 1971 Rules and that FNEL by submission of overstated NCB has prima facie submitted 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.

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

“if any person contravenes or otherwise fails to comply with the provisions of the Ordinance or any rules or regulations made there under; 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 a 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 May 29, 2012, as to why action as provided in 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 **Wednesday, May 30, 2012 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/defense of your stance. This notice sufficiently discharges the Commission’s obligation to afford FNEL an opportunity of hearing in terms of section 22 of the Ordinance and in case of failure to appear on the stated date of hearing it will be deemed that FNEL has nothing to say in its defense and the matter will be decided on the basis of available record.*

*Sd/-
Hasnat Ahmad
Director*

4. Thereafter, the hearing fixed for May 30, 2012 was adjourned till June 5, 2012 on the request of the Respondent. The Respondent submitted a written response to the SCN dated June 1, 2012. The following arguments were put forward by the Respondent in its written response and during the hearing held on June 5, 2012:

(a) Overstatement of Current Assets

1. Trade receivables overstated

In this connection the Respondent in its written response dated June 1, 2012 stated as follows:

“As per objection that a sum of Rs. 165 (M) was included as trade receivable from Mr. Muhammad Shoaib Rais and further as per the ledger, Shoaib Rais was shown with an amount of Rs. 281.62 (M) as receivable however the same was overdue by more than 14 days. It may be submitted with respect that Shoaib Rais has acknowledged the receivable as 281.62 (M). Regarding the further clarification, it may be mentioned here that as per the month May closing an amount of Rs.116.562 (M) was receivable from Mr. Shoaib as per books. On the date of audit when Mr. Shoaib was confronted with this figure, he replied that this is not the amount payable rather it is 281.62 (M) and not 116.562 (M). Accordingly, a reversal entry was made, the system accordingly generated the

said figure as 165 (M) as being an increased amount and that figure was shown as increased figure and the same amount has become receivable within 14 days. So this observation may kindly be dropped.”

During hearing the Respondent stated that as per the closing of May 2011, a sum of Rs. 116.562 million was receivable from Mr. Mohammad Shoaib Rais and a sum of Rs. 165 million was due to be received from five to six other clients; however, when Mr. Mohammad Shoaib Rais was confronted with this figure, he replied that the exact amount is Rs. 281.62 million which also included a sum of Rs. 165 million due from other clients. Therefore, the Respondent made a reversal entry in the system during the month of June, resulting in change in the ageing of said trade receivable and hence the same was included in trade receivable due within a period of 15 days for the purpose of calculating NCB.

2. Securities purchased for the clients overstated

In respect of above the Respondent in its written statement stated as under:

“It is submitted with respect that we have already replied this observation in our reply dated April 19, 2012 and we again reiterate that in the CDC statement attached dated 30.6.2011 the shares of the SITE Ltd. were available in the CDC account and it may be pointed out that at Para 4.6.3 in forth column of balance as per CDC note 1, the said is blank. It is therefore humbly submitted that this observation is not only misconceived, rather on the basis of the misconception without going into the details and the material provided to us, the observation was made. Hence it is requested that this observation may kindly be dropped.”

3. Investment overstated/duplicated

In respect of above the Respondent in its written statement stated as under:

“Regarding investment overstated / duplicated, it may be submitted with respect that whatever was submitted to the auditor was on the basis of the system generated reports and the same was not manually prepared, lest it may not be taken as a mistake with intention, because of the main reason that thousands of clients are dealing with our company regarding the sale purchase of shares which report is prepared by the system and if the system has taken any error the same could not be manually gone into hence the duplication if any, is not a part of human mistake. Hence, it is requested that this observation as per reply may kindly be dropped.”



(b) Understatement of current liabilities

In respect of above the Respondent in its written statement stated as under:

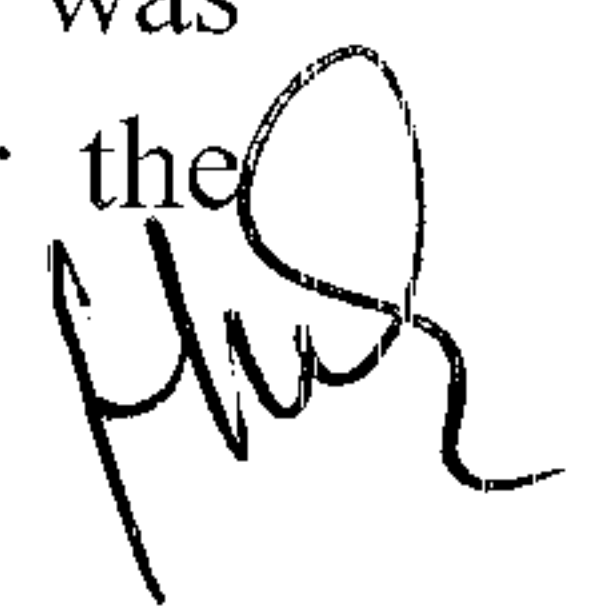
“Regarding this observation, it may be submitted with respect that net capital certificate was issued on the basis of the available management accounts by taking over all view coupled with the audit account of 2010 which was in consonance with the management accounts. It may be submitted with respect that at that point of time the exact figures could not be made available as the audit was not done. It is further submitted with respect that after the final statutory audit, the subsequent net capital certificate was submitted of Dec, 2011 and March, 2012 which pertains to the exact figures as per the account reviewed by the auditor in Dec, 2011. The figures now made available in the shape of net capital certificate become progressive in nature and speaks about the improved situation as appropriately required by the Commission. Hence it is submitted that the observation may kindly be dropped.”

