SECP

Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director

In the matter of

Al-Abbas Sugar Mills Limited

Number and date of notice:	CSD/ARN/507/2017-570-76 dated September 26, 2017
Date of hearing:	February 22, 2018
Representation:	Mr. Muhammad Jawwad Shekha, Partner, Shekha & Mufti, Chartered Accountants, (Authorized Representative)

ORDER

Under Section 492 read with Section 476 of the Companies Ordinance, 1984

This order shall dispose of the proceedings initiated against following Directors of Al-Abbas Sugar Mills Limited hereby referred to as Respondents against whom proceedings were initiated vide Show Cause Notice dated September 26, 2017 *(the "SCN")* under the provisions of Section 492 read with Section 476 of the Companies Ordinance, 1984 *(the "Ordinance")*:

1 Mr. Muhammad Iqbal Usman
2 Mr. Shunaid Qureshi
3 Mr. Asim Ghani
4 Ms. Asma Aves Cochinwala
5 Ms. Darakshan Ghani
6 Mr. Duraid Qureshi
7 Sayyed Rafay Akber Rashdi

2. Brief facts of the case are that the examination of half yearly accounts of the Company for the period ended March 31, 2017 (*the "Accounts"*) revealed that the Company has reclassified its short term investments (*the "investments"*) from 'fair value through profit or loss' category to 'available for sale' and classified these investments as long term. The aforesaid reclassification from 'fair value through profit or loss' category to 'Available for Sale' category by the Company in the Accounts was *prima facie* contrary to the requirements of IAS 39, 'Financial Instruments: Recognition and Measurement'.

3. Relevant provisions of the IAS-39 (2009 edition) are stated hereunder for ease of reference:

Para 50 (c) of IAS-39 (2009 edition) states as:

"An entity:

may, if a financial asset is no longer held for the purpose of selling or repurchasing it in the near term (notwithstanding that the financial asset may have been acquired or incurred principally for the purpose of selling or repurchasing it in the near term), ***reclassify that financial asset out of the fair value through profit or loss category if the requirements in paragraph 50-B or 50-D are met.***

An entity shall not reclassify any financial instrument into the fair value through profit or loss category after initial recognition."

Para 50-B of the IAS-39 (2009 edition) states that:

"A financial asset to which paragraph 50(c) applies (except a financial asset of the type described in paragraph 50D) may be reclassified out of the fair value through profit or loss category ***only in rare circumstances****."*

Para 50-C of the IAS-39 (2009 edition) states that:

"If an entity reclassifies a financial asset out of the fair value through profit or loss category in accordance with paragraph 50B, the financial asset shall be reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in profit or loss shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable."

Para 50-D of the IAS-39 (2009 edition) states that:

"A financial asset to which paragraph ***50(c)*** *applies that would have met the definition of loans and receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the fair value through profit or loss category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.*

4. In reply to commission's letter dated June 12, 2017, the Company in its letter dated July 12, 2017 has referred clause para 50(c) and paras 50-B and 50-C of the IAS-39 and stated that the reclassification has been made in the accounts by complying with the requirements of para 50-C of the IAS-39 and disclosure requirements of IFRS-7. Reply of the Company was not found cogent as reclassification out of the 'fair value through profit or loss' category is possible only in rare circumstances as per para 50-B of the IAS-39. The reply was also found unsatisfactory because change in intention of management of the Company do not represent a rare circumstance.

5. It was observed that in case of the Company there were no rare circumstances that would have allowed it to reclassify the investment out of the 'fair value through profit or loss' category as

envisaged in the IAS-39. Therefore, *prima facie* the reclassification in the accounts of the Company is contrary to the requirements of IAS-39. The reclassification by the Company has resulted in understatement of results in its accounts for the half year ended March 31, 2017 and its effect on the profit can be seen as under:

Amount in (000)

Particulars		Profit before taxation (PBT)
Reported	(a)	284,614
Should have been reported	(b)	416,583
Difference	c = a– b	(131,969)
Materiality	d = c/ b	(31.68%)

6. Subsequently, the SCN was issued to the respondents wherein they were called upon to show cause in writing as to why penal action may not be taken against them. Mr. Muhammad Jawwad Shekha, Partner, Shekha & Mufti, Chartered Accountants (Authorized Representative) submitted reply on behalf of the respondents along with power of attorney. The paragraph-wise reply dated October 27, 2017 is reproduced hereunder:

i. *This is a matter of fact that the Company has reclassified the short term investments from 'fair value through profit or loss' category to 'available for sale' and classified them as long term.*

ii. *In the management's opinion, the reclassification made is in compliance with requirements of International Accounting Standard ("IAS") 39, 'Financial Instruments" Recognition and Measurement' (2009 edition).*

