



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. EY Ford Rhodes, Chartered Accountants

Number and date of Show Cause Notice (SCN)	ID/Enf/TPL/2022/2527 dated February 8, 2023
Date(s) of Hearing:	March 17, 2023
Present at the Hearing(s):	Mr. Sheikh Ahmad Salman, Partner Mr. Ahsan Shahzad, Partner Mr. Sameer Tayebaly, Advocate Syed Ubaidullah, Shariah Consultant (Authorized Representatives)

ORDER

Section 48 of the Insurance Ordinance, 2000 read with Section 249 of the Companies Act, 2017 and Section 253(1) and Section 479 of the Act

.....

This Order shall dispose of the proceedings initiated against **M/s. EY Ford Rhodes, Chartered Accountants (the Auditor and/or the Audit Firm or the Respondent)** under Section 48 of the Insurance Ordinance, 2000 (**the Ordinance**) read with Section 249 the Companies Act, 2017 (**the Act**) and Section 253(1) and Section 479 of the Act vide Show Cause Notice dated February 08, 2023 (**the SCN**). The Audit Firm was appointed as the Statutory Auditor of TPL Insurance Limited (**the Company**) for audit of its Annual Accounts and Regulatory Returns for the year ended December 31, 2020 (FY 2020).

2. Brief facts of the case are that during examination of the Annual Audited Accounts and Regulatory Returns of the Company for FY 2020, it has been observed that the Company has contravened the provisions of Section 36 read with Section 11(1)(c) of the Ordinance and rule 15 of Insurance Rules, 2017 (**the Rules**), which require a non-life insurer to have at all times its admissible assets in excess of its liabilities of an amount greater than or equal to the minimum solvency requirement. However, the Auditor, prima facie, have failed to bring out the material facts in their Report on the Company's Financial Statements and Regulatory Returns for FY 2020 and issued an unmodified opinion thereon.

3. In view of the foregoing, the Auditor/Respondent, *prima facie*, has failed to comply with the requirements of Section 48 of the Ordinance read with Section 249(3), 253(1) and 479 of the Companies Act, 2017. The SCN was issued to the Respondent/Auditor, calling upon them to show cause in writing within fourteen (14) days of the date thereof.

4. In response to SCN, M/s. Mohsin Tayebaly & Co., Counsel for the Auditor vide letter dated February 27, 2023 submitted their reply, the relevant extracts of which are summarized as under:



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- (a) Section 6(2) of the GTAR 2019 modifies the solvency regime for Conventional Insurers, but the Company found it inconsistent with the Insurance Rules 2017 and Takaful Rules 2012, which are independent regulations. The GTAR 2019 does not state that it will override other laws or repeal the Insurance Rules, 2017, or Takaful Rules, 2012. Regulation 21 allows the Commission to relax requirements if compliance is not possible. The GTAR 2019 is subordinate legislation and not created to supersede other applicable laws. The GTAR 2019 applies to operators, including Takaful Operators or Window Takaful Operators, authorized by the Commission under the Takaful Rules, 2012. The Company interpreted the law in accordance with Insurance Rules, 2017, and deemed the separate regimes to continue, with the GTAR 2019 being applicable only to Takaful Businesses.
- (b) The Respondent denied the contents of para 3(b) due to the Company's interpretation that GTAR 2019 was not applicable to Conventional Insurers. The solvency statement for Takaful Operation was prepared in accordance with GTAR 2019 requirements, which do not prescribe qard-e-hasna presentation. As a result, the consolidated statement of solvency was not prepared, and the matter of excluding qard-e-hasna from consolidated numbers does not arise. The Company was transparent in reporting and disclosed all relevant laws and regulations.
- (c) The Respondent denied the contents of para 4 as the Statement of Solvency was prepared by the Company under Insurance Rules, 2017 framework.
- (d) The Respondent denied the contents of para 5 and 6. The notice's adjudication relies on the Company's interpretation of the GTAR 2019. The Company was transparent about its regulatory framework and interpreted the GTAR 2019 as inapplicable to its Conventional Business. The Commission identified the issue with the presentation of the Statement of Solvency, which was informed by the Company's interpretation and the Company's acceptance of it. No misstatement was made, as there is a significant difference between different presentation approaches.

5. In order to provide the Respondent/Auditor an opportunity of personal representation, hearing in the matter was fixed for March 17, 2023. The hearing was attended by Sheikh Ahmad Salman (Partner); Syed Ubaidullah (Shariah Consultant); Mr. Ahsan Shahzad (Partner); and Mr. Sameer Tayebaly (Advocate) as the Authorized Representatives of the Respondent (**the Representatives**). The Representatives reiterated the submissions and arguments made earlier in the written reply dated February 27, 2023. The Representatives stated that the Takaful Regulations became applicable for the first time on solvency statement for the year ended December 31, 2020. Furthermore, they submitted that the non-compliance occurred due to misinterpretation of the Takaful Regulations' applicability. The Representatives were advised to submit written assurance that the Company has prepared the solvency statement for subsequent year in conformity with the requirement of regulation 6(2) of the Takaful Regulations and such solvency statement is duly audited.

