

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

In the matter of Show Cause Notice Dated January 23, 2013 issued to
Nasir Javaid Maqsood Imran Ashfaq, Chartered Accountants

Date of Hearing: March 13, 2013

Present at the Hearing: M. Javed Qasim (Partner)
M. Hanif (Manager)

Representing MSRD: Ms. Saima Shafi Rana (Deputy Director- MSRD)

ORDER

1. This Order shall dispose of the proceedings initiated through Show Cause Notice No. 4(BRK-199)SE/SMD/05 dated January 23, 2013 (“**the SCN**”) issued to M/s. Nasir Javaid Maqsood Imran Ashfaq, Chartered Accountants, (“**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. Al-Hoqani Securities & Investment Corporation (Private) Limited (the “**AHSICL**”), TREC Holder of Karachi Stock Exchange Ltd. and registered with the Commission as a broker under the Brokers and Agents Registration Rules, 2001 (“**Brokers Rules**”).
3. The report dated November 06, 2012 submitted by the Inspection Team highlighted major irregularities in calculation of Net Capital Balance (“**NCB**”) of AHSICL as on June 30, 2012, the calculation of which was duly verified and certified by the Respondent. It appeared that NCB was not in accordance with Third Schedule of Securities and Exchange Rules, 1971 (the “**SE Rules**”) Thereafter, the Commission served a SCN to the Respondent, the contents of which are reproduced below:-

SUBJECT: SHOW CAUSE NOTICE UNDER SECTION 22 OF THE SECURITIES AND EXCHANGE ORDINANCE, 1969 IN THE MATTER OF AL-HOQANI SECURITIES & INVESTMENT CORPORATION (PRIVATE) LIMITED

WHEREAS, the Securities and Exchange Commission of Pakistan (“Commission”) in exercise of its powers under Sub-section (1) of Section 6 of the Securities and Exchange Ordinance, 1969 (“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 vide order No. SMD/MS&CID-C&IW/10-1(145)/2012 dated September 4, 2012 of the books and record required to be maintained by Al-Hoqani Securities & Investment Corporation (Private) Limited (“AHSIC”) a TREC Holder of Karachi Stock Exchange Limited (“Exchange”). The

Page 1 of 1

Inspection Team after conducting the inspection of Books and Record of AHSIC submitted the inspection report to the Commission on November 06, 2012.

2. **AND WHEREAS**, on review of the inspection report, it has been observed that the Net Capital Balance (“NCB”) as on June 30, 2012 of AHSIC as verified and certified by M/s. Nasir Javaid Maqsood Imran Ashfaq (“Auditors”) is not in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 (“1971 Rules”) and following discrepancies were observed which if not done would have resulted in negative NCB of Rs. 68,131,204.

- i. Securities purchased for clients were **overstated** by an amount of Rs. 119,518,098
- ii. Trade receivables were **understated** by an amount of Rs. 621,803
- iii. Investment in listed securities in the name of company were **overstated** by an amount of Rs. 79,313
- iv. Total Current Assets were **overstated** by an amount of Rs. 118,975,608
- v. Trade payables were **understated** by an amount of Rs. 367,449
- vi. Other liabilities were **understated** by an amount of Rs. 5,150,143
- vii. Total Current Liabilities were **understated** by an amount of Rs. 5,517,592
- viii. NCB was overstated by an amount of Rs. 124,493,200

3. **AND WHEREAS**, in terms of Rule 2(d) of the 1971 Rules read with Clause 2.1 of the Regulations Governing Risk Management of the Exchange (‘the Regulations’), the NCB are required to be calculated in accordance with the Third Schedule to the 1971 Rules. Further, the TREC Holders of the Exchange are required to submit bi-annually a certificate from an auditor as specified in Clause 2.1 (b) of the said Regulations confirming their NCB on the format prescribed by the Exchange. The NCB is also required to be duly audited/verified in terms of Clause 2.1 (c) of the said Regulations which provides that

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

4. **AND WHEREAS**, prima facie it appears that the certificate of NCB of AHSIC as on June 30, 2012 certified by the auditors is not in accordance with the Third Schedule of the 1971 Rules and that the auditors have 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.

5. **AND WHEREAS**, in the light of the facts mentioned above, prima facie, it appears that the auditors are in contravention of Section 18 of the Ordinance, the contravention of which invokes penalty under Section 22 of the Ordinance.

