

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

In the matter of Show Cause Notice issued to IECNet S.K.S.S.S. Chartered Accountants

Date of Hearing

January 05, 2023

Order-Redacted Version

Order dated January 17, 2023 was passed by Director/Head of Department (Adjudication-I) in the matter of IECNet S.K.S.S.S. Chartered Accountants. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated September 09, 2022.
2. Name of Respondent	IECNet S.K.S.S.S. Chartered Accountants (the "Audit Firm" or the "Respondent"), auditor of M/s K & I Global Capital (Pvt.) Limited (the "Company").
3. Nature of Offence	Alleged contraventions of <u>Regulation 32(2), 34(2) and Schedule-III of the Securities Brokers (Licensing and Operations) Regulations, 2016 (the "Regulations") read with Section 159(5) of the Securities Act, 2015 (the "Act")</u> .
4. Action Taken	<p>Key findings were reported in the following manner:</p> <p>I have gone through the relevant provisions of Regulation 32(2), 34(2)(b), 34(2)(g) and Clause 1.17 of Schedule-III of the Regulations and submissions made by the Audit Firm. I have also perused Section 159(5)(b) of the Act, which stipulates penal provisions for contravention of the Regulations. I have noted the following pertinent aspects in the matter at hand:</p> <p>a. The Regulation 32(2), 34(2)(b), 34(2)(g) of the Regulations explicitly mandates disclosures in the financial statements with regards to basis of preparation of financial statements of a securities broker (i.e. trade or settlement date), value of customers' pledged securities and aging analysis of trade receivables. The Audit Firm was obliged under the International Standards on Auditing (ISAs) and the Regulations <i>inter alia</i> to obtain sufficient appropriate audit evidence regarding compliance with the provisions of laws and regulations, and identify instances of non-compliance with such laws.</p>

b. The annual audited financial statements of the Company for the year ended June 30, 2021 (the "Accounts") were evidently and as already admitted by the Respondent were deficient on account of Regulation 32(2) of the Regulations. However, the non-compliance has been rectified subsequently and requisite disclosure has been provided in the annual audited financial statements of the Company for the year ended June 30, 2022 (reference Note 3.2).

c. W.r.t Regulation 34(2)(g) of the Regulations, although a specific disclosure providing an aging analysis has not been provided, note 30.3 of the Accounts reasonably discloses the receivables amount outstanding for more than 14 days. Further, Note 9.2 of the subsequent 2022 accounts (under Trade and Other Receivables disclosure) adequately provides the requisite aging analysis.

d. W.r.t Regulation 34(2)(b) of the Regulations, it is noted that the Company has disclosed in Note 2.1 of the Accounts that they have been prepared *inter alia* in accordance with the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs). Section 8.2 of IFRS for SMEs stipulates that *the notes shall provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them*. Section 2.32 thereof also mentions that *an item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes or explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements*. Therefore, a specific disclosure identifying the fact that there are no customer assets pledged with financial institution(s), if that is the case, is aimed to result in a true and fair presentation of the financial statements of a broker. Such a disclosure was evidently missing in the Accounts of the Company. Although this missing disclosure hindered the true presentation of the 2021 Accounts, the subsequent 2022 accounts disclose in Note 11.1 that *no client shares pledged with bank*, and no comparative information (for the year 2021) is provided therein which apparently confirms the absence of disclosure relating to pledging of customer assets/shares in the year 2021.

e. W.r.t haircut/adjustment (v) of Clause 1.17, the fact that a compensating error existed in the LC computation provided in the Accounts prepared by the Company does not absolve the auditor of its responsibility to report or modify its opinion in case

	<p>such disclosures are not in accordance with the requirements of the Regulations. An auditor is obliged under the ISAs to take reasonable measures to ensure reliability of the financial statements being subject to audit. Existence of compensating errors is not a valid reasoning to not identify the non-compliances, and the inherent characteristics of reliability, and true & fair presentation of the financial statements resultantly become redundant. Nevertheless, the Respondent has subsequently in the hearing held on January 05, 2023 has admitted the non-compliance being a presentation error and requested for a lenient view.</p> <p>f. W.r.t haircut/adjustment (vi) of Clause 1.17, the law clearly segregates the receivables from related parties (whether occurred in the course of normal trading or otherwise) from all other categories of customer receivables, and enunciates that any such amount of receivable from related parties will be included in LC computation only after application of the relevant haircuts. The submission made by the Audit Firm that the receivables from Mr. Khalid Mahmood and Mr. Ijaz Ahmed (directors of the Company) were debit balances only on June 31st, 2021 (i.e. on the last day of accounts) does not carry weight, since Note 9.1 of the Accounts itself discloses the aggregate amount of Rs. 1,994,380 as a receivable from related parties as on the said date of balance sheet. Thus, the same amount should have been consistently reported in the succeeding LC disclosure in Note 30.4 in the similar manner. For reference, it is mentioned that the subsequent 2022 accounts report 'nil' receivables from related parties.</p> <p>In view of the above-stated facts, circumstances and submissions made by the Audit Firm including the fact that the Audit Firm demonstrated a corrective behavior and the omissions have been duly rectified in the subsequent audited accounts for the year 2022 (wherever applicable), I, in exercise of the powers conferred upon me under Section 159(5) of the Act, hereby conclude the instant proceedings without imposing any monetary penalty on the Audit Firm; however, the Audit Firm is hereby warned to remain vigilant and ensure meticulous compliance with all applicable laws including the Regulations & the Act in true letter and spirit in the future.</p>
5. Penalty Imposed	Warning
6. Current Status of Order (As of the uploading date)	No Appeal has been filed by the respondent.