iii. *Paragraphs reproduced from IAS-39.*

iv. *Yes, in its reply dated July 12, 2017 the Company referred to paras 50, 5OB and 50C of IAS 39 as the basis of management's decision on reclassification.*

v. *In management's opinion the rare circumstance, as referred to in IAS-39, would vary from company to company, depending on its internal situation and external environment. The primary business of the Company is manufacturing and sale of sugar, processing and sale of industrial ethanol and providing bulk storage facility. Investment in shares, in general, and trading in shares, in particular, is not the core business activity of the Company. This is also evident from the fact that during the last two financial years i.e. 2015 and 2016, there was no* *sale or purchase of shares in the reclassified scrips. However, volatility of the share price and unrealized gain/loss in these scrips was affecting the Company's financial results in every reporting period.*

The management had no intention to trade in scrips in foreseeable future. At the same time it could see volatility in stock market, due to the prevalent economic and political situation in the country; thus affecting the results of the Company. Accordingly it was considered appropriate and prudent to reclassify the investments to portray more relevant underlying financial results to Company's shareholders and other stakeholders.

The Company reclassified its investment in first quarter of the financial year ending 2017. We would like to highlight that had there been no reclassification, the unrealized gain in the first and second quarter would have been Rs. 91.683 million and Rs. 40.286 million. On the other hand, in third and fourth quarter the unrealized loss would have been Rs. (40.240) million and Rs. (39.928) million respectively. This volatility in value of investments can be seen from the following tables:

Name of scrips	September 30, 2016		
	Shares	Rate	Value
IGI Insurance Company Limited	759,000	203.00	154,077,000
Mehran Sugar Mills Limited	253,000	180.05	45,552,650
Fauji Cement Company Limited	1,000,000	35.27	35,270,000
			234,899,650

Name of scrips	December 31,2016		
	Shares	Rate	Value
IGI Insurance Company Limited	759,000	307.89	233,688,510
Mehran Sugar Mills Limited	253,000	188.99	47,814,470
Fauji Cement Company Limited	1,000,000	45.08	45,080,000
			326,582,980

Difference from last quarter- net gain 91,683,330

Name of scrips	March 31, 2017		
	Shares	Rate	Value
IGI Insurance Company Limited	759,000	360.46	273,589,140
Mehran Sugar Mills Limited	253,000	200.00	50,600,000
Fauji Cement Company Limited	1,000,000	42.68	42,680,000

Difference from September 30, 2016- net gain	*131,969,490*
Difference from last quarter – net gain	*40,286,160*

Name of scripts	*June 30,2017*		
	Shares	*Rate*	*Value*
IGI Insurance Company Limited	*759,000*	*316.80*	*240,451,200*
Mehran Sugar Mills Limited	*253,000*	*178.45*	*45,147,850*
Fauji Cement Company Limited	*1,000,000*	*41.03*	*41,030,000*
			326,629,050

Difference from September 30,2016- net gain	*91,729,400*
Difference from last quarter - net loss	*(40,240,090)*

Name of scripts	*September 30,2017*		
	Shares	*Rate*	*Value*
IGI Insurance Company Limited	*759,000*	*288.08*	*218,652,720*
Mehran Sugar Mills Limited	*253,000*	*140.43*	*35,528,790*
Fauji Cement Company Limited	*1,000,000*	*32.52*	*32,520,000*
			286,701,510

Difference from September 30,2016- net gain	*51,801,860*
Difference from last quarter - net loss	*(39,927,540)*

It can be seen from the above tables the unrealized gain/(loss) in every reporting quarter would have varied, significantly from the previous reporting period affecting the Company's profit and loss account abruptly. We would again reiterate that the effect of these bumps would not have been due to Company's normal operation but instead due to unrealized gain on short term investments, which is not the Company's main business.

So it was only a combination of a) intention to hold the investments and b) the anticipation of volatility in the stock market the management of the Company decided to reclassify the investments to 'available for sale'.

We would like to highlight an extract from a commentary (GAAP, Chapter C2 Financial Assets) on IAS - 39 by renowned accounting firm DELOITTE where the circumstances explained for re-classification are similar to that of the Company.

"The first condition to be met in order to reclassify a financial asset from FVTPL is that the financial asset is no longer held for the purpose of selling or repurchasing it in the near term. [IAS 39:50(c)]. This criterion applies irrespective of whether the asset was initially classified as held for trading because (i) it was acquired principally for the purpose of selling in the near term or (ii) because it is part of a portfolio of identified financial instruments that ore managed together and for which there is evidence of a recent actual pattern of short-term profit-taking."

