

Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division

7th Floor, NIC Building, Jinnah Avenue, Islamabad

Before Rashid Sadiq, Executive Director

In the Matter of
M/S ADIL POLYPROPYLENE PRODUCTS LIMITED

Number and date of notice	EMD/265/22/2002 dated June 21, 2002
Date of hearing	July 11, 2002
Present	None

**ORDER UNDER SECTION 265 OF
THE COMPANIES ORDINANCE, 1984**

This order shall dispose of the proceedings initiated against M/S Adil Polypropylene Products Limited (the “Company”) under the provisions of Section 265 of the Companies Ordinance, 1984 (the “Ordinance”) through show cause notice dated June 21, 2002.

2. In order to dispose of the aforesaid matter, a brief narration of the background facts leading up to the issue of show cause notice is necessary. The Company was incorporated in 1989 under the Ordinance as a private company limited by shares. It was converted into a public company and was listed on the Karachi and Lahore Stock Exchanges in 1994. The Company is engaged in the manufacture and sale of polypropylene products. The manufacturing facility of the Company is located at Gadoon Amazai Industrial State, Swabi and comprises of 24 looms and 26 extruders as on June 30, 2001.

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3. The financial statements of the Company for the year ended June 30, 2001 received at the Commission in terms of Sub-section (5) of Section 233 of the Ordinance were examined and it was found that the Company has reported a loss of Rs. 7.90 million for the year. Moreover, as on June 30, 2001, its accumulated losses amounted to Rs. 92.12 million, which exceeded its total equity comprising only of paid up capital of Rs. 55.30 million, by Rs. 36.83 million. The auditors' of the Company namely, M/s Nazir Chaudhri & Co. Chartered Accountants have issued a disclaimer of opinion in their report to the shareholders because of several deficiencies found in the record and limitation on scope of their work. The Company has suspended its production and the lenders have filed suits for the recovery of their loans. It was also noticed that the Company has been unable to pay any dividend to its shareholders since 1997.

4. In view of the aforesaid state of affairs, the scope of examination was further extended, which disclosed that funds were raised by the Company through public issue of shares for the *specific purpose of repayment of outstanding short-term borrowings to National Development Finance Corporation*. The relevant Para 2.7 of Part II of the prospectus is reproduced as hereunder:

Quote

“The proceeds of the public issue will be utilized by the Company to repay short term borrowing of National Development Finance Corporation amounting to Rs. 25.00 million and meet the working capital requirements amounting to Rs. 2.650 million.”

Unquote

5. The subsequent financial statements, however, demonstrated that the Company has not utilized the funds it raised from public issue for the purpose set

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out in the prospectus. Instead, the public funds were utilized mainly to partially pay off 105% dividend to the directors/sponsors declared on December 31, 1993, i.e. prior to public issue, which was converted into a term loan due to non-availability of funds at that time and to reduce the amounts due to the associated undertakings and partial payment to National Bank of Pakistan to the extent of Rs. 10.31 million. It was regretfully noticed that the Company had stated in Para 5.5 of Part V of the prospectus issued for public offering that the dividend @ 105% declared prior to issue of prospectus had already been paid on May 15, 1994. For ease of reference, the aforesaid Para of the prospectus is reproduced hereunder:

Quote

“Interim dividend declared at the rate of 105% for the half year ended 31st December, 1993 has been paid to the shareholders on 15th May, 1994.”

Unquote

6. The precarious financial health of the Company also necessitated a detailed look into the past financial statements of the Company. The annual accounts of the Company for the years 1994-2001 were, therefore, examined and it was noted with great concern that the Company’s performance after the public issue of shares has deteriorated considerably. The highlights of results of the Company in these years is placed below:

<i>Year</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>
	<i>Rupees in million</i>							
Sales	140.2	180.5	122.2	119.5	67.1	29.0	3.3	0.7
Gross Profit/(Loss)	23.6	19.0	15.7	7.5	(17.6)	(18.1)	(13.1)	(1.0)
Net Profit/(Loss)	6.8	3.4	(1.4)	(15.5)	(10.5)	(22.6)	(39.1)	(7.1)
Accumulated Profit/(Loss)	10.3	6.1	0.5	(15.0)	(25.5)	(45.9)	(85.3)	(92.1)
Dividend	*105%	**15%	**15%	-	-	-	-	-
Gross Profit/(Loss) Ratio	16.8%	13.6%	11.2%	5.3%	(12.6)%	(12.9)%	(9.3)%	(0.7)%
Net Profit/(Loss) Ratio	4.9%	2.4%	(1.0)%	(11.1)%	(7.5)%	(16.2)%	(27.9)%	(5.1)%

* This represents interim dividend declared on December 31, 1993, prior to the public issue.

** The company at the time of public offer of its shares committed to pay guaranteed dividend@ 15% annually for three years post public offer.

