

**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**  
**Ilyas Saeed & Company, Chartered Accountants**

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**Date of Hearing:** May 30, 2012

**Present at the Hearing:**

1. Mr. Muhammad Ilyas (Senior Partner)
2. Mr. Irfan Ilyas (Partner)
3. Mr. Imran Ilyas (Partner)

**Representing (BR&ICW):**

1. Ms. Saima Shafi Rana (DD-BR&ICW)
2. Mr. Muhammad Tanveer Alam (JD) through video conference)

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**ORDER**

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4/BRK-176/SE/SMD/2004 dated May 11, 2012 ("**the SCN**") issued to M/s. Ilyas Saeed & Company ("**the Respondent**"), under Section 22 of the Securities and Exchange Ordinance, 1969 ("**the Ordinance**").

2. Brief facts of the case are that the Securities & Exchange Commission of Pakistan ("**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 M/s. First National Equities Limited (FNEL), member of the Karachi Stock Exchange Ltd. and registered with the Commission as a broker under the Brokers and Agents Registration Rules, 2001.

3. The report dated January 17, 2012 submitted by inspection team highlighted major irregularities in calculation of Net Capital Balance ('NCB') of FNEL as on June 30, 2011, the calculation of which were duly verified and certified by the Respondent. Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-



**SUBJECT: SHOW CAUSE NOTICE IN THE MATTER OF INSPECTION OF BOOKS AND RECORD OF M/S FIRST NATIONAL EQUITIES LIMITED - MEMBER KARACHI STOCK EXCHANGE (GUARANTEE) LIMITED.**

1. **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 books and records required to be maintained by M/s First National Equities Limited ('FNEL'). The inspection team submitted the inspection report to the Commission on January 17, 2012 which was communicated to FNEL in accordance with rule 7 of the Inspection Rules on January 30, 2012.

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

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

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.

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

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

*Handwritten signature*

<b>Net Capital Balance (NCB) As on June 30, 2011</b>		
	<b>Rupees in million</b>	
	<b>As submitted in KSE</b>	<b>Adjusted NCB</b>
<b>CURRENT ASSETS</b>		
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	
<b>TOTAL CURRENT ASSETS (A)</b>	<b>487.682</b>	<b>208.883</b>
<b>CURRENT LIABILITIES</b>		
Trade payables (excluding overdue for more than thirty days)	21.945	
Other liabilities	453.986	
<b>TOTAL CURRENT LIABILITIES (B)</b>	<b>475.931</b>	<b>717.648</b>
<b>NET CAPITAL BALANCE (A – B)</b>	<b>11.751</b>	<b>(508.765)</b>

4. **WHEREAS**, in terms of the rule 3 of the Securities and Exchange Rules 1971 ("1971 Rules") and clause 2.1 (b) of Regulations Governing Risk Management of Karachi Stock Exchange it is a duty of every member of the exchange to submit bi-annually a certificate from the auditor confirming their NCB on the format prescribed by the Exchange. Further 2.1 (c) provides that:-

*"the certificate shall specify that the Net Capital Balance calculated have been duly audited/verified by the auditor"*

5. **WHEREAS**, 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."*

*HS*



6. **AND WHEREAS**, Prima facie, it appears that the certificate of NCB provided 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.

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 11.30 a.m.** at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you consider necessary for clarification/defense of your stance. This notice sufficiently discharges the Commission obligation to afford the auditor 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 auditor has nothing to say in its defense and the matter will be decided on the basis of available record.

Sd-

**Hasnat Ahmad**

Director

4. The Respondent submitted written response to the SCN vide letter dated May 28, 2012. The following arguments were put forward by the Respondent in its written response and during the hearing held on May 30, 2012.

**a) General Observations**

At the outset, the Respondent submitted that the proceedings are not carried out properly and are *void-ab-initio*. Moreover, the Respondent stressed that it



verified NCB based on management accounts provided by FNEL. The Respondent further confronted that NCB was issued on October 3, 2011; whereas the inspection team verified the figures from the audited financial statements for the year ended June 30, 2011 which were issued on October 30, 2011.

