



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director

In the matter of

Nazir Cotton Mills Limited

Number and date of Notice: CSD/ARN/151/2015-749-55 dated November 6, 2017

Date of hearing: November 30 2017 & February 22, 2018

Present: Mr. Muhammad Hayat Jasra. FCMA
Mr. Maqbool Hussain Bhutta, Director, Nazir Cotton Mills
Limited
(Authorized Representatives)

ORDER

UNDER SECTION 492 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984

This Order shall dispose of the proceedings initiated against the Directors of Nazir Cotton Mills Limited (*the "Company"*) for default made under the provisions of Section 492 read with Section 476 of the Companies Ordinance, 1984 (*"the Ordinance"*) initiated vide Show Cause Notice dated November 6, 2017(*the "SCN"*).

2. Brief facts leading to this case are that inspection under Section 231 of the Ordinance was ordered against the Company vide Order dated January 6, 2017. The Inspection officers were specifically mandated to inspect books of account and books and papers of the Company and probe into following:

- a) Obtain copy of settlement agreement with Samba Bank Limited (*"SBL"*) and clearance letter regarding settlement of loan;
- b) Obtain auction notice by SBL, copies of Rs. 20 million as proof of settlement with SBL, copies of cheque of Rs. 3.5 million payable to National Bank of Pakistan (NBP);
- c) Winding up proceedings under Section 305(c) read with Section 309(b) are initiated against the Company. Company failed to provide any concrete plan therefore inspection was conducted to determine Company's current position and find out probability of revival, if any to conclude the proceedings;



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- d) Obtain supporting documentation in respect of disposal of land; and
- e) Conduct the inspection of statutory records without limiting its scope.

3. During the course of inspection, inspection team obtained overview of the transactions in question, management of the Company and changes therein. Scrutiny of the records made available to the team revealed the transactions, which resulted in material misstatements in the accounts of the Company in relation non-recognition of full amount of loan payable to bank, Stores, and Spares and trade debts, as discussed below in the following paragraphs.

4. Furthermore, proceedings under Section 305(c) read with Section 309(b) were initiated against the Company to wind up the Company. The Company in response to Show Cause Notice and verbal submissions made during the course of hearings submitted that the Company intended to restart its operations and entered into an agreement with SBL, the main lender of the Company, for settlement of loans pending litigation since 1999. The Company paid Rs.20 million, which were arranged by the sponsors from their personal sources. SBL claim was of Rs 593 million, however, Company informed that it had entered into an agreement in which they settled the amount by paying Rs.20 million to SBL. However, copy of agreement with SBL and clearance letter regarding the settlement of loan was not provided. Inspectors were specifically instructed to obtain copy of settlement agreement with SBL and clearance letter regarding the settlement of loan.

5. During the on-site inspection and discussion held with the management of the Company and review of accounts of the Company and Silver Fiber Spinning Mills Limited ("SFSML") an associate of the Company, it was revealed that loan was contracted by the Company from SBL (then Doha Bank) for financing import of machinery from Japan in year 1992, a major part of the loan was sub-lent by the Company to SFSML, without first obtaining the required NOC from bank. The Company could not lawfully make this transaction of transfer of loan to its associate, as the directors of the Company signed the loan agreements, which required consent of the bank for any such transfer of loan liability. This fact is also recognized by the SFSML in its accounts. It was observed that the Company recorded 22.5% of the entire loan liability in its books instead of recording full amount and recorded a corresponding receivable in respect of loan portion sub-lent to SFSML. Following is the breakup of outstanding loan recorded in accounts of the Company and in the available accounts - 2014 of SFSML:



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Name of Company	Amount (Rs in Million)	Remarks
Nazir Cotton Mills Limited	60.14*	Company's Audited Annual Accounts-2016
Silver Fiber Spinning Mills Limited	147.55	SFSML Audited Annual Accounts- 2014
	<u>207.69</u>	

* Increased liability due to non-deposit of 1st installment, recovered from associated but not deposited in the bank.

6. Subsequently SBL and the Company entered into a loan settlement agreement dated August 27, 2015 for cumulative loan liability of Rs. 475.09 million of the Company to be settled for Rs. 71 million as full and final settlement.

7. Loan was obtained by the Company from the SBL and transferred to its associated company, which was utilized for acquisition of plant and machinery. SFSML Accounts 2014 recognize 77.5 % of the loan as its liability whereas Accounts of the Company disclosed remaining 22.5 % of bank liability as its proportionate share in the bank loan as per Note 9 to the Accounts. The Accounts of the Company were therefore materially misstated and understated as full amount of liability was not recorded and corresponding receivable was not recorded thereby attracting penal provisions of section 492 of the Ordinance.

8. In addition to above, Stores and spares of the Company amounted to Rs 1.8 million as at June 30, 2016. Stores and spares amounting to Rs.1.32 million pertaining to unit 3 of the factory were expensed out in the year 2012 whereas, stores and spares actually exist on ground as per the inspection report. This issue also attracts provisions of section 492 of the Ordinance due to misstatement in the Accounts.

