

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN



[Islamabad]

Before Ali Azeem Ikram, Director (Enforcement)

In the matter of

M/s. Hameed Khan & Co., Chartered Accountants

Under Section 260 (1) read with Section 255 and Section 476 Of The Companies Ordinance, 1984

Number and date of notice:	No: EMD/233/718/2008-1261 January 05, 2009
Date of Final hearing:	March 03, 2009
Present:	Mr. Atta Mohammad Khan, Advocate (Legal representative)
Date of Order:	April 01, 2009

ORDER

This Order shall dispose of the proceedings initiated through Show Cause Notice No. EMD/233/718/2008-1261 dated January 05, 2009 ("SCN") against M/s. Hameed Khan & Co., Chartered Accountants under Section 260(1) read with Section 255 and 476 of the Companies Ordinance, 1984 (Ordinance).

2. Mr. Abdul Hameed Khan of M/s. Hameed Khan & Co., Chartered Accountants ("Auditor") was appointed as the auditor of Credit Insurance Company Limited ("Company") in the Annual General Meeting held on April 28, 2007 to audit the accounts of the Company for the year ended December 31, 2007 ("Accounts").

3. Brief facts of the case are that Enforcement Department of this Commission conducted examination of the Accounts which revealed that the Auditor had issued a qualified report, dated April 30, 2008, on following issues:

- "As stated in Note 11 to the financial statements, the company has paid a total amount of Rs. 13,828,289 on account of leased vehicles. These vehicles are used by various employees. The title of these vehicles will be transferred in the name of the company after the completion of lease period.
- As stated in Note 11 to the financial statements, the company has advanced a total amount of Rs. 18,400,000 for purchase of land. The company is in the process of transferring the title of the land in its name.

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- As stated in Note 11 the company has advanced Rs. 24,114,300 on account of construction of office building. The construction work of the office building is due to start shortly.
- As disclosed in note 12 to the financial statements the company has purchased a piece of land amounting to Rs. 10,000,000 during the year. We have not seen the original document for the purchase of this land.

4. The directors of the Company furnished following explanation for auditors qualifications in their report to members:

- The Company has obtained undertaking from the employees of the company, and the vehicles will be transferred in the name of the Company in due course of time.
- The Company is in process of completing registration facilities for the transfer of land.
- The construction work on office building will commence very shortly.
- The Company has sold this land to other party with mutual consent of the owner before transferring ownership into Company's name. The original documents were held by them.

5. Detailed scrutiny of Accounts of the Company revealed that advances for purchase of vehicles (Rs.13.828 million), land (Rs.18.400 million) and construction of office building (Rs.24,114 million) were appearing in the accounts of the Company since long. The fact that a significant portion of Company balance sheet comprise of advances, raised concerns of the Commission. Besides, certain other irregularities were also observed during examination of Accounts, requiring detailed inspection of records and books of accounts of the Company. Consequently, the Commission in exercise of powers conferred to it under Section 231 of the Ordinance authorized its officers to conduct inspection of books of accounts and records of the Company with reference to issues highlighted in the Auditor's report along with other irregularities observed in the Accounts.

6. In the light of observations of inspection team, it was apprehended that Auditor had failed to bring out all material facts about the affairs of the Company and make a report in accordance with the requirements of the statute. Consequently, a show cause notice under Section 260(1) read with Section 255 and Section 476 of the Ordinance was issued to the Auditor on January 05, 2009. The show cause notice was responded by the Auditor vide his letter dated January 28, 2009, however, the same was not found satisfactory. Hearings in the matter were held on February 06, 2009 and March 03, 2009 which were attended by Mr. Atta Mohammad Khan, Advocate, legal representative of the Auditor.



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7. The submissions of the Auditor and his authorized representative have been analyzed in detail in the ensuing paragraphs:

i. Advance for Vehicles (Rs.13,828,289/-):

Submissions of the Auditor/authorized Representative:

- The advances are in fact cost of leased vehicles which are in the name of agents and employees of the Company. These vehicles are used by field staff/employees who are responsible for the procurement of insurance business. The Company has not transferred in its name as the credit rating of the Company is not very good and it is difficult for the Company to avail financing from banks.
- All field staff has given undertaking for transfer of vehicles in the name of Company. Copies of transfer deed/agreements are enclosed.
- The vehicles will be transferred in the name of Company after completion of lease period.

Analysis of submission:

- Inspection team has reported that the leased vehicles are held in the name of the employees and agents of the Company. There is more than one vehicle in the name of one person. As per Accounts the Company has eighteen (18) employees on its payroll while the Company has purchased around one hundred (100) motor cycles and cars out of which thirty two (32) are not in the name of the Company.
- Before discussing the submissions of the Auditor and his representative I would refer to the provisions of Section 39 of the Insurance Ordinance 2000, non-compliance of which has been entirely ignored by the Auditor:

"None of the assets in Pakistan of any insurer shall, except in the case of deposits made with the State Bank of Pakistan under section 29, or in the case of assets, other than deposits, with a scheduled bank acting as a custodian, be kept otherwise than in the corporate name and under the direct control of the insurer and, in the case of assets of a statutory fund of a life insurer, in the name of the statutory fund".

