



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter or

Appeal No. 106 of 2017

M/s. Rahman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants

..... Appellant

Versus

The Commissioner Insurance Division, SECP

..... Respondent

Date of Hearing:

December 31, 2024

Present:

For the Appellant:

1. Mr. Anwar Kamal, Authorized Representative
2. Mr. Muhammad Umar Khan Vardag, Authorized Representative

For the Respondent:

Mr. Shafiq ur Rehman, Additional Joint Director, Adjudication-I, SECP

ORDER

1. This Order shall dispose of Appeal No. 106 of 2017 filed by M/s. Rahman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants (the Appellant), against order dated October 11, 2017 (the Impugned Order), passed by the Commissioner, Insurance Division (the Respondent) under Section 48(1) of the Insurance Ordinance, 2000 (the Insurance Ordinance), read with Section 255, 256, 257 and 260 of the Companies Ordinance, 1984 (the Ordinance).



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2. At the very outset, it is pertinent to note that Mr. Abdur Rahman Mir, who was the authorized representative in the present appeal and engagement partner in the Appellant, passed away on January 16, 2019. Initially, Mr. Abdur Rahman Mir engaged Anwar Kamal Law Associates as counsel on behalf of the Appellant in the present appeal. After Mr. Mir's passing away, the Appellant authorized Anwar Kamal Law Associates through a fresh power of attorney to continue representing them in the matter.

3. Brief facts of the case are that an investigation was conducted under Section 59 of the Insurance Ordinance into the financial affairs of M/s. Pakistan General Insurance Company Limited (the Company). The investigation unearthed an undisclosed bank account maintained at the Bank of Punjab, Patiala Ground Branch, Lahore, (the Bank) bearing Account No. 565-28 (Undisclosed Bank Account), which was not reflected in the Company's financial records, including its trial balance and audited financial statements. The investigation report stated that the Undisclosed Bank Account operated as a running finance facility with an overdraft limit of Rs. 112 million, secured by a lien on Term Deposit Receipts (TDRs) of the Company. The investigation report further stated that the review of the bank statements for the period from November 26, 2013, to December 31, 2015, revealed substantial financial transactions, with an overdraft balance of Rs. 111,789,829 as of December 31, 2015. Upon inquiry, the Company stated that the Undisclosed Bank Account was a personal account of Ch. Zahoor Ahmed (CEO of the Company), therefore, the Company was not required to maintain official record of the transactions. As per the investigation report, a comparative review of the bank statements and Company's record from December 31, 2014, to December 31, 2015, disclosed a series of high-value transactions, including the transfer of Rs. 137.75 million from the Company's funds to the Undisclosed Bank Account in connection with 87 purported insurance claims. The investigation further disclosed that after independent verification of these transactions through confirmations obtained from claimants, surveyors, banks, and rescue centers revealed that allegedly 57 of these claims, amounting to Rs. 106.06 million, were fictitious, fabricated, and fraudulent. The investigation report also stated that Rs. 89.39 million of these fraudulent claim payments had been transferred to the Undisclosed Bank Account, Rs. 5.53 million had been withdrawn in cash, and Rs. 11.16 million had been transferred to other untraced accounts. Furthermore, investigation report stated that the running finance



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facility availed through the undisclosed account was secured by a lien on the Company's TDRs/CDRs amounting to Rs. 118 million, which were issued by the Bank.