9. Trade debts of the Company as at June 30, 2016 amounted to Rs. 2.83 million. Trade debts pertain to year 2000 and have not been recovered yet. Recoverability of debts is doubtful and no material efforts from management for recovery of debts was provided to inspection team. Since debts are very old and recovery of these debts is doubtful, provision for doubtful debts need to be



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recorded in the books of account. Accounts of the Company are materially misstated in terms of material omission for non-recording of required provisions for aforesaid trade debts, in contravention of the requirements of section 492 of the Ordinance.

10. In view of foregoing paragraphs, the Accounts of the Company for the year ended June 30, 2016 were misstated which makes the directors of the Company liable to the penalty as stated under section 492 of the Ordinance. Therefore, SCN dated November 6, 2017 was issued to the Respondents to show cause in writing within fourteen days from the date of this notice as to why penalty may not be imposed for attracting the afore-referred provisions of the Ordinance.

11. Subsequent to the issuance of SCN, hearing in the matter was fixed on November 30, 2017. Mr. Maqbool Hussain Bhutta CFO and director of the Company attended the said hearing. During the hearing proceeding, Authorized Representative was advised to submit the written reply to the SCN, which he agreed to. Thereafter, Mr. Muhammad Hayat Jasra from M/s Abdul Rehman Qureshi & Associates submitted the reply to the SCN vide letter No. NCML/02/18 dated February 9, 2018. It was submitted that:

- i. Copy of Agreement with SBL is attached. The entire loan of the SBL stands adjusted, the Company has taken up the matter with the said Bank for issue of clearance certificate which will be submitted in due course.
- ii. SFSMIL is wholly owned subsidiary. The action to transfer the loan to it was taken pursuant to the decision/approval of members in an EOGM held on August 26, 1995. All the record is available in the record of the Commission. This being a matter of 25 years old, the objection does not appear to be justifiable at such a belated stage.
- iii. The entry has been made in consonance with the arrangement explained against Para ii above. The corresponding entry was made to balance the accounting transactions.
- iv. Store and spares of Mill No. 3 have been written off with the approval of competent authority. The scrap is lying in the store room. As and when they are sold the sale proceeds will be shown as other income in the accounts.
- v. Debtors are being pursued vigorously at appropriate level. We are quite hopeful of their recovery.



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12. Considering the written submission with respect to the SCN, the Company was provided a hearing opportunity on February 22, 2018. Mr. Muhammad Hayat Jasra FCMA, and Mr. Maqbool Hussain Bhutta appeared as the authorized representatives on behalf of the Respondents. During the hearing proceeding, they reiterated their viewpoint as submitted in written reply to the SCN.

13. I have gone through the facts of the case, arguments put forward during the hearing proceedings and written submission made in reply to the SCN. At the outset, I would like to mention here that one of the non-compliances of law by the Company is that *"loan was obtained by the Company from the SBL and transferred to its associated company, which was utilized for acquisition of plant and machinery. SFSML Accounts 2014 recognize 77.5 % of the loan as its liability whereas Accounts of the Company disclose remaining 22.5 % of bank liability as its proportionate share in the bank loan as per Note 9 to the Accounts"*. In this regard, I would like draw attention of Para 32 of IAS 1 Presentation of Financial Statements, which states that *an entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS*. In the instant matter, following are the facts which need attention:

- a) The loan was contracted by the Company from SBL (then Doha Bank) for financing import of machinery from Japan in year 1992.
- b) The said agreement was signed between the Company and the then Doha Bank.
- c) Settlement Agreement dated August 27, 2015 was executed between SBL and the Company and Mian Shahzad Aslam. This shows that the liability for payment of SBL lies with the Company.
- d) State Bank of Pakistan vide letter No. MR/9043 dated January 18, 2005 issued the settlement terms and conditions, issued to the Company.
- e) SFSML in its Annual Audited Accounts for the year ended June 30, 2014 in Note 5.1, itself disclosed that *"this represents amount payable for unpaid installments of principal amount, mark up, exchange risk fee, letter of credit and letter of guarantee commission for the machinery acquired by the Company to Nazir Cotton Mills Limited and ultimately to Samba Bank Limited. Furthermore, out of total loan liability Nazir Cotton Mills Ltd is treating 22.5% as its liability and balance liability of 77.5% is appearing in the books of the Company"*.



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All the above said factors substantiate that the Company had the responsibility for payment of loan to SBL. However, the Company had not recorded the full and complete liability towards the payment of loan, and same is construed as misstatement in the Accounts of the Company.

14. During the hearing proceedings, the Authorized Representative provided the copy of Special Resolution passed by the members of the Company in their general meeting held on August 26, 1995, as evidence to transfer of loan to SFSML. In this regard, I have reviewed the resolution passed in the said meeting. I would like to mention that in the said meeting the shareholders passed the resolution under Section 208 of the Ordinance that the Company be and is hereby authorized to acquire shares of its associated company M/s Silver Fiber Spinning Mills Limited of the face value of Rs 36 million for consideration other than cash i.e. import incidental charges such as license fee. L/c opening charges and Exchange Risk fee etc. and thereby constitute M/s Silver Fiber Spinning Mills Limited a subsidiary of the Company. The said resolution does not in any way substantiate that the loan obtained by the Company from SBL was to be transferred to SFSML in any manner. Therefore, argument of the Authorized Representative in this regard is not tenable.