Therefore, the leased assets amounting to Rs.13.828 million (about 31% of total fixed assets and 12% of total assets) are held in the name of employees/agents in sheer violation of Insurance Ordinance, 2000.

Furthermore, the Company has accounted for leased vehicles in its Accounts as advance for the purchase of vehicles while these assets have actually been delivered and are being used by Company's employees/agents. The said treatment is in contravention with IAS-17(Leases).



ii. Advance for purchase of land (Rs. 18,400,000/-):

Submissions of the Auditor:

- The Company was in process of transferring the title of the land in its name when the audit of accounts was performed and auditor highlighted the same by expressing its qualified opinion.
- Advances for purchase of land have been carried forward from previous years. No further payments were made during this year. Supporting evidence of land and year wise breakup of advances is attached.

Analysis of submission:

- The Inspection team has reported that the Company has made advances of Rs.18.4 million against purchase of land during 2001-2003. Out of total Rs.18.4 million advances amounting to Rs.6.2 million have been made to different directors of the Company.
- It has been observed that the Auditor expressed the qualified opinion in respect of these advances, in the year 2006 on the same grounds that the Company was in process of transferring the title of land in its name. However, the land was not transferred in the name of the Company in the year 2007 and the Auditor repeated his qualification with the same observation that the transfer was in process. When the representative of the Auditor, at the time of personal hearing, was asked to explain the reasons for the delay in transfer, and procedures adopted by the Auditor to verify that the transfer was actually in process he could not furnish any satisfactory explanation. The Auditor has presented before the undersigned copies of agreements between buyer and seller extending the date of transfer which I do not consider satisfactory as such extension agreements are continuously being signed since the purchase agreements extending date of transfer every year.
- The Company was required to disclose advances to directors separately as required by IAS-24(Related Party Disclosures). A significant fraction of total advances was made to the directors of the Company however the same was neither disclosed by the Company nor highlighted by the Auditor.

iii. Advance for Construction of office building (Rs. 24,114,300/-):

Submissions of the Auditor:

- Mr. Atta Mohammad Khan argued that Rs. 24,114,300/- were paid by the Company on account of construction of office building at 7- marla plot situated at Empress Road, Lahore to M/s Friends Construction Company and the construction work was due to start



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shortly on the date of signing of audit report and the same was stated in the Auditor report.

Analysis of submission:

- The detail of the advance balance as at 31, December of the following years is as under:

Balance as at December 31,	Amount of Advance Given (Rs)
2004	4,000,000
2005	4,000,000
2006	4,000,000
2007	24,114,300

The agreement for construction of building with M/s Friends Construction Company was dated March 17, 2008 (which has been cancelled subsequently in September 2008) however advances were appearing since 2004. Auditor failed to highlight these facts in its reports and stated in its report for the year ended December 31, 2006 that the construction work is due to start in next six months. Such statement of the Auditor was not supported with any agreement between the parties.

iv. **Purchase of Land (Rs. 10,000,000/-):**

Submissions of the Auditor:

- No supporting document for payment of Rs. 10 million as advance for purchase of land was provided to us and the same was conveyed to shareholders in Auditor report.

Analysis of submission:

- Auditor has only reported purchase of land, however he has failed to report the following which have come to notice of the Commission through the inspection:
 - Rs. 10 million was paid by Company in cash.
 - The Company has subsequently on January 15, 2008 i.e a date well before the signing of audit report, sold the said land for Rs. 10.7 million with a gain of Rs. 200,000.

v. **Others**

- The Auditor in his written arguments stated that:
 - i). In case of insurance companies, the auditor is appointed under Section 48 of Insurance Ordinance, 2000 to express his opinion on statements prepared in pursuant to Section 46(1) and under Section 48(4) of Insurance Ordinance, 2000 he is required to discharge the duties and liabilities provided under Section 255, 256, 257 and 260 of Companies Ordinance, 1984. According to Section 255(3) the auditor is required to make a report on the accounts audited by him and under Section 255(4) where any matter referred in Section 255(3) is answered in negative or with qualification, the report shall state reason for such along with the factual position to the best of auditor's information. The

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Auditor's report for the year ended December 31, 2007 speaks that all opinion expressed in pursuant to Section 255(3) were not answered in negative except with qualification mentioned by way of note on balance sheet item which provide further information with the reason of their occurrence and factual position thereof as per Auditor's best information as required by law. Hence there is no violation which can be termed as willful default on the part of Auditor under Section 260(1) of the Ordinance.