6. **AND WHEREAS**, section 18 of the Ordinance provides:-

“No person shall, in any document, paper, accounts, information or explanation which he is, by or under this Ordinance, required to furnish, or in any application made under this Ordinance, make any statement or give any information which he knows or has reasonable cause to believe to be false or incorrect in any material particular.”

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

“ If any person refuses or fails to furnish any document, paper or information which he is required to furnish by or under this

Ordinance; or refuses or fails to comply with any order or direction of the Commission made or issued under this Ordinance; or contravenes or otherwise fails to comply with the provisions of this Ordinance or any rules or regulations made thereunder, the Commission may if it is satisfied after giving the person an opportunity of being heard that the refusal, failure or contravention was willful, by order direct that such person shall pay to the Commission by way of penalty such sum not exceeding fifty million rupees as may be specified in the order and in the case of continuing default, a further sum calculated at the rate of two hundred thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.”

8. **NOW THEREFORE**, you are hereby called upon to show cause in writing by February 4, 2013, as to why action as provided under Section 22 of the 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 **February 7, 2013** at 3:00 p.m. at the SECP Headquarters – Islamabad. You are advised to bring all relevant record in original, which you may consider necessary for clarification or in your defense. This notice sufficiently discharges the Commission’s obligation to afford an opportunity of hearing in terms of Section 22 of the Ordinance. In case of your failure to appear on the stated date of hearing it will be deemed that you have nothing to say in your defense and the matter will be decided ex-parte on the basis of available record.

9. Please note that this show cause is being issued without prejudice to any action, which may be taken or warranted for the above said or any other default under the above referred or any other provisions of law. Kindly acknowledge receipt of this show cause notice through return fax or courier at your earliest.

Sd/-
Hasnat Ahmad
Director

4. Thereafter, the hearing fixed for February 7, 2013 was adjourned on the request of the Respondent. The Respondent submitted a written response to the SCN dated February 14, 2013. The following arguments were put forward by the Respondent in its written response and during the hearing held on March 13, 2013:

a) **Overstatement of Securities Purchased for Clients:** In this connection, the Respondent in its written response stated as follows:

“..No overstatement have been made on this account. The difference is mainly due to amount of Rs. 102,114,352/- being late payment charges receivable on overdue balances of trade receivables. AHSIC's has merged this amount along with overdue balances under the head of securities purchased for clients on the basis of excess value of securities held against these overdue balances. In our opinion the calculation adopted by the company is in accordance with the Third Schedule of the Securities & Exchange Rule, 1971 for calculation of net capital balance.

The third schedule clearly mention valuation basis for item No.4 under Section 'A' as "securities purchased for the client and held by the member where the payment has not been received within fourteen days".


Page 3 of 7

The above valuation basis clearly states that those balances which are not recovered within 14 days are overdue. Overdue balances always attract levy of late payment charges and such charges become part and parcel of overdue balances receivable from customers. The above valuation basis definition do not exclude any incidental delayed payment charges when securities valuation far exceeds the total receivables from client. The logic is simple that risk is under control till securities valuation exceeds overdue balance plus late payment charges. We do not agree to the opinion of your inspection team that above definition only allows trade balances excluding late payment charges. Further financial costs for delayed payments are permissible under section 74 of the Contract Act 1872. In our opinion inclusion of late payment charges is justified being part and parcel of overdue receivables and its inclusion in working of net capital balances is logical as it reflects total recoverable amount from customers which will ultimately converted into cash.

The difference of Rs. 21,437,917 related to non-acceptance of outstanding overdue balance of Mr. Ahmed Sulaiman Saeed for securities purchased. Mr. Suleman Hoqani has issued written confirmation committing to offer his securities against above balances; which was provided before us as evidence and thus provide adequate security and do not create any doubt regarding its recoverability and its inclusion under head securities purchased for client.”

