



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
(Securities Market Division)  
Public Offering And Regulated Persons Department

127

File No. 1(7) SMD/PRPD/LSE/2016

April 25, 2016

**Naveed Zafar Ashfaq Jaffery & Co Chartered  
Accountants**

Senior Partner, 201-Regency Plaza,  
M.M. Alam Road,  
Gulberg-II,  
Lahore.

**Subject: ORDER IN RESPECT OF SHOW CAUSE NOTICE DATED FEBRUARY 25,  
2016 BEARING NO. 1(7)SMD/PRPD/2016**

Please find enclosed herewith a copy of order in the title matter for your record and necessary action.

(Muhammad Farooq)  
Additional Director (PRPD)

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Securities and Exchange Commission of Pakistan  
Securities Market Division  
Public offering and Regulated Persons Department

128

Through Courier

Before the Executive Director (PRPD)  
In the matter of Show Cause Notice Issued To Naveed Zafar Ashfaq Jaffery & Co  
Chartered Accountants

Date of Hearing

March 04, 2016

Present at the Hearing

Representing Naveed Zafar Ashfaq Jaffery & Co  
Chartered Accountants

(i) Mr. Shahid Mohsin Shiekh

Authorized Representative

Assisting the Executive Director/HOD (PRPD)

(i) Mr. Nasir Askar

Director (PRPD)

(ii) Mr. Sabeel Ahmed

Management Executive (PRPD)

**ORDER**

This Order shall dispose of the proceedings initiated through Show Cause Notice bearing No. 1(7)SMD/PRPD/2016 dated February 25, 2016 ("SCN") served to M/s Naveed Zafar Ashfaq Jaffery & Co Chartered Accountants ("**Respondent**") by the Securities and Exchange Commission of Pakistan ("**Commission**") under section 22 of the Securities and Exchange Ordinance, 1969 ("**Ordinance**")..

2. Brief facts of the case are that the Commission in exercise of the its power under subsection (1) of section 6 of the Ordinance read with rule 3 and rule 4 of the Stock Exchange member (Inspection of Books and Records) Rules, 2001 ("**Inspection Rules**") ordered an inspection of the books and records of Harvest Smartrend Securities (Pvt.) ("**HSPL**") who was a trading right entitlement certificate ("**TREC**") holder of the then Lahore Stock Exchange ("**LSE**") and registered with the Commission as a broker under Brokers and Agents Registration Rules, 2001 ("**Brokers Rules**"). The TREC of HSPL was forfeited by the then LSE vide notice dated July 03, 2015 under Regulation 2(A) (1) of the General Rules and Regulations of LSE.

3. The Inspection team submitted the report ("**Inspection report**") on July 31, 2015 which highlighted irregularities in calculation of net capital balance ("**NCB**") of HSPL as on June 30, 2014 and *prima facie*, it appeared that NCB was not calculated in accordance with the Third Schedule of the Securities and Exchange Rules, 1971 ("**SE Rules**").

4. In terms of Rule 2(d) of the SE Rules read with Clause 2.2 of the Regulations Governing Risk Management of the then Lahore Stock Exchange ("**LSE Regulations**"), the NCB is to be calculated in accordance with the Third Schedule to the SE Rules. Moreover,

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Securities and Exchange Commission of Pakistan  
Securities Market Division  
Public offering and Regulated Persons Department

129

Continuation sheet 2

the NCB Certificate is required to be duly audited/verified in terms of Clause 2.2 (c) of the then LSE Regulations which provides that:-

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

5. The Inspection report highlighted that the duly audited/verified NCB as on June 30, 2014 was overstated by Rs. 7.710 million by including shares of the then LSE amounting to Rs. 7.710 million in the NCB in contravention of SE Rules.

6. 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 on March 04, 2016. Mr. Shahid Mohsin Sheikh, partner of the Respondent, authorized representative of the Respondent (**Representative**) attended the hearing on behalf of Respondent through video conferencing from SECP Lahore. The written response to the SCN was received by the Commission on March 09, 2016. The following stance was taken by the Respondent in its written response to the SCN:

*(a) Pursuant to the promulgation of the Stock Exchanges (Corporatization, Demutualization and Integration Act, 2012 on May 9, 2012, the ownership in the Stock Exchanges has been segregated from the right to trade on the exchanges. Therefore, the membership card has now been replaced by:*

*a) Shares in the exchange; and*

*b) Trading Right Entitlement Certificate (TREC)*

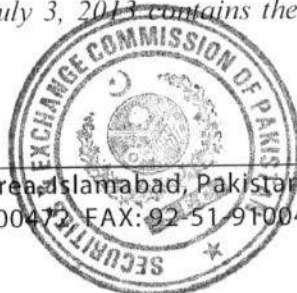
*Each membership card holder has received 843,795 shares of LSE along with a TREC. These shares are classified as 'Available for Sale' by the client and effect of any subsequent measurement of their fair value is recognized in accordance with the requirements of IAS 39. Further, the TREC issued to the original membership card holder is separately identified as an intangible asset under the requirements of IAS 38.*