- ii). As provided under Section 260 the report was strictly in compliance of requirements of Section 255 and nowhere case of any willful default would be ascertained. As per oxford dictionary the word default means fail to fulfill obligation whereas the word willful means intentional, deliberate etc. Our case of qualified report intent to provide more information about the events reflected in Accounts for information of the readers which do not in any way fall with the definition willful of default.
- iii). SECP has accepted the financial statements and auditors report for the year 2006 and prior to that and most of the balances/qualifications are appearing in the previous year financial statements. The High Court has decided that if the department has accepted the previous year accounts, the current accounts cannot be challenged on the same grounds.
- It was also contended that the Company is an unlisted Company having eighty five (85) shareholders who are mostly family members. The Auditor is morally and legally bound to convey his concern to the members and other stakeholders by qualifying the audited report. The Securities and Exchange Commission of Pakistan can issue show cause notice if the Auditor has done something wrong and done it prejudicial to the public interest by qualifying the audited account. The opinion expressed by Auditor is not misleading rather it was necessary to keep the stakeholders informative about the present status and affairs of the Company. Moreover, the opinion was expressed after obtaining sufficient evidence and it was not against the auditing practice. There appears no reason to issue notice on the basis of mere technicalities.

Analysis of Submission:

- i). Before proceeding further, it would be relevant here to quote below the relevant provisions of the Ordinance and relevant paragraphs of the ISA which were required to be followed by the Auditor while expressing his opinion in his report to the members:

Sub Section (4) of Section 255 of Ordinance requires that "Where any of the matters referred to in sub-section (3) is answered in the negative or with a qualification, the report shall state the reason for such answer along with the factual position to the best of the auditor's information."



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Para 14 of Auditing Standard 701 (Modifications to Independent Auditors Report) states that "An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements."

Para 15 of Auditing Standard 701 (Modifications to Independent Auditors Report) states that "Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effects(s) on the financial statements."

The aforesaid provisions of law and requirements of auditing standards are explicitly clear on the basis of which the Auditor is required to give his opinion. The qualifications reported by the Auditor do not give clear description of the substantive reasons with regard to the aforesaid issues. Further, the issues are 'material' and 'pervasive' to justify the adverse opinion rather than giving the qualified opinion. The Auditor has also failed to highlight the non compliance of IAS 17 and IAS-24. The auditor therefore failed to bring out all material facts about the state of affairs of the Company and make his report in accordance with the requirements of law.

- ii). I do not concur with the Auditor's statement that the default was not willful. In this connection, I find it quite relevant to refer to the order of the Appellate Bench of the Commission in the case of Shaikh Jalaluddin, FCA vs. Commissioner (Enforcement), which was upheld by the Honorable Sindh High Court in an appeal filed by the auditor in that case. In the said order the auditor who was penalized argued that his default was not willful although he had failed to comply with the provisions of the law and applicable auditing standards. The Appellate Bench while holding that his default was indeed willful observed that "In the case of City Equitable Fire Insurance Co. Ltd. Re. 1925 Ch 407, it was held that a default, in case of breach of duty, will be considered 'willful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent. Simply put, if the Appellant admits to know the auditing standards and claims to have followed them when in reality, as proven above he has not, then keeping in view his status as a professional and his duty as a fiduciary he should be held to be willfully in default." In the instant case the Auditor admits to be acquainted with the ISAs and in his report he claims to have followed them. However, while making report on the Accounts of the Company he has not followed the ISAs. Thus the Auditor is held to be willfully in default.



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- iii). Commission is a regulatory authority and accounts and other documents are filed with Commission for monitoring and record purposes and by filing the accounts and documents with Commission it does not mean that they cannot be challenged.

8. I have carefully examined the arguments offered by auditor/authorized representative and have also studied the record placed before me in detail. I have also referred to the relevant provisions of the Ordinance and applicable IASs & ISAs. I am not convinced with the arguments presented by the authorized representative and am of the view that the qualifications were so material and pervasive that Auditor should have given an adverse opinion as elaborated in para 14 and para 15 of the ISA 701 (Modifications to Independent Auditors Report). The aforesaid contravention indicates that Auditor has not discharge its duties of making a truthful report to the members of the Company and has been grossly negligent in conducting its professional duties. The auditor has thus contravened Section 255(4) which attracts the penal provisions of Section 260(1) of the Ordinance. The facts of the case warrant no sympathy for the Auditor and require a stern action against the Auditor. I, therefore, impose a fine of Rs. 100,000/- (Rupees One Hundred Thousand Only) on Mr. Abdul Hameed Khan, Chartered Accountant for contravening the provisions of section 260(1) of the Ordinance.

9. The Auditor is hereby directed to deposit the aforesaid fine of Rs. 100,000/- (Rupees One Hundred Thousand Only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited or pay through a demand draft in the name of Securities and Exchange Commission of Pakistan within thirty (30) days from the receipt of this Order and furnish receipted vouchers to this Commission failing which proceedings for recovery of the fine under the Land Revenue Act, 1967 would be initiated.

Ali Azeem Ikram
Director (Enforcement)