**b) Overstatement of Current Assets**

i). Trade Receivable overstated

In this connection, the Respondent in its written response stated as follows:

*"We have looked into the detail provided to us and observed that there is no debtor of that name in the list provided by the company to us in support of debtors falling within 14 days. We selected few sample accounts from the client receivable aging report and checked those with their respective ledger accounts (on the system of client) to verify the aging of debtors list. On test check, we generally found the list in order with relevant book entries in ledger accounts in the stated period. System generated debtors aging report was relied upon for trade receivables"*

ii). Securities Purchased for clients

In this respect, the Respondent in its written response stated as under:

*"On demand, we were shown few "Client Securities Balances" in the system as on 30-6-2011. Since this is the report sent to clients for verification; this was deemed appropriate for valuation purpose... No previous audited accounts ever differed with the given sums as secured. No previous NCB certificate ever made any adjustments. Having no reasons for suspicious, we relied on management figures"*

iii). Investments overstated/duplicated

In this respect, the Respondent in its written response stated as under:

*"List of investments in listed securities available for sale grossly amounting to Rs. 83,412,589/- was provided by the company along with market rate and valuation. We checked market values of shares from KSE website as at June 30, 2011 and generally found them in order. We applied analytical procedures on the investments with comparative audited figures as given in management accounts. In audited accounts of previous two years the referred investment have all along been shown by the auditors as clients investment available for sale"*



### c) Understatement of Current Liabilities

In this respect, the Respondent in its written response stated as under:

*"Total Current Liabilities for NCB were determined on the basis of management accounts (un-audited) for the period end June 30, 2011. Analytically we compared the short term and long term liabilities with comparative audited accounts for the year ending June 30, 2010"*

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

#### (a) Overstatement of Current Assets

##### i). Trade receivables overstated

The Respondent was asked to provide the documentary evidence in support of trade receivable amounting to Rs. 165 million. The Respondent provided 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, however, an amount of Rs. 60 million was appearing as receivable from Pushtoon. Responding to the query as to how did it verify aging of Pushtoon, the Respondent informed that it relied on system generated aging report and it did not keep the copy of the ledger. However, it was argued by the representative of the Commission that the verification is always based on a selected sample and Pushtoon's receivable was the largest figure in the Report **and the Respondent was required to obtain sufficient and appropriate evidence with regard to receivable balance of Rs. 60 million.**

The Respondent further responded that FNEL made a reversal entry in the system during the month of June, resulting in change in the aging of trade receivable of Rs. 165 million and hence the same was included in trade receivable due within a period of 15 days for the purpose of calculating NCB.

With regard to balance of aging of Pushtoon it may be clarified that as per ledger account of Pushtoon (Account No.3328) for the year ended June 30, 2011 an amount of Rs. 3,665,717.3 was appearing as receivable as on July 1, 2010 and during the year only one transaction of Rs.300 regarding sub-account maintenance fee was charged to the said account on September 20, 2010 through Journal Voucher No.330 resulting in closing balance of Rs. 3,666,017.3 as on June 30, 2011. It



was further clarified that the balance of Rs. 60 million appearing in the Aging Report as receivable from Pashtoon was dummy figure and had the Respondent looked into it, it would have pointed it out.

It may further be clarified that certification of Net Capital Balance is an Assurance Engagement and appropriate assurance procedures should have been performed to enable the auditor to issue the required certificate. International Standard on Assurance Engagements 3000 requires that the Practitioner should obtain sufficient appropriate evidence on which to base the conclusion.

Moreover, the Respondent being a firm of Chartered Accountants is required to comply with the Code of Ethics for Chartered Accountants issued by The Institute of Chartered Accountants of Pakistan which requires that a Chartered Accountant should perform professional services with due care, competence and diligence and all professional services are required to be carried out in accordance with the relevant technical and professional standards.

It was observed that the Respondent failed to perform its professional duty with due care and showed negligence in verifying the calculation and certifying the NCB. The amount of trade receivables appearing in NCB was required to be verified with sufficient appropriate evidence such as verification of relevant General Ledger Account. The Respondent failed to obtain sufficient evidence; therefore, contentions of the Respondent have no merit and it stands established that the trade receivables have been overstated and this fact has not been reported by the Respondent in certificate of NCB.

ii). Securities purchased for the clients overstated

With regard to the observation that there were discrepancies in calculation relating to securities purchased for clients; the Respondent was inquired about the sufficient evidences to verify the working and value of 'securities purchased for clients'. The Respondent replied that it checked the clients' ledger and values of securities as on that date. It was pointed out by the representative of the Commission that to assess the genuineness of working and value of 'Securities purchased for clients', the conclusive evidence is always reconciliation of respective CDC balance statements with that of client's ledger as of the same date. In response, the Respondent categorically informed that it did not check CDC balances and restricted itself only to checking the calculation of NCB. Since, the Respondent has not verified the genuineness of the said figure and in a separate proceedings against FNEL it has been established that the securities





purchased for clients have been overstated, therefore contentions of the Respondent have no merit.

It has been observed that the Respondent failed to perform its professional duty with due care and showed negligence in verifying the calculation and certifying the NCB. The amount of securities purchased for clients appearing in NCB was required to be verified with sufficient appropriate evidence such as verification of respective CDC Balance Statements of relevant period. The Respondent failed to obtain sufficient evidence; therefore, contentions of the Respondent have no merit and it stands established that the securities purchased for clients have been overstated and this fact has not been reported by the Respondent in certificate of NCB.