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

(i) Failure of Auditor to highlight Non-Reporting of Insolvency of the Company and to bring out material facts in the Audit Report (Section 36 of the Ordinance read with Section 11(1)(c) thereof and rule 15 of the Rules):

The Auditor denied that the Company has made any misstatement, whatsoever, as even if the Company's interpretation was deemed to be incorrect, there is a significant difference between adopting a different approach to presentation against making a false statement.



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In this regard, it is made abundantly clear that the assets, liabilities and related operational balances of PTF were not taken into account in preparation of Solvency Statement and Note 39 to the Financial Statement of the Company for FY 2020. Moreover, an amount of Rs. 103.9 million representing *Qard-e-Hasna* was accounted for as an admissible asset for solvency calculation but its corresponding liability reported in PTF was not considered for solvency calculation. If the aforesaid related balances of window takaful operations are considered in addition to conventional business, in compliance of regulation 6(2) of the Takaful Regulations, the minimum solvency requirement would be Rs. 432.616 million and Net Admissible Assets would be Rs. 318.568 million. Consequently, the Company becomes insolvent by an amount of Rs. 114.048 million as at December 31, 2020, as shown in para 10 above; however, the Auditor did not highlight the insolvency of the Company in the aforesaid Auditor's Report.

Actual solvency position of the Company as at December 31, 2020 in compliance of regulation 6(2) of the Takaful Regulations would be calculated as shown in the tables below:

Table -1: Solvency Calculation taking into account the balances of PTF:

Description	Solvency (without PTF) * as Form GJ and Note 39 of the Accounts	PTF** as per Form GJT-WTO	Solvency (with PTF) as per regulation 6(2) of Takaful Regulations
Total Assets	2,749,767,688	1,147,427,607	3,897,195,295
less: Inadmissible assets	466,878,703	81,783,224	548,661,927
Admissible assets	2,282,888,985	1,065,644,383	3,348,533,368
less: Total Liabilities	1,933,445,139	992,619,970	2,926,065,109
Less: Qard e Hasna***	-	-	103,900,000
Net Admissible assets	349,443,846	73,024,413	318,568,259
Less: Min. Solvency Requirement (Table-2: Highest of the amounts determined using Methods A, B & C)	209,452,049		432,616,403
Excess solvency margin over min. Requirement	139,991,797		(114,048,144)

* Refer Form GJ of Regulatory returns and Note 39 of Financial Statement

** Refer Form GJT of WTO regulatory returns

*** *Qard-e-Hasna* excluded because it is included in operator fund assets.

Table-2: Minimum Solvency Requirement Working (Highest of Amount Determined using Methods A, B & C):

METHOD	Provision of the Law	FY 2020 (Rs.)
Method A	Section 36 (3)(a)	
As prescribed by the Commission		150,000,000
Method B	Section 36 (3)(b)	
Gross Earned Premium		2,576,488,165
Less – Reinsurance Expense (Upto 50%)		(413,406,148)



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Net earned premium		2,163,082,017
20% of net earned premium		432,616,403
Method C	Section 36 (3)(c)	
Provision for Unearned Premium (UC)		1,098,511,906
Provision for Outstanding Claims (OC)		525,295,311
Sub-total Provisions		1,623,807,217
Less Prepaid Reinsurance Premium (Upto 50%)		269,991,190
Less Reinsurance Recoveries Against OC (Upto 50%)		262,647,656
Less – Sub-total		532,638,846
Total Unearned Premium & Outstanding Claims		1,091,168,372
20% of Total UC&OC		218,233,674

Table-3: Net Admissible Assets & Min. Solvency Requirement (MSR):

Net Admissible Assets	(Rs.)
Admissible Assets as per Regulatory Return	3,244,633,365
Liabilities as Per Annual Accounts	2,926,065,109
Excess Assets Over Liabilities	318,568,256
MSR	
Min. Solvency Requirement (Highest of amount determined from Methods A, B & C)	432,616,403
Shortfall in Solvency Margin relative to MSR	(114,048,147)
Solvency Ratio	0.74
Solvent? (Yes/No)	No

It is evident from the above calculations that the Company is insolvent by an amount of **Rs. 114.048 million**, in violation of the provisions of Section 36 of the Ordinance read with Section 11(1)(c) thereof and rule 15 of the Rules. Therefore, the Statement of Solvency (Form GJ) of the Regulatory Returns and Note 39 of the Financial Statements of the Company for FY 2020 is not in accordance with the requirements of the relevant regulation. Hence, the Auditor, has failed to highlight the said non-compliance in the Auditor's Report.

