



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department- I

Adjudication Division

ORDER	
Name of Company:	M/s. Highnoon Laboratories Limited
Show Cause Notice No. and Date:	Adj-I/ARN/47/2024-787 dated December 31, 2024
Name of Respondent/Auditor:	1. M/s. EY Ford Rhodes, Chartered Accountants 2. All partners of M/s. EY Ford Rhodes, Chartered Accountants
Date of Hearing(s):	(i) January 24, 2025; (ii) January 29, 2025; and (iii) April 10, 2025.
Case represented by:	(i) Mr. Saad Amir – Legal Counsel from M/s. Mohsin Tayebaly & Co., Corporate Legal Consultants; (ii) Mr. Omer Chughtai, Partner EY Ford Rhodes, Chartered Accountants; and (iii) Shaikh Salman, Partner, EY Ford Rhodes, Chartered Accountants (as the Authorized Representatives)
Provisions of law involved:	Section 512(2) of the Companies Act, 2017, Regulation 36(3) of the Listed Companies (Code of Corporate Governance) Regulations, 2019 (the CCG Regulations) and Regulation 6(i) of the Auditors (Reporting Obligations) Regulations, 2018 (the Reporting Regulations) read with Regulation 37 of the CCG Regulations and Regulation 7 of the Reporting Regulations
Date of the Order:	April 24, 2025

This Order shall dispose of the proceedings initiated by the Securities and Exchange Commission of Pakistan (the “Commission”) through Show Cause Notice No. Adj-I/ARN/47/2024-787 dated December 31, 2024 (“SCN”) issued to all the partners of M/s. EY Ford Rhodes, Chartered Accountants (the “Auditors/Respondents/Audit Firm”), being the statutory auditor of M/s. Highnoon Laboratories Limited (the “Company”) for the relevant period, under Section 512(2) of the Companies Act, 2017 (the “Act”), Regulation 36(3) of the Listed Companies (Code of Corporate Governance) Regulations, 2019 (the “CCG Regulations”) read with Regulation 37 thereof and Regulation 6(i) of the Auditors (Reporting Obligations) Regulations, 2018 (the “Reporting Regulations”) read with Regulation 7 thereof on account of contravention of requirements of sub-regulation (3) of Regulation 36 of the CCG Regulations and sub-regulation (i) of Regulation 6 of the Reporting Regulations.

2. Sub-Regulation (3) of Regulation 36 of the CCG Regulations states that it is **mandatory** for the statutory auditors of the company to highlight any non-compliance with the CCG Regulations in their review report on the Statement of Compliance to be published and circulated by the company along with their annual report setting out the status of compliance with the requirements of CCG Regulations. Moreover, sub-regulation (i) of Regulation 6 of the Reporting Regulations read with Annexure VI thereof clearly require the statutory auditors to highlight any non-compliance with the CCG Regulations in their review report on such Statement of Compliance by the Company.

3. Brief facts of the case are that the review of the annual audited financial statements for the years ended December 31, 2021 (FY 2021) and December 31, 2022 (FY 2022) revealed that the Auditors were engaged as the statutory auditors of the Company; whereby they gave an unqualified/unmodified opinion in their Review Report on the Company’s Statement of Compliance with the CCG Regulations. However,

24-04-2025

as per the records of the Commission, Ms. Nael Najam's election as an independent director on the Board of the Company in its Extraordinary General Meeting (EOGM) held on August 31, 2021 was in contravention of the requirements of sub-section (2) of Section 166 of the Act due to the fact of her evident ineligibility to be appointed as an independent director as prior to the said election, she, in concert with her family/group, held more than 10% shareholding in an associated company namely Route 2 Health (Pvt.) Ltd. (R2H), and that the annual accounts of the Company as well as those of R2H for the years 2018 to 2022 revealed that R2H has been in a material business relationship with the Company. Additionally, Ms. Nael Najam, despite the fact that she did not meet the requirements of Regulation 27(1)(ii) of the CCG Regulations due to her ineligibility to be appointed as the independent director, was also appointed as Chairman of the Board's Audit Committee in clear contravention of Regulation 27 of the CCG Regulations.

4. The Auditor issued the Review Reports on the Statement of Compliances with the CCG Regulations for FY 2021 and FY 2022 but failed to highlight the aforesaid non-compliances and clearly fell short of the requirements of Regulation 36(3) of the CCG Regulations as well as those of Regulation 6(i) of the Reporting Regulations. In order to probe the matter, the Commission vide email dated October 22, 2024 sought explanation from the Auditor on the aforesaid non-compliances with the requirements of the CCG Regulations and Reporting Regulations, to which the Auditor responded vide email dated November 11, 2024, *inter alia*, stating:

- a) *SECP's view that the election of Ms. Nael Najam by the members of the company allegedly in violation of section 166(2)(c) of the Act constitutes a non-compliance with the CCG Regulations, is not technically correct, and that too one which was required to be flagged by the Company's Board in its Statements of Compliance under Regulations 36(1) for the years 2021 and 2022.*
- b) *Further, the SECP's view that there has been violation of Regulation 27(1)(ii) of the CCG Regulations by the Company's Board, is also not technically correct, insofar it is not upto the Board to question the legality of the election, or "independent" status of the director when appointing a chairman of the audit committee. The Board is simply to ensure that the chairman of the said committee is a director who has been elected as an independent director by the members of the company under sections 166 and 159 of the Act. Given that Ms. Najam was clearly so elected (whether correctly or incorrectly), it cannot be said that there has been a non-compliance with Regulations 27(1)(ii) of Regulations. Furthermore, it cannot be said that such an alleged non-compliance also constitutes a separate non-compliance with Regulation 36(1), insofar as the Board simply has to state the composition of the audit committee in its Statement of Compliance, not opine on the legality of the committee chairman's appointment.*
- c) *Given that there has been no non-compliance with the CCG Regulations by the Company in general, and particularly so in preparing its Statements of Compliance for the years 2021 and 2022, it follows that there has also been no such non-compliance by EYFR under Regulation 36(3), in reviewing and certifying said Statements of Compliance.*

5. Since the aforesaid explanation by the Auditor was not found to be satisfactory and contrary to the facts which clearly showed contraventions with the provisions of the CCG Regulation, SCN was issued to the Audit Firm as well as all of its partners/the Respondents calling upon them to show the cause in writing as to why a penal action may not be taken against them for the non-compliances of the CCG Regulations and the Reporting Regulations. In response to the SCN, M/s. Mohsin Tayebaly & Co., the 'Legal Counsel' of the Auditors vide letter dated January 21, 2025 submitted, *inter alia*, as under:

- (i) "The allegations raised against our client in the show cause notice relates to a purported and separate violation of Section 166 of the Act; however, the SCN contains no details/records on the basis of which was claimed that Section 166 of the Act was violated by the Company or as to when such a violation was found to have been committed by the Company.

- (ii) If it is assumed for the sake of argument that the Board must ensure that an independent director appointed to the audit committee is indeed "independent" as per the criteria stipulated under Section 166(2) of the Act and must state to such extent in the Statement of Compliance, it is neither the scope of an auditor's obligations under the law nor within his professional competence to independently opine on or certify such matters, which are clearly legal in nature.
- (iii) The Commission's suggestion in the SCN that our client has allegedly violated Regulation 36(3) of the CCG Regulations in issuing its review reports on the Company's Statement of Compliance for FY 2021 and FY 2022 is misplaced.
- (iv) There is nothing in the CCG Regulations or Annexure A thereof which requires a company to state in its Statement of Compliance as to whether independent directors have been lawfully elected to its Board of Directors under Section 166 of the Act.
- (v) The texts of format of Statement of Compliance (prescribed under Annexure A to the CCG Regulations) simply requires the Board to state the composition of the Board as well as that of its committees but does not require to opine on the legality of the Board members. It would be incorrect to claim that election of Ms. Nael by the Company allegedly in violation of Section 166(2)(c) of the Act constitutes a non-compliance with the CCG Regulations.
- (vi) It appears that the Commission considers that Ms. Nael being major shareholder of R2H, an associated company or being niece of Mr. Tausif Khan, Director of the Company could not have been considered to be an independent director of the Company. However, the ICAP's Code of Ethics for Chartered Accountants does not envision that being a niece poses a threat to independence of a director unless she is dependent.
- (vii) Given that there has been no non-compliance with the CCG Regulations by the Company in general and particularly so in preparing its Statements of Compliance for FY 2021 and FY 2022, it follows that there has also been no such non-compliance by the Respondent under Regulation 36(3) in reviewing and certifying the said Statements of Compliance.
- (viii) A review is limited primarily to inquiries from the company's personnel and review of various documents prepared by the company to comply with the CCG Regulations."

6. In order to provide the Respondents an opportunity of personal representation and to meet the ends of justice, a hearing in the matter was fixed for January 24, 2025; however, Mr. Saad Amir of M/s. Mohsin Tayebali & Co., Legal Counsel, being the Authorized Representative of the Respondents, requested for rescheduling the same as they have been facing internet connectivity issues during the online hearing session. Another hearing in the matter was fixed for January 29, 2025, which was attended by Mr. Saad Amir, Legal Counsel, Mr. Omer Chughtai and Shaikh Salman, Partners of the Audit Firm as the **Authorized Representatives** of the Respondents. The Authorized Representatives reiterated the submissions and arguments presented in the earlier written response dated January 21, 2025.

7. Subsequent to the hearing, the Respondents vide email dated January 29, 2025 shared a copy of the International Standard on Review Engagements 2400 in support of their contentions with regards to the limitation of the Review of Statement of Compliance by the Auditors in the instant matter and how they placed reliance upon the statements made by the management of the Company.