"if an entity wishes to reclassify a financial asset that was classified as held for trading because it was part of a portfolio of identified financial instruments that are managed together and for which there was evidence of a recent actual pattern of short-term profit- taking, the entity must demonstrate that the specific asset subject to reclassification is not intended to be sold in the near term. For an asset that forms part of a portfolio of assets, this may be difficult to demonstrate unless the asset has been isolated from the portfolio or the mandate of the portfolio has changed such that there is no longer evidence of short- term profit-making."

vi. *As a result of this reclassification, nothing has changed either in total comprehensive income or in total value of the investments as you can see in the below chart.*

	Total Comprehensive Income					
	December 31,2016		March 31,2017		June 30, 2017	
	Reclassification	Had there been no reclassification	Reclassification	Had there been no Reclassification	Reclassification	Had there been no reclassification
	Rupees in thousands					
Profit after taxation	149,701	241,384	244.974	376,943	215,763	307,492
Unrealized gain on remeasurement of available for sale investments	179.273	87,590	381,307	249,338	333,934	242,205
Total Comprehensive Income	328,974	328,974	626,281	626.281	549,697	549,697

Value of reclassified investments					
December 31,2016		March 31.2017		June 30,2017	
After reclassification	Had there been no reclassification	After reclassification	Had there been no reclassification	After reclassification	Had there been no reclassification
Rupees					
326,582,980	326,582.980	366,869,140	366,869.140	326,629,050	326,629,050

	Shareholders 'Equity					
	December 31,2016		March 31,2017		June 30,2017	
	Reclassification	Had there been no	Reclassification	Had there been no reclassification	Reclassification	Had there been no
	Rupees In thousands					
Issued, subscribed and paid up capital	173,623	173,623	173,623	173,623	173,623	173,623
Reserves	2,490.459	2,490,459	2,631,505	2,631,505	2,554.921	2.554.921
Shareholders' Equity	2,664,082	2,664,082	2,805,128	2,805,128	2,728,544	2,728,544

Bottom of Balance Sheet					
December 31,2016		March 31,2017		June 30,2017	
Reclassification	Had there been no reclassification	Reclassification	Had there been no reclassification	Reclassification	Had there been no reclassification
Rupees In thousands					
4329,014	4,329,014	6,745,555	6,745,555	6,171,182	6,171,182
4,329,014	4,329.014	6,745,555	6,745,555	6,171,182	6,171,182

The above charts clearly show that nothing has changed in statement of comprehensive income, value of investment, shareholders' equity and bottom of balance sheet.

vii. *The management believed that all the conditions of IAS 39 (2009 edition) were fulfilled. Before reclassification the management took all due care and after obtaining guidance from the Company's external auditors. The matter was placed before the Investment Committee. The Investment Committee then recommended the matter for its approval to the Audit Committee and the Board of Directors. The financial statements were approved by majority of Directors in accordance with the prevalent law. In the opinion of the Board this is not a material misstatement because it is just a reclassification of investment and nothing has changed either in the total comprehensive income or in the value of the investments.*

viii. *The reason for reclassification, its justification, impact on various financial statement items and the procedure followed by the Company and the Directors, more fully explained in paras 5, 6, 7 and 8 above, shows that this reclassification is in line with IAS - 39 and has not affected the total comprehensive income, shareholders' equity and bottom line of balance sheet. So we humbly stated that there were no misstatements of results and the directors have fully discharged their fiduciary responsibilities while approving the Accounts.*

ix. *The directors want to submit, as also evident from the above explanations, that the Balance Sheet and Profit and Loss Accounts of the Company are neither false nor incorrect. Also they did not omit any material fact as the reclassification of investment and its impact on the accounts, was fully disclosed in Notes no. 8.1 and 8.2 (reproduced below) of the Condensed Interim Financial Statements, for the period ended December 31, 2017.*

> *"8.1 The short term investments of Rs. 234.9 million has been reclassified from fair value through profit or loss to available for sale category and transferred to long term Investment. During the last two years there has been no sale in short term investments, therefore, on October 01, 2016, the management has decided to hold these investment for tong term period."*
>
> *"8.2 The unrealized gain of Rs. 179.273 million on remeasurement of available for sale investments recognized in other comprehensive income, out of which Rs. 91.683 million would have been recognized in profit or loss if no reclassification was made."*

x. *We believe that the above point wise response justifies the position of the respondents and absolve them from all the penalties imposed under the Ordinance.*

xi. *Notwithstanding the above you would appreciate that the intent of Section 492 of the Ordinance is to protect the users of financial statements against misstatements. However, the case under discussion is of Interpretation of the allowability of an accounting treatment rather a misstatement in the accounts.*

xii. *The majority of directors have made a decision based on their understanding of the financial reporting standards, backed by auditor's guidance. The directors had no malafide or personal interest in presenting misleading or incorrect accounts. Please also note there has been no trading by the directors, in shares of the Company, during or after the period of reclassification. Accordingly, they have not made any personal gains or saved any losses at the expense of outside shareholders.*