(ii) Failure of Auditor to highlight Non-compliance with regulation 6(2) of the Takaful Regulations:

The Auditor has confronted that they have brought on record all the material facts in their Report on the Company's Financial Statements and Regulatory Returns for FY 2020. It has been further stated that they have prepared their Report in a transparent and comprehensive manner and have taken into account all applicable laws and regulations and disclosed material facts therein.

In this regard, it has been noted that despite the fact that the assets, liabilities and related operational balances of PTF were not taken into account for solvency computation in contravention of regulation 6(2) of the Takaful Regulations, the Auditor did not highlight the said contravention of regulation 6(2) of the Takaful Regulations in their Report on the Financial Statements and Regulatory Returns of the Company for FY 2020. Resultantly, the Auditor has failed to report non-compliance of the requirements of the Takaful Regulations on the financial statements and regulatory returns of the Company for FY 2020.



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(iii) Applicability of Section 249, Sub-Section (3) of the Act:

The Auditor has contended that the Commission has not pointed out the specific provision of Section 249 of the Act, which the Auditor has breached on the basis of which a penalty can may be imposed.

It needs to be appreciated that Section 249(3) stipulates the matters which the Auditor is required to address in his Report while giving opinion to the members of the Company on the accounts and books of accounts and financial statements and every other document forming part of such statements including notes, statements or schedules attached thereto. Since the unmodified opinion was given in the Report despite the aforesaid non-compliances, the Auditor did not comply with the requirements of sub-section (3) of Section 249 of the Act while issuing the report to the Company.

(iv) Equitable treatment for the Auditor:

The Auditor has stated that since the Commission has already disposed of the proceedings initiated against the Company on account of its obligations in the matter, whereby proceedings were closed with warning; therefore, it would be contrary to the principles of equity and justice to impose a penalty on the Auditor. In this regard, it needs to be noted that the obligations of the Auditor to ensure compliance with the applicable framework is independent from those of the Company. As stated in the Section 48 (2) & (4) of the Ordinance, produced as under:

(2) The auditor shall in respect of the statements required to be provided pursuant to sub-section (1) of section 46 express an opinion as to whether:

- (a) the statements accurately reflect the books and records of the company;*
- (b) the company has maintained proper books and records;*
- (c) the statements present fairly the state of affairs of the company as at the balance date and the result of the company for the financial year ended on that date;*
- (d) in the case of a life insurer, the apportionment required to be performed under section 17 has been performed in accordance with the advice of the appointed actuary; and*
- (e) the statements have been prepared in accordance with this Ordinance.*

(4) The auditor shall in the audit of all such accounts and statements have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by sections 255, 256, 257 and 260 of the Companies Ordinance, 1984.

However, the Auditor has neglected to take into consideration the requirements of the Takaful Regulations particularly those of regulation 6(2) thereof and issued the Auditor's Report on the financial statements and regulatory returns of the Company for FY 2020 in complete disregard of the requirements of the Takaful Regulations.

Therefore, the Auditor being a frontline regulator cannot be absolved from its statutory obligations in the instant matter. As part of an audit in accordance with ISAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit. The objectives of the auditor are to consider whether there is a material inconsistency between the applicable regulatory frameworks and the financial statements. Based on aforesaid, the auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding the financial information and to express an opinion thereon. However, in the instant



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case, the Auditor failed to bring out the material misstatements / omission of facts before the stakeholders of the financial statements in the Audit Report of the Company for FY 2020.

(v) Subsequent Compliance of the Company for the FY 2021:

It has also been noted that there is the subsequent compliance, the Counsel for the Auditor vide letter dated March 21, 2023 submitted the conformation that:

“Our Client was engaged by TPLIL to perform audit of the regulatory returns of conventional and takaful businesses for the year ended December 31, 2021. TPLIL calculated the minimum solvency requirement for conventional business for the year ended 31 December 2021 by considering the requirements of the General Takaful Accounting Regulations, 2019 (i.e. on combined basis and our Client noted that TPLIL was meeting the minimum solvency requirement).”

7. In view of the above mentioned observations, the Auditor has failed to highlight the non-Reporting of Insolvency of the Company, non-compliance with regulation 6(2) of the Takaful Regulations, non-Compliance of Sub-Section (3) of Section 249 of the Act, and did not bring out material facts in the Audit Report for FY 2020, read with Section 48(2) & (4) of the Ordinance, which render them liable to penalty under Section 253(1) of the Act. Therefore, in exercise of the powers conferred under Section 253(1) read with Section 479 of the Act and other enabling provisions of the law, I hereby, impose a penalty of **Rs.50,000/- (Rupees Fifty 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.

8. 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 and United Bank Limited (UBL) within thirty (30) days of the date of this Order and furnish receipted voucher evidencing payment of the same.

9. This Order is being issued without prejudice to any other action that the Commission may initiate against the Respondent/Audit Firm/Auditors 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:

August 02, 2023
Islamabad