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**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN**  
**Adjudication Department- I**  
**Adjudication Division**

*Before*

**Shahzad Afzal Khan, Director/Head of Department (Adjudication-I)**

*In the matter of*

**M/s. BDO Ebrahim & Co., Chartered Accountants**

Number and date of Show Cause Notice (SCN) ID/Enf/TPLLife/2019/230 dated April 19, 2024

Date(s) of Hearing: September 27, 2024

Present at the Hearing(s): Mr. Zulfikar Ali Causer, Engagement Partner  
Mr. Zulfikar Jaffer Ali, Partner  
(Authorized Representative)

**ORDER**

**Section 48(2) & (4) of the Insurance Ordinance, 2000 read with Section 249(3) and Section 253(1) of the Companies Act, 2017**

.....

This Order shall dispose of the proceedings initiated against **M/s. BDO Ebrahim & Co., Chartered Accountants (the Auditor and/or the Audit Firm and/or the Respondent)** under Section 48(2) & (4) of the Insurance Ordinance, 2000 (**the Ordinance**) read with Section 249(3) and Section 253(1) of the Companies Act, 2017 (**the Companies Act**) vide Show Cause Notice dated April 19, 2024 (**the SCN**). The Audit Firm was appointed as the Statutory Auditor of TPL Life Insurance Limited (**the Company**) for audit of its Annual Accounts and Regulatory Returns for the year ended December 31, 2022 (**FY 2022**).

2. Brief facts of the case are that during examination of the Annual Audited Accounts and Regulatory Returns of the Company for FY 2022, it has been observed that the Company has contravened the provisions of Section 35(3) read with Rule 14(3) of the Insurance Rules, 2017 (**the Rules**) and Section 11(1)(c) of the Ordinance, as its 'Conventional Life Fund' & 'Accident & Health Takaful Business Fund' did not comply with the requirement of maintaining surplus of admissible assets over liabilities other than policyholders' liabilities equal to or greater than amount of policyholders' liabilities. However, the Audit Firm gave unmodified opinion in the Auditor's Report dated February 23, 2023 on the Accounts of the Company for FY 2022. Thus, the Auditors, prima facie, failed to bring out the material facts about the aforesaid solvency issues of the Company in their Report on the Annual Accounts and Regulatory Returns for FY 2022.



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3. The aforesaid matter was taken up by the relevant department of the Commission with the Audit Firm, who made the following submissions vide letter dated January 19, 2024 January 19, 2024:

*"Commission vide its letter issued on June 8, 2018 provided approval to the Company to maintain solvency margin under Rule 14(2)(a) of the Insurance Rules 2017 on aggregate basis instead of each individual fund....As the solvency margins in aggregate were maintained in accordance with the requirements of Section 35 in aggregate, no adverse comment was included by us in our auditor's report on the financial statement and the regulatory returns for the year ended December 31, 2022.".....*

*"However, if it is the esteemed Commission's view, notwithstanding the approval given under letter dated June 8, 2018, that each Statutory Fund should also have an excess of Admissible Assets, then we shall make a recommendation to the Company to comply with this interpretation and shall ensure its compliance in future audits carried out by us..."*

4. In view of the foregoing, the Auditor, *prima facie*, has failed to comply with the requirements of Section 48(2) & (4) of the Ordinance read with Section 249(3) and 253(1) of the Companies Act.

5. While taking cognizance in the matter, the SCN was issued to the Auditor, calling upon it to show cause in writing within fourteen (14) days of the date thereof as to why penalty may not be imposed on it for contravening the aforesaid provisions of the law.

6. In response to SCN, the Auditor vide letter dated May 15, 2024 submitted its reply, the relevant extracts of which are reproduced as under:

(Quote)

*"Our comments offered in the ensuing paragraphs are in continuation of our comments already furnished on the subject of this letter, in our earlier submission dated January 19, 2024.*

### **Summary of Comments**

*We would like to reiterate that the aggregate solvency margin requirements of the Ordinance were duly complied with. On this basis, no adverse comment was included in our auditor's report on the financial statements and the regulatory returns for the year ended December 31, 2022.*

*Even if we consider the requirement to maintain surplus of admissible assets over policyholder liabilities in each statutory fund, notwithstanding the approval to maintain solvency margin in aggregate, this would not have resulted in a modification to our auditor's report thereon, as the solvency margin requirements are met on an aggregate basis. This would represent a Non Compliance with Laws and Regulations (NOCLAR) and we are not required to modify our opinion in respect of NOCLAR if the matter does not have a direct effect on the determination of material amounts and disclosures in the financial statements. Accordingly, the reports are in accordance with Section 249(3) of the Companies Act, 2017 and the provisions of Section 253 of the Companies Act, 2017 are not invoked.*

## Material Facts

We would like to reiterate that the aggregate solvency margin requirements of the Ordinance were duly complied with. On this basis, no adverse comment was included in our auditor's report on the financial statements and the regulatory returns for the year ended December 31, 2022.