5. I have examined all the arguments raised by the Respondent which are discussed and appraised hereunder in seriatim:

(a) Overstatement of Current Assets

1. Trade receivables overstated

The Respondent was asked to provide the documentary evidence in support of trade receivable amounting to Rs. 165 million. The Respondent was shown the FNEL's Client Receivable Aging Report as on June 30, 2011, wherein not a single entry in respect of the reported amount of Rs. 165 million was available. In response thereto, the Respondent submitted that as per the closing of May 2011, a sum of Rs. 116.562 million was receivable from Mr. Mohammad Shoaib Rais and a sum of Rs. 165 million was due to be received from five to six clients; however, when Mr. Mohammad Shoaib Rais was confronted with this figure, he replied that the exact amount is Rs. 281.62 million which also included in sum of Rs. 165 million due from other clients. Therefore, the Respondent made a reversal entry in the system during the month of June, resulting in change in the ageing of said trade receivable and hence the same was included in trade receivable due within a period of 15 days for the purpose of calculating NCB. To further assess the Respondent's claim that Rs. 165 million comprise of trade receivable of five or six clients, the Respondent was advised to provide copies of ledger statement of said clients, however the Respondent failed to provide the same.



The Respondent categorically acknowledged that the amount of Rs. 281 million (including Rs.165 million) was actually due for more than 15 days. The same was also evident from the following ledger of Mr. Mohammad Shoaib Rais as on June 30, 2011 provided by the Respondent to the inspection team.

REF	VOUCHER #	DATE	PARTICULARS	DEBIT	CREDIT	BALANCE	DR/CR
			Opening balance			285,929,481.06	DR.
Jv	330	20-sep-10	Sub a/c maintenance fee – renewal	300.00		285,929,781.06	DR.
Br	978	02-dec-10	Rec ag divi kapco(500)@2.75		1,272.00	285,928,509.06	DR.
Ps	759	21-dec-10	Sp000011 dated 21-12-2010 - t+0		607,798.36	285,320,710.70	DR.
Ps	766	22-dec-10	Sp000014 dated 22-12-2010 - t+0		606,548.67	284,714,162.03	DR.
Jv	1154	31-dec-10	Pledge shares (8508500) of pioc sold bop		2,775,437.00	281,938,725.03	DR.
Br	1971	26-may-11	Rec amnt ag sales of trust shares		376,709.00	281,562,016.03	DR.
			Client's net	300.00	4,367,765.03	281,562,016.03	DR.

The Respondent stated that the trade receivables overdue by more than 14 days were made reclassified by making reversal entry in the account of Mr. Mohammad Shoaib Rais, however, no reversal entry as stated by the Respondent was observed in the aforesaid ledger account. Therefore, contentions of the Respondent have no merit and it stands established that the trade receivables have been overstated.

2. Securities purchased for the clients overstated

With regard to the observation that there were discrepancies in back office record of the securities purchased for clients with those of CDC balances of those client as of same date; the Respondent showed the CDC balance statement as on June 30, 2011 showing that the shares of SITE were available in CDC thereby negating the above allegation. The Respondent further stressed that there were technical errors in the report. Therefore, the Respondent was asked to provide documentary evidence supporting its claim that there was no discrepancy in securities purchased for clients and CDC balances as of that date. However, the Respondent failed to provide the same. Therefore, contentions of the Respondent have no merit and it stands established that securities purchased for clients have been overstated.