- b) **Understatement of Trade Receivables:** In this connection, the Respondent in its written response stated as follows:-

“The amount of Rs. 621,803/- was inadvertently classified in the Trade Receivables by the Commission as it was a part of other receivables and therefore, were not included in "trade receivables" for the calculation and preparation of Net Capital Balance. However, this does not mean understatement of this amount. The term under-statement connotes deliberate suppression of any material fact or figure with a view to gain any advantage. Had this sum been taken as part of Current Assets, its NCB would have been higher to that extent. Hence, this cannot be a case of understatement”

- c) **Overstatement of Investment in Listed Securities:** In this connection, the Respondent in its written response stated as follows:

“The company had purchased certificates of KASB Modaraba during the last week of June 2012 of trading at the Karachi Stock Exchange. The settlement of this transaction was effectuated on July 3, 2012. Hence, the securities purchased were rightly shown as investments in AHSIC's book. The deliveries of these securities already purchased were eventually received by AHSIC through clearing on July 3, 2012, being the settlement date which was inspected by us.”

- d) **Overstatement of Total Current Assets:** In this connection, the Respondent in its written response stated as follows:

“This para is merely a summation of the figures given in Points No. i, ii and iii of Para 3 of the Show Cause Notice, which have been fully explained above”

- e) **Understatement of Trade Payables:** In this connection, the Respondent in its written response stated as follows:

“This small difference was due to inadvertent mistake on company's part and being classified as overdue and excluded from trade payables and immaterial for review purpose.”

- f) **Understatement of Other Liabilities:** In this connection, the Respondent in its written response stated as follows:

“Rs. 5 Million difference is due to misunderstanding on the part of inspection team and its classification as current liability instead of long term liability as shown under audited financial statements and client direct confirmation. Other differences of Rs. 150,143/- relates to audit adjustments of accrued expenses, lease liability etc made after issuance of our review report on net capital balance”

- g) **Overstatement of NCB:** In this connection, the Respondent in its written response stated as follows:

“This point is the overall summation of the Points No. i, ii, iii, v and vi of Para 3 of the Show Cause Notice, which has been duly explained above. There is no overstatement whatsoever the only main differences is due to interpretation of overdue receivables from customers”

- h) **General Observation:** With regards to responsibility of Chartered Accountant Firms, the Respondent, in its written response, stated as follows:-

“We have issued our review report after complete inspection of relevant records and available documents in accordance with International Standard on Review Engagements-2410 as per directive issued by the Institute of Chartered Accountants of Pakistan. Here we like to reproduce scope of review and conclusion as provided in our review report for your information.

Scope of Review: We conducted our review in accordance with International Standard on Review Engagements 2410. A review of computation consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have provided our review on the basis of professional judgment and integrity and no contravention of Section 18 of the Ordinance and no penalty can be invoked in any case under section 22 of the Ordinance”




4. I have examined all the arguments raised by the Respondent and observed that there were two major miscalculations; "Securities purchased for clients" and "Understatement of other liabilities". Rest of the miscalculation was not material in nature.
5. From perusal of the record, it was apparent that Account No. 1025 was basically used by AHSICL to record the personal expenses of Mr. Al-Hoqani and family members and also comprised mainly of late payment charges on debit balances of Mr. Al-Hoqani and his family members. Since charging of late payment charges are prohibited under section 16 of the Ordinance therefore the amount appearing in the said account cannot be considered for calculation of NCB. Hence question of allocation of value of securities against said account does not arise. It is also apparent that such late payment charges are in violation of section 16 of the Ordinance and the Respondent failed to raise any observations regarding said violation.
6. It is also evident from perusal of the record that the AHSICL included full amount of receivables amounting to Rs. 21.437 million from Mr. Ahmed Sulaiman Ahmed Saeed. However, as per the record, the said amount was overdue for more than 14 days and it is also important to mention that no shares were available in sub account of Mr. Ahmed Sulaiman Ahmed Saeed; therefore, the value of the securities against overdue balance should have been treated as Nil. Further, the shares appearing in one's sub-account cannot be treated as owned by another person merely on the basis of a confirmation. The Respondent failed to highlight this fact while issuing the certificate on NCB and thus found to be professionally guilty in performing its obligations in this regard. The contention of the Respondent regarding "Understatement of other liabilities" is however accepted.
7. 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. Moreover, KSE Notice dated August 29, 2002 clearly requires a firm of Chartered Accountants to perform an audit while certifying the Net Capital Balance.
8. 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 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. Moreover, shares appearing in one's sub account cannot be transferred just on the basis of a confirmation. 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.
9. 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 SE 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 SE 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.

10. 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.

11. 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 (MS R.D)

Announced on April 11, 2013
Islamabad.