The Commission vide its letter issued on June 8, 2018 provided approval to the Company to maintain solvency margin under Rule 14(2)(a) of the Insurance Rules 2017 on aggregate basis instead of each individual fund. This calculation is presented below:

	Aggregate December 31, 2022 Rupees in '000'
Total Net Admissible Assets	330,637
Minimum Solvency Requirement	
Shareholder's Fund	165,000
Policyholders' Liability	119,389
Solvency Margins	37,314
	321,703
Excess in Net Admissible Assets over Minimum Requirements	8,934

Based on the information presented above, the aggregate solvency margin requirements of the Ordinance were duly complied with. On this basis, no adverse comment was included in our auditor's report on the financial statements and the regulatory returns for the year ended December 31, 2022.

We would further like to reproduce Section 35(3) of the Insurance Ordinance 2000:

"A life insurer shall, in each statutory fund maintained by it for the conduct of business other than investment linked business, maintain at all times a surplus of admissible assets in Pakistan over liabilities in Pakistan other than policyholder liabilities, equal to or greater than the amount of policyholders liabilities calculated in accordance with such principles as may be prescribed by the Commission."

It was our understanding that the said Approval was also granted for the solvency margin calculation under Section 35 (3) and on aggregate basis, there is no deficit. The deficit over the Policyholders' Liability occurred under Conventional Life business by an amount of Rs.126, 969 million and Accident and Health Takaful Business by an amount of Rs. 0.349 million. The Company has a surplus balance of Rs.338,489 million under the Shareholders' Fund. As such, sufficient surplus was available in aggregate in



*the Shareholders' Fund to cater to any negative balance in other statutory funds even after taking into account minimum solvency requirement for Shareholders' Fund.*

*Ordinarily, transfers from Shareholder's Fund to other statutory funds are made from time to time based on advice of the appointed Actuary. Subsequent to the year end, the Company has made such transfers to comply with the requirements.*

*Based on the Show Cause Notice, it is clear that the esteemed Commission's view is that notwithstanding the approval given under letter dated June 8, 2018, that each Statutory Fund should also have an excess of Admissible Assets over Policyholder Liabilities (not only in aggregate). Accordingly, we have also applied the same interpretation in assessing the solvency requirements for the year ended December 31, 2023 and have ensured that there is an excess of net admissible assets over policyholder liabilities in each statutory fund as well.*

## **2. AUDITOR'S RESPONSIBILITIES IN RESPECT OF MATTERS OF NON-COMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR)**

*Under the requirements of International Standards on Auditing 250 (Revised), the auditor is required to ICAP Code of Ethics does not require practicing chartered accountants to seek or perform procedures to identify acts of NOCLAR at their clients when providing professional services to the clients.*

*While performing audits of financial statements, we are required under ISA 250 (Revised), Consideration of Laws and regulations in an Audit of Financial Statements, to:*

- (a) obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;*
- (b) perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements.*

*Therefore, when encountering or becoming aware of NOCLAR, we are required to assess the laws and regulations that generally have financial impact as well as laws and regulations that are related to operations of the audit client.*

*Rectifying, remediating or mitigating the adverse consequences of identified or suspected NOCLAR or deterring the commission of NOCLAR are the sole responsibility of the client's management, with the oversight of TCWG. Paragraph R360. 9 of the ICAP Code 2019 only requires the auditor to advise the audit client to take appropriate and timely action in that regard, if they have not already done so. We are not required to modify our opinion in respect of NOCLAR if the matter does not have a direct effect on the determination of material amounts and disclosures in the financial statements.*

## **3. FINAL SUBMISSION**

*Based upon above referred explanations, in our humble view, clearly demonstrate that there has been no intended contravention of IFRSs or ISAs. Further, the matter would not have resulted in a modification to our auditor's report as it represents a NOCLAR. We, hereby, respectfully request you to take a lenient view and consider our comments and dispose the Show Cause Notice after issuing a warning as the matter has already been addressed in subsequent audits in accordance with the interpretation preferred by*

*the Commission and has primarily arisen owing to a different interpretation regarding the requirement to maintain solvency margin in aggregate."*

(Unquote)

7. In order to provide the Auditor/Audit Firm an opportunity of personal representation, hearing in the matter was fixed for September 27, 2024. The hearing was attended by Mr. Zulfikar Ali Causer, Engagement Partner along with Mr. Zulfikar Jaffer Ali (Partner)/Authorised Representatives of the Respondent Audit Firm (**the Representatives**). The Representatives reiterated the submissions and arguments made earlier in the written reply.