4. The investigation further disclosed that the Appellant was the statutory auditor of the Company for the financial years ending December 31, 2014, and December 31, 2015, however, it failed to trace the Undisclosed Bank Account. The investigation report stated that the Appellant was under a legal duty to ensure compliance with the applicable auditing standards, including the International Standards on Auditing (ISA), as well as the statutory provisions governing financial reporting, but notwithstanding the material significance of the Undisclosed Bank Account and the fraudulent claims transactions, the Appellant issued unqualified audit reports for both years without ensuring the assertions as required under Para A124 of ISA 315, thereby failing to identify and report the financial misstatements arising therefrom. The Respondent, upon examination of the matter, observed that the Appellant had not exercised due professional care in the verification of TDRs which would have reasonably led to the detection of the Undisclosed Bank Account. Further, the Respondent found that the Appellant had failed to demonstrate the requisite level of professional skepticism in the course of auditing the Company's insurance claims, as their audit sample contained multiple fictitious claims that were subsequently found to be fraudulent. The Respondent also found that the Appellant, in deviation from the standards prescribed under ISA 200, had not adopted a critical approach to detecting irregularities in the claims verification process and overlooked several red flags indicative of financial misreporting. The Respondent further observed that the financial statements, if properly assessed, would have raised substantial concerns regarding the authenticity of the claims and the accuracy of the financial statements. The Respondent maintained that the Appellant's reliance on management representations and standard audit procedures was deemed untenable, as the duty imposed upon auditors necessitated independent verification of financial data and the exercise of due diligence to detect material misstatements. The Respondent also maintained that the Appellant, as statutory auditors of the Company were required to assess the authenticity of the Company's books and records and the fraudulent activities of its management, however, the Appellant issued unqualified audit reports despite the existence of an Undisclosed Bank Account and fraudulent transactions, therefore, the Appellant failed to fulfill its statutory duties under Section 255 of the



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Ordinance, and Section 48 of the Insurance Ordinance, raising concerns about their professional conduct and due diligence.

5. In view of the foregoing, the Respondent issued a show-cause notice dated May 09, 2017 (the SCN) against the Appellant. The Appellant submitted written replies vide letters dated May 17, 2017 and August 02, 2017. Hearing in the matter was held on August 10, 2017. The Respondent concluded the SCN proceedings and in the exercise of powers conferred under Section 48(1) of the Insurance Ordinance, removed the name of the Appellant from the list of approved auditors authorized to conduct audits of insurance, reinsurance and takaful entities with immediate effect.

6. The Appellant assailed the Impugned Order on multiple legal and factual grounds, asserting that the charge of negligence was not made out, as no omission or failure in the audit process was specifically identified by the Respondent. The Appellant contended that the fraudulent activities of the Company's management could not automatically translate into negligence on part of the Appellant, as fraud may be deliberately concealed in a manner that evades detection even upon a careful audit. The Appellant argued that it had conducted the audit in accordance with established auditing standards and industry practices, and that no previous auditor, including *Deloitte Yousuf Adil*, had issued qualified reports in similar circumstances. The Appellant further submitted that it had relied on management representations, surveyor reports and bank confirmations, which did not disclose the existence of the undisclosed bank account, overdraft facility or bogus claims of insurance. The Appellant further contended that the audit process does not involve forensic investigation, and that the discrepancies in the claims, if any, were not apparent from the available documentation. The Appellant argued that the Respondent had applied an unrealistic standard, expecting an investigatory approach that exceeded the scope of a statutory audit.

7. The Appellant also challenged the legal basis of the Impugned Order, asserting that the Respondent had acted beyond the scope of his authority under Section 48(1) of the Insurance Ordinance, which governs the appointment of auditors but does not empower the



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Commissioner to remove an auditor from the approved list. The Appellant submitted that penalties prescribed under the applicable laws, including Section 48(4) of the Insurance Ordinance and Section 255 of the Ordinance, do not include disqualification, and that any such action was beyond the powers conferred upon the Respondent. The Appellant further submitted that the Impugned Order was in violation of its fundamental rights under Articles 4, 9, 10-A, 18, and 25 of the Constitution of Pakistan, 1973 (the Constitution), as it arbitrarily deprived the Appellant of its right to practice its profession without due process. The Appellant, in support of its submissions, cited *Messrs Mansoor Aslam Seraj Saleem Shahid, Chartered Accountants (2015 CLD 822)*, where the Appellate Bench imposed a nominal penalty of Rs. 10,000 for a first-time violation, emphasizing leniency. Reliance was also placed on the Supreme Court's judgment in *State Bank (C.A. No.1406/2016) and SECP & Others v. Official Liquidator, Islamic Investment Bank Limited & Others (C.A. No.1407/2016)*, which held that no determination could be made in the absence of specific allegations. The Appellant asserted that consistency in penalties is a fundamental legal principle binding on the Appellate Bench. Additionally, reference was made to *M/s. Kulja Industries Ltd. v. Chief Gen. Manager W.T. Project Bank (AIR 2014 SC 9)*, where the Indian Supreme Court ruled that disbarment must be based on explicit grounds, considering the frequency and history of violations, and must always be time-bound, ensuring fairness and proportionality. The Appellant also relied on the principle articulated by *Lord Justice Lopes* in *Kingston Cotton Mill Co. (No. 2) [1896] 2 Ch. 27*, which states that an auditor is a watchdog, not a bloodhound and the auditor is justified in relying on representations from management unless red flags exist. Their role is to provide reasonable assurance, not to uncover frauds. The Appellant also cited *(1987) 61 Comp. Cases 548: Tri-Sure India Limited vs. A.F. Ferguson & Co. & others* which held that the auditor is required to employ reasonable skill and care, but he is not required to begin with suspicion and to proceed in the manner of trying to detect a fraud or a lie, unless some information has reached which excites suspicion.