8. In order to conclude the proceedings in an efficacious manner, final hearing in the matter was held on April 10, 2025 which was attended by Mr. Omer Chughtai and Shaikh Salman as the "**Authorized Representatives**" on behalf of the Respondents. During the course of the hearing, the Authorized Representatives, while not pressing forward the technical grounds taken in their earlier submissions and during the earlier hearing with regards to lack of applicability and responsibility of the Auditors in terms

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of undertaking a detailed effort for verifying compliance with the provisions of Section 166(2) of the Act, admitted the omissions and made additional submissions, summarized as under:

- (i) The said omission in the review report was unintentional and made without any *mala fide* intent. The Authorized Representatives requested that a lenient view may be taken in the matter. The Authorized Representatives reaffirmed their commitment on behalf of the Audit Firm to ensure regulatory compliance and continued improvement in internal controls and procedures.
- (ii) The Engagement Partner, who reviewed the Statement of Compliance, is no longer associated with the Audit Firm.
- (iii) In order to prevent recurrence of such issue, the Audit Firm has taken necessary proactive measures including strengthening its Standard Operating Procedures (SOPs) for reviewing the Statement of Compliance with the CCG Regulations and to ensure implementation of the same by all the relevant teams across the Audit Firm.
- (iv) The Audit Firm instead of asserting the jurisdictional issues relating to the breach of Section 166 of the Act, acknowledged its oversight in the matter and assured adherence to the requirements of the applicable provisions of the law, in future with diligence.

9. Despite the aforesaid contraventions of the law, the Auditor failed to highlight any non-compliance of the CCG Regulations in his review report. Therefore, the Auditor has contravened the requirements of Regulation 36(3) of the CCG Regulations and Regulation 6(i) of the Reporting Regulations.

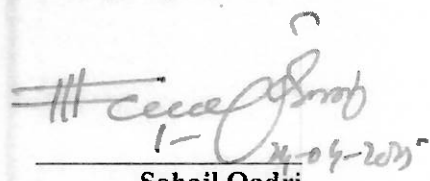
10. I have reviewed the facts of the case and also considered the verbal and written submissions made by the Auditors and the Authorized Representatives during the proceedings. At this juncture, it is important to discuss the following legal and factual elements:

- i) Prior to her election as an independent director in EOGM of the Company held on August 31, 2021, Ms. Nael Najam, in concert with her family/group, held more than 10% shareholding in an associated company, namely; R2H. Moreover, it is evident from the annual accounts of the Company as well as those of R2H for the years 2018 to 2022 that R2H has been in a material business relationship with the Company. Therefore, a clear contravention with the requirements of the law existed with the Company and the BoD of the Company failed to identify the same in its Statement of Compliance with the CCG Regulations.
- (ii) It is observed that sub-regulation (3) of Regulation 36 of the CCG Regulations, in the overall context of Regulation 36, mandates the auditors to highlight any non-compliances with the CCG Regulations in their Review Report on the Statement of Compliance by the Company which is also required to be certified by the Auditors as per provision of sub-regulation (2) thereof. This requirement is fundamental in ensuring that companies adhere to good corporate governance practices, promoting transparency through comprehensive and regular reporting thereby supplementing investors' confidence and regulatory compliance.
- (iii) Similarly, Regulation 6(i) of the Reporting Regulations requires auditors to review and report on the Statement of Compliance with the CCG Regulations as per the required format which is abundantly detailed. The Regulations, when seen in context of Regulation 36 of the CCG Regulations, establish that the review should cover compliance with corporate governance requirements which is a comprehensive framework requiring detailed effort of review. However, in the instant matter the Auditors fell short of highlighting the non-compliances of the Company, thereby contravening both the CCG Regulations and Reporting Regulations.

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- (iv) It is also important to observe that the Auditor's obligation to report/highlight non-compliances with requirements of CCG Regulation as a whole and specifically in matters like ascertaining independence of director, remains paramount as the shareholders are completely dependent upon their reporting without having any direct access to such information. While the Auditor may rely upon the Company's assertions, submissions and documentary evidence to a certain extent, it is expected of them to conduct sufficient independent inquiry to verify the accuracy of such assertions. It is observed that in the instant matter by placing reliance solely on information provided by the Company without conducting own assessment and verification, the Auditors could not undertake sufficient due diligence required for carrying out the review of the SOC.
- (v) It is observed to emphasis that external auditors play a crucial role in providing assurance to all types of stakeholders, including investors and regulators about the accuracy and reliability of financial and governance-related disclosures; therefore, highlighting non-compliance in an effective and timely manner is crucial for maintaining investor confidence and ensuring transparency in corporate governance.

11. In view of the aforesaid, the contravention of Regulation 36(3) of the CCG Regulations and Regulation 6(i) of the Reporting Regulations have been established beyond any doubt, which attract a penal action in terms of Regulations 37 of the CCG Regulations and Regulation 7 of the Reporting Regulations read with Section 512(2) of the Act. I, with due consideration to Auditor's admission of the aforesaid omission and firm commitment to ensuring future compliance by carrying out necessary modifications in the SOPs relating to Review of the Statement of Compliance with the CCG Regulations, I, in terms of powers conferred under Section 512(2) of the Act read with Regulation 37 of the CCG Regulations vide SRO 1545(I)/2019 dated December 06, 2019, conclude the instant proceeding with a strict **Warning** to the Respondents and advise them to exercise careful assessment and due diligence in ensuring compliance with regulatory requirements in the future, in true letter and spirit.


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Sohail Qadri
Director / Head of Department
Adjudication Department-I

Announced:
April 24, 2025
Islamabad