6. In order to provide opportunity of personal hearing, the case was fixed on January 17, 2018 but was adjourned at the request of the Authorized Representative. The case was re-fixed on

February 15, 2018 though again adjourned at the request of the Authorized Representative. The third hearing in the matter was fixed on February 22, 2018. The Authorized Representative appeared on the date of the hearing and reiterated the stance as earlier taken in the submissions made in the written reply. The Authorized Representative further submitted that the Company is a profitable entity and has earned and distributed profits in the past. He took the stance that the subject matter only pertains to a technical clarification. He admitted that the Company did not carefully treated the investments initially and that the representation has been better after the classification at available for sale instead of fair value through profit and loss. The Authorized Representative submitted supporting documents vide letter dated February 26, 2018.

7. Before proceeding further, it is necessary to advert to the relevant provisions section 492 of the Ordinance provides as under:

> *"Whoever in any return, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of accounts, application, information or explanation required by or for the purposes of any of the provisions of this Ordinance or pursuant to an order or direction given under this Ordinance makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material, shall be punishable with fine not exceeding five hundred thousand rupees."*

8. In terms of the Commission's notification SRO 751 (I)/2017 dated August 2, 2017, the powers to adjudicate cases under section 492 of the Ordinance have been delegated to the Executive Director (Corporate Supervision Department).

9. I have analyzed the facts of the case, provisions of Sections 492 of the Ordinance, IAS 39, arguments put forth in writing and during the hearing by the Authorized Representative and have observed that the classification of investments from fair value through profit and loss category to available for sale category is allowed in rare circumstances only as stated by IAS 39. In the instant case, the Authorized Representative has also admitted that the initial classification of the investments would have been appropriate as "available for sale" and the management had no intention to trade in scrips in foreseeable future. The IAS 39 allows reclassification of investments in the cases wherein the financial asset is no longer held for the purpose of selling or repurchasing it in the near term. I have observed that as per the financial statements there has been no sale or

purchase of shares in the reclassified scrips during the years 2015 and 2016 and the number of shares in the aforesaid three scrips remains the same as on September 30, 2017 as well. On the other hand the investments can only be reclassified in rare circumstances for which the example given by IASB in its press release of October 13, 2008 is that of deterioration of financial markets of the world such as during the 3rd quarter of the year 2008. In light of the above, I am of the opinion that the rare circumstances as envisaged by the IASB did not exist in the case of the Company. If the rare circumstances cushion given by the IAS 39 is allowed on the intention of the management and case to case basis then true and fair presentation of financial statements in the relevant period is not possible. I also do not agree with the demonstrations given by the management on the change in profitability on every quarter due to change in unrealized gain/loss. Such presentation should be strictly in accordance with the IFRS. Further change in market price of any scrip could not be accurately apprehended in advance therefore justification of reclassifying the short term investments as long term out of the fair value through profit or loss as envisaged in the IAS-39 was not cogent at relevant time.

10. As the impact of departure with the requirements of IFRS is material and such departure was made willfully as is evident from the response given by the respondents. It may be seen that due to departure from requirements of IAS 39, the profit before tax has been understated by Rs.131.969 million thus materially misstating the accounts. This material misstatement in the accounts attracts the penal provision of section 492 of the Ordinance. In view of the foregoing, I, hereby impose a total fine of Rs.70,000 (Seventy Thousand Rupees only) i.e. Rs.10,000 (Ten Thousand Rupees only) on each respondent with a direction to be careful in future to follow the requirements of the applicable accounting standards in future. The detailed breakdown of the penalty imposed is as follows:

S.No.	Name of Respondent	Penalty
1	Mr. Muhammad Iqbal Usman	Rs.10,000
2	Mr. Shunaid Qureshi	Rs.10,000
3	Mr. Asim Ghani	Rs.10,000
4	Ms. Asma Aves Cochinwala	Rs.10,000
5	Ms. Darakshan Ghani	Rs.10,000
6	Mr. Duraid Qureshi	Rs.10,000
7	Mr. Sayyed Rafay Akber Rashdi	Rs.10,000
	Total	Rs. 70,000

11. The aforesaid fine must be deposited in the designated bank account maintained with MCB Bank Limited in the name of the "Securities and Exchange Commission of Pakistan" within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of fine, proceedings for recovery of the fines as arrears of land revenue will be initiated. It may also be noted that the said fines are imposed on the Respondent in their personal capacity; therefore, they are required to pay the said amount from personal resources.

Abid Hussain
Executive Director
Corporate Supervision Department

Announced:
May 18, 2018
Islamabad