3. Investment overstated / duplicated

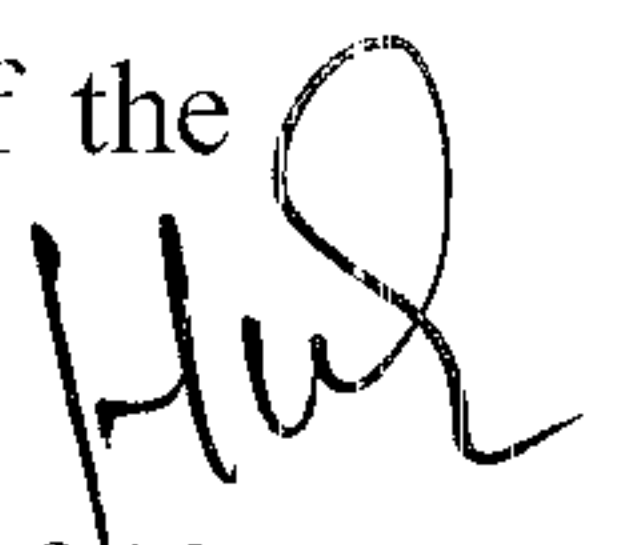
With regard to the observation that an amount of Rs. 54.647 million; discounted at 15% and representing the shares of Sindh Industrial Trade Limited (SITE); included in ‘Investment in listed securities in the name of the company’ were also included in “value of securities purchased for clients” at gross value of Rs.

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64.29 million resulting in duplication/ overstatement, the Respondent explained that the transaction is in fact a Repo transaction and a portfolio investments of the Respondent itself has always been shown as the Respondent's investments in financial statements. The Respondent further explained that since the title of the shares were still with SITE; therefore it was being shown in securities purchased for clients. The Respondent acknowledged that these should not have been shown in securities purchased for clients. The Respondent further submitted that due to this system error NCB has been overstated by an amount of Rs. 64.29 million. The Respondent further acknowledged that the same was being overlooked by the management of the Respondent. The Respondent was asked to provide the copy of the Repo agreement proving that the shares were actually owned by it. However, the same was not provided.

(b) Understatement of Current Liabilities

On a query regarding understatement of current liabilities by the Respondent for the purposes of calculating NCB; the Respondent contested that the NCB was issued on the basis of available management accounts and audited accounts of 2010. The statutory auditor of the Respondent, while auditing the financial accounts for the year 2011, had classified certain portion of long term liability as current by introducing the 'current portion of the long term liabilities'. However, since that was not in the knowledge of the Respondent at the time of preparation of NCB, the same was not included in current liabilities. The Respondent was inquired about the underlying agreements based on which the said liability was classified as 'current liabilities'. In response, the Respondent replied that the agreements with the banks were finalized in the year 2009 and will be shared with the Commission in couple of days, however, the copies of said agreements were not provided. In this regard reference may be made to Note 17 of the audited financial statements of the Respondent for the year ended June 30, 2009 according to which the short-term financing provided by the two commercial banks were rescheduled and restructured for a period ranging between 1 to 7 years with a grace period of 1 to 2 years. The maximum grace period of two years expired on or before June 30, 2011. Moreover, as per note 20.4 of the audited financial statements of the Respondent for the year ended June 30, 2010 a loan of Rs. 200 million obtained from Sindh Industrial Trade Estate was repayable by August 2009 but disclosed as long-term financing. In respect of long term loan from two commercial banks stated above it may further be noted that the term of repayment as disclosed in audited financial statements for the year ended June 30, 2010 and 2011 are the same, meaning thereby that no change took place in respect of term of repayment till June 30, 2011. Therefore, the base documents for calculation of current maturity of long term loan are the agreements with respective banks which were made in the year 2009 as disclosed in audited financial statements of the



Respondent for the year ended June 30, 2009. In the preparation of NCB for the period ended June 30, 2011, the 'current portion of long term borrowings/financing' was not taken into account by the Respondent and a considerable amount of Rs. 248.719 million was not included in current liability, resultantly NCB of the period ended June 30, 2011 was understated by the said amount. From the above fact it stands established that current liabilities have been understated by the Respondent while calculating NCB for the period ended June 30, 2011.

6. 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. 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 of the Respondent would have been in negative thereby implying that Respondent by submission of false NCB had not only attained the certificate of registration as broker but also much higher trading exposure thereby increasing the systemic risk in the market. Therefore, it stands established that the NCB as calculated by Respondent is not in accordance with the Third Schedule of the 1971 Rules and that Respondent by submission of overstated NCB has submitted 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.

7. The violation of the Ordinance, rules and regulations is a serious matter and in view of the regulatory violations as discussed above, in exercise of the powers under Section 22 of the Ordinance, through this Order, the Respondent is directed to deposit a sum of Rs. 500,000 (Rupees Five Hundred Thousand Only), to the Commission by way of penalty. The Respondent is further directed to ensure full compliance with the Ordinance, rules, regulations and directives of the Commission in future.

8. The matter is disposed of in the above manner and the Respondent is directed to deposit the penalty 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 and furnish copy of the deposit chalan to the undersigned.

9. 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 (MSCID)



**Announced on July 10, 2012
Islamabad.**