*(b) LSE shares held by Harvest Smartrend have been partly sold in the market which indicates that these shares are being treated as liquid assets held by the Brokerage Houses and may be used in the settlement of any trade related or other liability.*

*(c) There has been no specific guidance on the accounting treatment or the treatment for the purpose of NCB by the SECP in respect of the unusual and one-off transactions referred to in Para 1 above. Given the unusual nature of these shares, they warranted some public clarification/guidance in the manner they are to be treated both in the accounts as well as for the purposes of NCB.*

*(d) In the absence of specific guidance, a reference was made verbally to the Internal Auditor of LSE, who advised that the shares may be included in computation of NCB as it appears to be the practice being followed by other Brokerage Houses. According to him, there had been no clarification from the SECP in this regards.*

*(e) The clarification/guidance issued by SECP on July 3, 2013 contains the following para with regards to securities:*



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Securities and Exchange Commission of Pakistan  
Securities Market Division  
Public offering and Regulated Persons Department

130

Continuation sheet 3

(a.) Details regarding securities on exposure list: To calculate value of investment in listed securities in the name of brokerage house, the investment made in tradable listed securities is to be included.

(b.) Further, while giving illustrations of the 'Other Assets' which are to be excluded, the following are mentioned:

"The current assets item not prescribed in Third Schedule of SEC Rules should not be included for the purpose of calculation of NCB, for instance:

1. Loan and Advance to employees
2. Loan and Advances to associated companies
3. Income tax receivable/refundable
4. Commission receivable
5. Advance to suppliers or advance to customers
6. Markup or interest receivable o loan balance
7. Prepayments
8. Deposits for office rent, telephone etc."

It may kindly be noted that it does not include shares issued by the Stock Exchanges as part of the demutualization process.

- (f) The guidance and clarification make no mention of the shares issued by the Stock Exchanges to the members as part of the demutualization process. It would have been beneficial to the members and would set the prescribed treatment for the auditors, had the Commission made a reference to the shares issued by the stock exchanges in the list of assets to be excluded from the NCB. The absence of which leaves the matter open to interpretation.

We are hopeful that the above adequately explains the position regarding the treatment of the LSE shares by Harvest Smartrend (Pvt.) Limited and assure the Commission and it has never been our intention or practice to violate any Rules and Regulations laid down by the Commission."

7. The Representative during the hearing also adopted the above stated stance. In the end, the Representative assured that they would ensure compliance with the applicable laws, rules and regulations in letter and spirit.

8. I have heard the arguments presented by the Representative at length during the hearing. Additionally, I have perused the available record and written response filed by the Respondent.

9. In its written response and verbal submissions, the Respondent quoted the following reasons for including the shares of then LSE while calculating NCB:

- (i) The HSPL sold a part of the then LSE shares in the market which indicated that these shares were liquid in nature.



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131

**Securities and Exchange Commission of Pakistan**  
**Securities Market Division**  
**Public offering and Regulated Persons Department**

*Continuation sheet 4*

(ii) There was no specific guidance from the Commission or the then LSE with respect to treatment of LSE shares for NCB purposes.

(iii) The internal auditor of LSE also advised HSPL that the LSE shares could be included for computation of NCB.

10. I have considered the submission of the Respondent. The Commission has issued detailed guidelines on July 3, 2013 for calculation of NCB ("**Guidelines**"). With regard to inclusion of LSE shares in NCB, the Guidelines clearly states that only listed shares could be included. As far as the lack of specific guidance from the Commission is concerned, the Respondent should have approached the Commission for seeking any guidance in the matter, if required. Further, the Respondent was asked to provide documentary evidence with regard to the advice sought from the then LSE. However, the same could not be provided by the Respondent.

11. The auditor is considered as a professional service provider and must ensure compliance with the law. Hence, the auditor is required to ensure that due verification/audit process has been carried out in certifying the calculated NCB.

12. Based on the foregoing discussion, I am of the considered view that the Respondent did not exercise the requisite due diligence while rendering professional services as mentioned in the then LSE Regulations. The violation attracts penal provision under section 22 of the Ordinance. However, I am not imposing any penalty on the Respondent in view of the following reasons:


- (i) The Respondent admitted that this is the only instance of noncompliance which occurred due to incorrect understanding of the guidelines issued by the Commission.
- (ii) The Respondent has assured that they would exercise the requisite due diligence while rendering professional services in future.

The Respondent is however strictly warned to be careful in future while discharging its professional obligations as an auditor.

13. 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.



**Announced on April 25, 2016**  
Islamabad.

  
**Asif Jalal Bhatti**  
Executive Director (PRPD)