8. The Appellant further argued that removal of its name from the list of approved auditors amounted to an excessive and disproportionate penalty because it had not violated any law and the requirements contained therein. The Appellant further stated that in the instant matter, violations of relevant laws could only be attributed the Company and its



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managements because the Company was advised vide order dated June 7, 2017 to refund Rs 57.15 Million to the Pakistan Reinsurance Company Limited (PRCL) and in addition an aggregate fine of Rs. 2.2 million was imposed on the CEO and other directors of the Company.

9. The Appellant also submitted a newspaper clipping of “The Nation” dated May 23, 2018, which stated that management of the Company entered into a plea bargain with National Accountability Bureau (NAB) and paid Rs. 86.2 Million of which Rs. 64.6 Million was handed over to PRCL. The Appellant stated that plea bargains is sufficient to establish that the Company and its management had committed fraud and failed to disclose the bank account. In view thereof, the Appellant prayed for the setting aside of the Impugned Order and reinstatement on the list of approved auditors.

10. In response to the submissions of the Appellant, the Respondent, *inter alia*, submitted that the Impugned Order was in strict adherence to the applicable legal framework, following a thorough examination of all relevant facts and due consideration of the Appellant’s submissions. The Respondent further submitted that being a statutory auditor, the Appellant was obligated to conduct the Company’s audit in accordance with the ISA and the statutory provisions governing financial reporting. The Respondent argued the Appellant’s failure to detect material misstatements, an Undisclosed Bank Account, and fictitious insurance claims constituted a fundamental breach of its professional obligations. The Respondent further argued that the Appellant’s undue reliance on management representations, without exercising the requisite professional skepticism or conducting independent verification, amounted to gross negligence. The Respondent further submitted that an auditor’s duty is not confined to a mechanical review of financial statements but extends to identifying potential risks and ensuring the accuracy and reliability of financial disclosures. The Respondent argued that the Appellant’s failure to apply a risk-based approach or adopt enhanced due diligence measures in light of evident financial anomalies rendered its audit deficient and misleading, thereby necessitating regulatory action.



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11. The Respondent further submitted that the removal of the Appellant from the list of approved auditors was neither excessive nor beyond the jurisdiction of the Respondent but was lawfully imposed in accordance with Section 48(1) of the Insurance Ordinance, and Section 255 of the Ordinance. The Respondent submitted that these provisions empower the Respondent to take disciplinary action against auditors who fail to discharge their statutory obligations with due diligence and care. The Respondent refuted the Appellant's contention that the penalty imposed was disproportionate, maintaining that the gravity of the violations warranted strict regulatory intervention to uphold the integrity of financial reporting. The Respondent further argued that auditors serve a critical function in ensuring financial transparency and accountability, and any failure to adhere to prescribed standards necessitates corrective measures proportionate to the severity of the breach.
12. The Appellate Bench (the Bench), having conducted a comprehensive review of the statutory framework governing the professional responsibilities of auditors under the Ordinance and the Insurance Ordinance read with ISA, finds that the Appellant was required to meet the prescribed standards of professional conduct and regulatory compliance. The statutory obligations imposed upon auditors are not merely procedural but form the foundation of corporate transparency, financial integrity, and investor protection. Section 255 of the Ordinance, read with relevant provisions of ISA 200, explicitly mandates that auditors exercise due professional care, apply an appropriate degree of professional skepticism, and conduct their audit engagements in compliance with applicable legal provisions and ISA. The Appellant's failure to identify material misstatements was unintentional and resulted from the Company's management concealing facts, for which the management was later penalized. Nevertheless, the Appellant was under a duty to ensure compliance with the regulatory framework and should have exercised professional skepticism when encountering suspicious entries, rather than disregarding them as mere clerical errors as an auditor is expected to adopt a critical approach, especially when financial anomalies suggest potential misstatements, and failure to do so constitutes a breach of professional obligations.