15. It is important to mention that the Authorized Representative submitted that the Company has settled the liability towards SBL by paying Rs. 71 million to SBL. However, no evidence in this regard is provided during the hearing proceedings. In this regard, I have reviewed the annual audited accounts of the Company for the year ended June 30, 2016 and June 30, 2017. Review of the said accounts shows that the liability toward SBL has been paid by the Company amounting to Rs 60.142 million. The said amount is also disclosed in the cash flow statement of the Company. Directors of the Company in their Report to the members for the year ended June 30, 2016 and June 30, 2017 disclosed this very fact that the Company has paid off all the loan of its major lender M/s Samba Bank Ltd.

16. With regard to store and spares, the inspectors in their report pointed out that the said store and spares existed there, but the company expensed out these store and spares amounting to Rs 1.8 million. The Authorized Representative in this regard submitted that revaluation of store and spares was carried out and it was concluded that these store and spares are of no worth and are treated as scrap. Beside this, these items are also not in usable condition. The Company will sell out these store and spares and any proceed will be duly recorded in the books of accounts. The Company in this regard was advised to furnish the revaluation report of store and spares to arrive at their fair value,



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which Authorized Representative acceded to and promised to submit the same. Later on the Mr. Maqbool Hussain Bhutta vide his letter dated March 5, 2018 submitted that regarding valuation of stores, it is stated that the Company internal management on the factory site while evaluating the value of store and spares suggested that the store and spare of the Mill No. 3 become non-usable and was regarded as scrap. So the store amounting Rs. 1.3 million was written off on the suggestion of the Company staff at the mill. I have observed that the factory is lying close and there is no appropriate staff available and the authorized representative has taken different stances regarding the valuation therefore the appropriateness of such provisioning is highly doubtful.

17. With regard to the trade debts amounting to Rs. 2.83 million, the inspectors were of the view that these trade debts pertained to year 2000 and have not been recovered yet. Recoverability of debts is doubtful and no material efforts from management for recovery of debts was provided to inspection team. Since debts are very old and recovery of these debts is doubtful, provision for doubtful debts need to be recorded in the books of account. The Authorized Representative in this regard submitted that Debtors are being pursued vigorously at appropriate level. We are quite hopeful of their recovery. The management is making efforts for recovery of these amounts and do not consider them as irrecoverable. So no provision has been made in this regard. The Company is also contesting in the court and a decree has been issued by the Court in favor of Company. The Authorized Representative in this regard provided the copy of decree issued by Honorable Justice Mohsin Ali Khan Civil Judge 1st Class, Lahore. The said Decree was issued for recovery to be made from M/s Pak Weaving Company, one of the Trade Debtors. The Company however, has not provided any other evidence for recovery of amount from other debtors, which includes Sunrise Textile Ltd (Rs 381,083), M/s New Grace Hosery Lahore (Rs 1,223,445) and M/s Khalid Mahmood Chawala (Rs 19,000,000). Since the matter of recovery to an extent is *subjudice*, so I hereby agree with the stance of the Authorized Representatives.

18. At this juncture, I would like to advert to the provisions of Section 492 of the Ordinance provides that:

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.



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19. 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 Executive Director (Corporate Supervision Department).

20. In view of the foregoing, I am of the view that the Company has misstated in its financial statements for the year ended June 30, 2016, by not recording its full liability of the bank loan as well as corresponding receivable which attracts the provisions of Section 492 of the Ordinance. I have observed that the loan amount has been settled by the Company while the SFSML has also contributed towards the settlement of loan by the Company by paying cash amounting to Rs.20 million and through adjusting the current receivable account from the Company. SBL has also acknowledged the settlement of the loan and has released the collateral in this regard. However, the loan was obtained by the Company from the SBL and transferred to SFSML which was utilized for acquisition of plant and machinery. SFSML recognized 77.5 % of the loan as its liability whereas accounts of the Company disclosed remaining 22.5 % of bank liability as Company's proportionate share in loan. The authorized representatives have not come up with any plausible argument which could justify the aforesaid treatment of loan by the Company which resulted in material misstatement in the accounts. I therefore believe that the law has been breached here in the matter of loan obtained and transferred to SFSML by the Company and impose a penalty of Rs.15,000 on each of the respondents under section 492 of the Ordinance for the misstatement in accounts caused due to the issue of loan taken from SBL as elaborated. The detail of penalty imposed on each director is as under:

S.#	Names of Directors	Rs.
1	Mian Shahzad Aslam	15,000
2	Mian Farrukh Naseem	15,000
3	Mian Aamir Naseem	15,000
4	Mr. Maqbool Hussain Bhutta	15,000
5	Mr. Muhammad Asghar	15,000
6	Mr. Muhammad Abbas	15,000
7	Mr. Sibgat Ullah	15,000
	Total	105,000



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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 Respondents 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 23, 2018
Islamabad