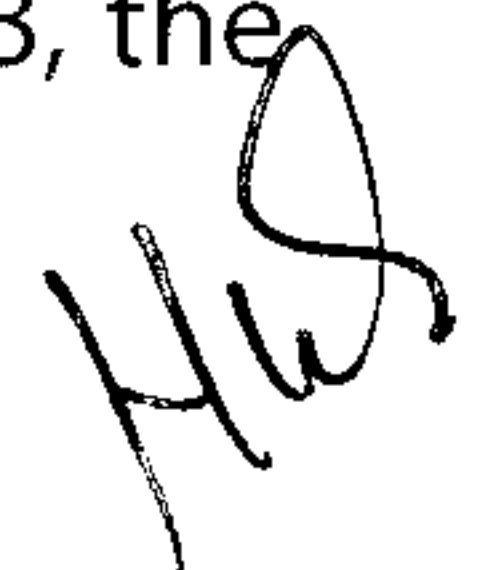
iii). Investment overstated / duplicated

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. 64.29 million resulting in duplication/ overstatement, the Respondent informed that it did not has breakup of Rs. 242.11 million but it was confident that shares of SITE were not included in 'Securities purchased for clients'.

It was observed that had the Respondent prudently checked and verified the breakup of 'Securities Purchased for clients', it would have known that shares of SITE were included under this head. It is imperative to note that in separate proceedings against FNEL, the representative of FNEL acknowledged that shares of SITE were included in both 'Investment in listed securities in the name of company' and 'securities purchased for clients' resulting in duplication and overstatement of NCB by an amount of Rs. 64.29 million.

**(b) Understatement of Current Liabilities**

On a query regarding understatement of current liabilities by the FNEL for the purposes of calculating NCB; the Respondent contested that the NCB was certified on the basis of available management accounts and audited accounts of 2010. The statutory auditor of FNEL, 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 verifying NCB, the same was not included in current liabilities.

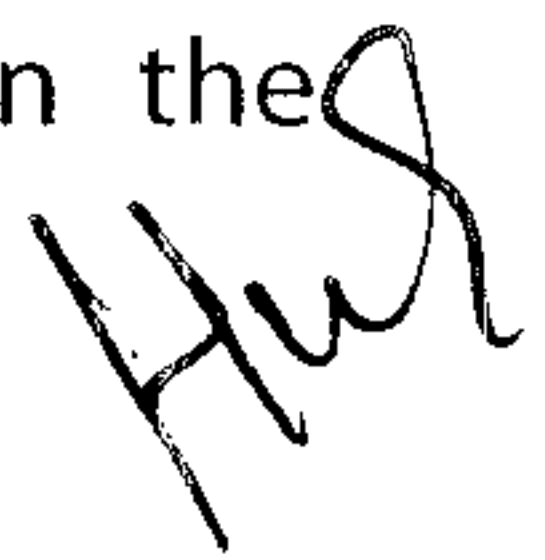


In this regard reference may be made to Note 17 of the audited financial statements of FNEL for the year ended June 30, 2009 according to which the short-term financing provided by the two commercial banks were rescheduled and restructured for a period ranging between 1 to 7 years with a grace period 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 FNEL for the year ended June 30, 2010 a loan of Rs. 200 million obtained from SITE 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, thereby meaning 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 executed in the year 2009 as disclosed in audited financial statements of the FNEL for the year ended June 30, 2009. Moreover, 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 FNEL nor adjusted/highlighted by the Respondent. Accordingly, a considerable amount of Rs. 248.719 million was not included in current liabilities, resultantly NCB of the period ended June 30, 2011 was overstated by the said amount. From the above fact it stands established that current liabilities were understated by the FNEL while calculating NCB for the period ended June 30, 2011, which the Respondent failed to discover.

6. I have examined the facts, evidences and documents on record, in addition to written and verbal submissions made on behalf of the Respondent. It is evident from perusal of the record that if NCB was calculated in strict compliance with the requirements of 1971 Rules; the NCB verified by the Respondent would have been in negative. It is further evident that Respondent had not applied the necessary prudence in certifying the NCB and was not aware about the significance of NCB and the systemic risk involved as a result of overstatement. Therefore, it stands established that the NCB as certified by the Respondent is not in accordance with the Third Schedule of the 1971 Rules and the Respondent has provided a statement 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 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. 50,000 (Rupees Fifty 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 challan 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 (SM)



Announced on October 4, 2012  
Islamabad.