8. Subsequent to the hearing, the Auditor made further submissions in the matter as under:

(Quote)

*"As per practice prevailing in the life Insurance business, any short-fall within any statutory fund in the minimum required net admissible assets is addressed by transfer from shareholder fund to statutory fund. The deficit over the Policyholders' Liability occurred under Conventional Life business by an amount of Rs.126,969 million and Accident and Health Takaful Business by an amount of Rs. 0.349 million. The Company has a surplus balance of Rs.338,489 million under the Shareholders' Fund. As such, sufficient surplus was available in aggregate in the Shareholders' Fund to cater to any negative balance in other statutory funds even after taking into account minimum solvency requirement for Shareholders' Fund. Therefore, there is no material non-compliance as there was excess solvency margins available in the shareholder fund and it is only a matter of presentation through a transfer.*

*Based on the Show Cause Notice, it is clear that the esteemed Commission's view is that notwithstanding the approval given under letter dated June 8, 2018, that each Statutory Fund should also have an excess of Admissible Assets over Policyholder Liabilities (not only in aggregate).*

*Accordingly, we have also applied the same interpretation in assessing the solvency requirements for the year ended December 31, 2023 and have ensured that there is an excess of net admissible assets over policyholder liabilities in each statutory fund as well. Accordingly, the matter is already remediated in the next set of financial statements.*

*Without prejudice to our foregoing submissions, the auditing standards regarding reporting of non-compliance of laws and regulations (NOCLAR) in an audit of financial statements coupled with the auditing standard on emphasis of matter paragraphs and other matter paragraphs in the independent auditors report, do not require the auditors to modify the audit report on the matters of immaterial NOCLAR. Accordingly, there was no material misstatement with respect to users of financial statements and audit report.*

*Based upon above referred explanations, in our humble view, clearly demonstrate that there has been no intended contravention of IFRSs or ISAs. Further, the matter would not have resulted in a modification to our auditor's report as it represents a NOCLAR.*

*We, hereby, respectfully request you to take a lenient view and consider our comments and dispose the Show Cause Notice after issuing a warning as the matter has already*





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*been addressed in subsequent audits in accordance with the interpretation preferred by the Commission and has primarily arisen owing to a different interpretation regarding the requirement to maintain solvency margin in aggregate. Further, the matter is clearly not material to the financial statements and would not have resulted in a modification to our audit opinion."*

9. Before proceeding further, it would be logical and appropriate to address key legal issues and questions arising in the instant matter, as discussed hereinbelow:

- a. **Can the Auditor rely on the approval from the Commission to maintain solvency margins on an aggregate basis without taking into account basic solvency requirement and does this relieve them of the obligation to report on individual statutory funds' solvency?**

No, the Auditor cannot fully rely on the Commission's approval to maintain solvency margins on an aggregate basis without taking into account basic solvency requirement in respect of individual statutory funds. The Commission's approval explicitly states that it does not discharge the Company from the basic solvency requirements outlined in Section 35(3) of the Ordinance. Therefore, the Auditor is still required to ensure that each statutory fund complies with the solvency requirements and must report any deficiencies accordingly.

- b. **Is the Auditor required to modify their opinion if they identify non-compliance with laws and regulations (NOCLAR) that does not have a direct effect on material amounts in the financial statements?**

Yes, while the Auditor may argue that modification is unnecessary for instances of NOCLAR not affecting material amounts, they are still required to disclose such non-compliance if it indicates a broader issue of solvency. The fact that insolvency exists in statutory funds represents a material risk that could impact stakeholders. The Auditor's obligation under Section 249(3) of the Companies Act requires them to report on significant non-compliance issues, regardless of their direct impact on amounts.

- c. **Did the Auditor fulfill their responsibilities under Section 249(3) of the Companies Act when they did not report the insolvency of the 'Conventional Life Fund' and 'Accident & Health Takaful Business Fund'?**

No, the Auditor did not fulfill their responsibilities under Section 249(3) of the Companies Act. by failing to report the insolvency of these statutory funds in their Auditor's Report. They neglected to provide a comprehensive assessment of the Company's financial position, thus violating the requirement to affirm the completeness and accuracy of the financial statements. This lack of reporting on material facts compromises the integrity of the audit process.