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13. As far as appointment and maintaining a list of approved auditors is concerned, Securities and Exchange Commission of Pakistan (the Commission) is empowered under Section 20(4)(jb) of the Securities and Exchange Commission of Pakistan Act, 1997 (the SECP Act), read with Section 48(1) of the Insurance Ordinance, to maintain and regulate the list of approved auditors. The bench has noted that by virtue of Section 21 of the General Clauses Act, 1897 (GCA), the power to “add” inherently includes the power to “remove”, however, such removal must be based on a specific and identifiable violation, which expressly warrants such regulatory action. Notwithstanding stated hereinbefore, the Bench finds that the removal of the Appellant’s name from the list of approved auditors lacks an explicit legal foundation in the present case because the provisions invoked through the SCN does not pertain to the appointment or removal of the auditors from the list. The Bench is of the view it is a settled principle of law that penal consequences must be expressly provided for under the statute, and no authority can assume punitive powers by implication where the governing law does not envisage such measures. A contravention of Section 255 of the Ordinance read with Section 48(1) and (4) of the Insurance Ordinance entails prescribed consequences under Section 260 of the Ordinance, *i.e. if the default is willful a penalty of up to one hundred thousand rupees may be imposed and if the default is done for profit or to cause loss, the auditor may be subjected to one-year imprisonment and a fine of one hundred thousand rupees*. However, the Bench has noted that the above provision does not contemplate the removal of an auditor from the list of approved auditors. The Bench reaffirms that no penalty can be imposed in the absence of an express legal provision, and any regulatory action must be strictly rooted in a clear legislative mandate rather than an inferred or implied interpretation. Consequently, any action taken in excess of the powers conferred by statute would be *ultra vires*, rendering it legally unsustainable.

14. Accordingly, in view of the facts and circumstances and in the interest of equity and justice, the Bench, is of the considered view that the Impugned order whereby the name of Appellant was removed from list of approved auditors is devoid of legal justification, as the relevant statutory provisions do not envisage the removal of an auditor from the list of approved auditors as a punitive measure. The Bench is of the view that the principle of legality, which serves as the foundation of all administrative and regulatory actions, mandates that no authority may assume punitive powers by implication, particularly in the



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absence of an express statutory provision authorizing such measures. In the instant case, while the Appellant may have exhibited a lapse in professional skepticism, it is evident that the fraudulent activities were orchestrated by the management of the Company, which had already been penalized. The Bench is of the view that findings of the investigation, though highlighting deficiencies in the Appellant's exercise of due professional care, do not establish willful misconduct or gross negligence of such gravity as to warrant disqualification or removal from the list of approved auditors.

15. Irrespective of the fact that the Impugned Order suffered from misapplication of law, nevertheless it was necessary for the relevant department of the Commission to have implemented the same till it was rectified or *set aside* as it was binding on all parties including the Commission. The Bench finds it alarming that despite the issuance of the Impugned Order, the Appellant's name continues to be included in the list of approved auditors as per **Circular No. 03 of 2024**, bearing reference No. **SMD/SE/2(322)/2022**, dated **February 06, 2024**. Despite of inaction on the part of relevant departments of the Commission, the Appellant, in good faith, refrained from acting as an auditor in compliance with the Impugned Order, notwithstanding that its name remains on the approved list.

16. In light of these considerations, the Impugned Order is found to be devoid of legal merit, lacking both statutory basis and enforceability, and therefore, while admitting the instant appeal we hereby *set aside* the Impugned Order.



(Akh Saeed)
Chairman



(Zeeshan Rehman Khattak)
Commissioner

Announced on:

17 APR 2025