- d. **What is the significance of the solvency margin requirement outlined in Section 35(3) of the Ordinance for the Company and its statutory funds?**

The solvency margin requirement in Section 35(3) of the Ordinance is crucial because it ensures that a life insurer maintains sufficient assets to cover its liabilities, particularly those owed to policyholders. This requirement protects policyholders' interests and helps maintain the financial stability of the insurance company. If a company fails to meet this requirement in individual statutory funds,

it could lead to insolvency, jeopardizing the insurer's ability to fulfill its obligations.

**e. What factors should the Auditor consider when determining whether to modify their audit opinion regarding non-compliance observed during audit of a life insurer?**

The Auditor should consider several factors, including:

- (i) **Significance of Non-Compliance:** The significance of the non-compliance in relation to the overall financial statements.
- (ii) **Impact on Solvency:** How the non-compliance affects the Company's solvency and ability to meet obligations.
- (iii) **Stakeholder Interests:** The potential impact on stakeholders, including policyholders and shareholders.
- (iv) **Frequency and Intent:** Whether the non-compliance is a one-time occurrence or part of a broader pattern, and whether there was intent to deceive.
- (v) **Legal and Regulatory Requirements:** Obligations under applicable laws and regulations, including the need to report any significant findings.

**f. In light of the auditor's responsibilities under ISA 250 (Revised), how should the Auditor have approached the identification of non-compliance in the financial statements and regulatory returns?**

Under ISA 250 (Revised), the Auditor should have:

- (i) **Conducted thorough assessments** of compliance with laws and regulations that directly affect the financial statements and regulatory returns.
- (ii) **Identified and evaluated risks** of non-compliance, particularly regarding solvency requirements.
- (iii) **Gathered sufficient audit evidence** related to the Company's adherence to solvency regulations, including reviewing the solvency statements and relevant communications with the Commission.
- (iv) **Maintained documentation** of their findings and evaluations related to non-compliance, ensuring clarity in their reporting.

10. I have examined the facts of the case in light of applicable provisions of the law and have given due consideration to the written as well as verbal submissions and arguments of the Respondent Auditor/Authorised Representative and have observed as under:

**(i) Incorrect Interpretation of the Approval of the Commission to maintain Solvency Margin on Aggregate Basis:**

The Auditor has stated that notwithstanding the approval given under letter dated June 8, 2018, if it is the Commission's view that each Statutory Fund should have an excess of admissible assets, then they will make a recommendation to the Company to comply with this interpretation.

The aforesaid stance indicates that the Auditor has adopted an incorrect interpretation of the approval given to maintain solvency margin on aggregate basis. The fact of the matter is that the approval given to maintain solvency margin on aggregate basis in no way means that individual Statutory Funds of the Company are no more required to meet the basic solvency required under



Section 35(3) of the Ordinance. In fact, the approval has granted relaxation of maintaining solvency margin only on aggregate basis. The individual Statutory Funds are still required to separately meet the basic solvency stipulated under Section 35(3) of the Ordinance. The foregoing obligation was clearly identified in para 3 of the Commission's approval letter dated June 8, 2018; however, despite failure of the Company to discharge the said obligation, the Auditors' Report on the Annual Accounts and Regulatory Returns of the Company for FY 2022 did not bring out this material fact.

(ii) **Non-Reporting of Insolvency in 'Conventional Life Fund' and 'Accident & Health Takaful Business Fund' in Auditors' Report:**

The Auditor has stated that in accordance with the Commission's approval vide letter dated June 8, 2018 to maintain solvency margin on aggregate basis, the aggregate solvency margin requirements of the Ordinance were duly complied with. Therefore, no adverse comments were included in the Auditors' Report on the financial statements and the regulatory returns for FY 2022. The Auditor further stated that it was their understanding that the said Approval was also granted for the solvency margin calculation under Section 35 (3) and on aggregate basis, there is no deficit.

As per the Solvency Statement of the Company for FY 2022, the deficit of Rs.144.405 million in net admissible assets over minimum solvency requirement of Rs. 17.436 million occurred under 'Conventional Life Fund' and the deficit of an amount of Rs. 0.349 million in net admissible assets over minimum solvency requirement of Rs. 10.959 million existed in 'Accident and Health Takaful Business Fund' as on December 31, 2022.. It was made categorically clear in para 3 of the Commission's Letter dated June 8, 2018 grating the approval to maintain solvency margin on aggregate basis under Rule 14(2) of the Insurance Rules that "this approval to maintain solvency margins in aggregate under the Rules, calculated in accordance with Annexure III thereof, does not discharge the company from complying with the basic solvency requirement provided in Section 35 of the Insurance Ordinance, 2000". Therefore, the said Approval does not provide exemption from complying with the provisions of Section 35(3) read with Rule 14(3) of the Rules, which requires the Company to maintain surplus of admissible assets over its liabilities excluding policyholders liabilities equal to or greater than amount of policyholders' liabilities in each statutory fund as a basic solvency.

The Auditor has argued that there is sufficient surplus in Shareholders' Fund to enable the Company to meet the deficit in the aforesaid Statutory Funds but has admitted in his reply that deficient amount was transferred subsequent to the year end. Thus, despite contravention of the provisions of Section 35(3) read with Rule 14(3) and Section 11(1)(c) of the Ordinance in respect of 'Conventional Life Fund' and 'Accident and Health Takaful Business Fund' as at December 31, 2022, the Auditor did not highlight insolvency of both the Statutory Funds in the Auditors' Report on the Annual Accounts and Regulatory Returns of the Company for FY 2022.



(iii) **Non-Compliance of Section 249(3) of the Companies Act read with Section 48 of the Ordinance by the Auditor:**

Pursuant to Section 249(3) of the Companies Act, the Auditor was required to make out a report to the members of the company on the accounts and books of accounts of the Company and on every financial statement and on every other document forming part of such statements including notes and statements. Further, the Auditor in their Report on the Regulatory Returns of the Company for FY 2022, was required to, inter alia, affirm (a) whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of the audit. Since the treatment and implications of the approval of maintaining solvency margin on aggregate basis were misinterpreted by the Auditor, necessary information and explanation were not obtained in respect of insolvency of both the statutory funds reported in Solvency Statement (Form LI) as part of the Regulatory Returns for FY 2022; hence, the Auditors failed to comply with the requirements of Section 249(3) of the Companies Act read with Section 48(2) of the Ordinance.

(iv) **Modified Opinion on Non-Compliance with Laws & Regulations (NOCLAR) when Insolvency of two Statutory Funds is significant information for Policyholders:**

The Auditor has argued that he is not required to modify his opinion in respect of NOCLAR if the matter does not have a direct effect on the determination of material amounts and disclosures in the financial statements.

Under auditing standards, specifically ISA 250 (Revised), the Auditors are required to consider non-compliance with laws and regulations (NOCLAR) and assess its implications on the financial statements. If the non-compliance affects the financial health of the Company or poses a risk to stakeholders, it would be considered as material, even though it does not directly impact specific amounts in the financial statements. In the context of solvency, failing to comply with statutory requirements can indicate broader financial instability, which is definitely significant information for users of the financial statements. The Auditors are duty bound to report significant issues that may not directly affect material amounts but could impact stakeholder perceptions or risk assessments. However, the Auditors have given the Auditor's Report on the Financial Statements and Regulatory Returns of the Company for FY 2022 in complete disregard of the requirements of the Solvency, as provided under the Ordinance. Therefore, the Auditor has failed to bring out the material facts of insolvency of 'Conventional Life Fund' and 'Accident and Health Takaful Business Fund' as on December 31, 2022' in the Auditor's Report on the Annual Accounts and Regulatory Returns for FY 2022.

11. In view of the above, it is established that the Auditor did not bring out material fact of the insolvency of 'Conventional Life Fund' and 'Accident and Health Takaful Business Fund' as on December 31, 2022' in the Auditor's Report on the Annual Accounts and Regulatory Returns for FY 2022. Therefore, the Auditor has failed to comply with the requirements of Section 249(3) of the Act read with Section 48(2) & (4) of the Ordinance, which render him liable to penalty under Section 253(1) of the Act.

12. In exercise of the powers conferred under Section 253(1) of the Companies Act and other enabling provisions of the law, I hereby, impose a penalty of **Rs. 100,000/- (Rupees One**

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**Hundred Thousand Only** on the Respondent/Audit Firm on account of the aforesaid established default of Section 249(3) of the Act read with Section 48(2) & (4) of the Ordinance.

13. Accordingly, the Respondent/Audit Firm is hereby directed to deposit the aforesaid fine in the designated Bank Account maintained in the name of the Securities and Exchange Commission of Pakistan with MCB Bank Limited or United Bank Limited within thirty (30) days of the date of this Order and furnish receipted voucher evidencing payment of the same.

14. This Order is being issued without prejudice to any other action that the Commission may initiate against the Respondent/Audit Firm/Auditor in accordance with the law on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

(Shahzad Afzal Khan)  
Director/Head of Department  
(Adjudication Department-I)

**Announced:**  
October 10, 2024  
Islamabad