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7. The aforesaid financial information indicated that the Company had been earning profits prior to the public issue of shares, which is evident from the its un-appropriated profit balance which stood at Rs. 32.5 million as on June 30, 1993 earned in a short span after its incorporation. After the public issue of shares, the sales and profitability have declined sharply. Sales of around Rs. 140 Million in 1994 have been reduced to just Rs. 0.7 million in 2001 and as reported in the most recent half yearly accounts sales are Nil for the six months period ended December 31, 2001. Instead of making repayments of loans to NDFC amounting to Rs 25 million as undertaken in the prospectus, the public money was utilized for repayment of amounts due to associated companies and sponsors' loans. The dividend @ 105% declared before public offer was in fact not paid, as stated in the prospectus and was converted into sponsors loans, which subsequently was paid by resorting to additional bank borrowings. The additional borrowings coupled with non-payment of loans to NDFC have put tremendous pressure on the financial resources of the Company due to drain of company's resources to service the cost of these borrowings.

8. The auditors of the Company namely, M/S Sajjad Ahmad & Co., Chartered Accountants have qualified the report signed by them on March 07, 1996 on the annual accounts of the Company for the year ended June 30, 1995 in the following words:

Quote

- *“Out of Rs. 29,260,076 an amount of Rs. 29,032,500 represents interim dividend declared during December 1993, payable to promoters/directors which was converted into interest free long term loan in June, 1994 instead of being paid in cash as required by the Companies Ordinance, 1984.*

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However a sum of Rs. 3,624,959 has been paid during the year leaving a net balance of Rs. 25,407,541.

- *Proceeds of public issue amounting to Rs. 27.650 million had not been utilized for the repayment of short term borrowings amounting to Rs. 25.000 million payable to National Development Finance Corporation as committed in part 2.7 of prospectus dated July 12, 1994.”*

Unquote

M/S Sajjad Ahmad & Co., Chartered Accountants were subsequently changed and M/S Sidat Hyder Qamar Maqbool & Co., Chartered Accountants were appointed as auditors of the Company. The new auditors did not qualify the subsequent audit reports till the accounts for the year ended June 30, 1997.

9. The audit report on the accounts for the year ended June 30, 1998 were, however, qualified by the auditors on the following issues only:

Quote

- *Balance of loans from National Bank of Pakistan, terms relating thereto and reversal of mark-up amounting to Rs. 4.8 Million charged in prior years on these loans remained unconfirmed from the bank. Moreover, mark-up amounting to Rs. 2.8 Million on these loans has not been accounted for*
- *Stock of raw materials valuing Rs. 5.4 Million lying with third party could not be physically verified.*

Unquote

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10. From 1999 onwards the auditors also started putting an emphasis on the Company's ability to continue as going concern in their report. In the auditors' report for year 2000, the following further qualifications were added to the ones mentioned above:

Quote

- *Stock of raw material valuing Rs. 5.438 million lying with third party as referred to in Note No. 12 could not be physically verified. The sale transaction of stock lying with third party, as reported in the last directors' report, does not appear in the books of accounts for the year under review. (The Directors' Report for the year ended June 30, 1999, referred above, stated that "The stocks lying with the third party could not be arranged for physical verification, but subsequently the sales have been made by the Company and verified by the auditors.")*
- *The record relating to shift wise production was not made available for our verification. Further, reconciliation of material consumed/produced was not made available.*
- *Confirmation certificates from legal advisors of the Company confirming the status of the cases and claims instituted for and against the company were not available as such the quantum of contingent liabilities arising there from could not be ascertained.*

Unquote

11. The auditors of the Company's were again changed and M/S Nazir Chaudhri & Co., Chartered Accountants were appointed in place of M/S Sidat Hyder Qamar Maqbool & Co., Chartered Accountants. The disclaimer of opinion expressed by the

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newly appointed auditors on the accounts of the Company for the year ended June 30, 2001 further compounded the situation. The auditors while issuing the disclaimer of opinion observed that:

Quote

- *We could not observe the physical verification of stock, work-in-process and stores due to lack of arrangement by the management as at June 30, 2001. Owing to the nature of the Company's record we were unable to apply the adequate alternative auditing procedure to confirm the physical balance as on that date.*
- *The balance of debtors, advances, other receivables, creditors and all the banks remained unconfirmed in the absence of balance confirmation from the respective parties/banks.*
- *The books of the Company have not been prepared in a proper organized manner.*

Unquote

12. The aforesaid circumstances demonstrated that the management of the Company did not pay any heed to the issues raised by the auditors in successive audit reports and did not take any corrective measures to improve the situation. The Directors' Reports attached to the annual balance sheets for these years under Section 236 of the Ordinance also suffered from legal infirmities. The directors of the Company failed to provide sufficient reasons for incurring losses in these years for the appreciation of the shareholders. They also failed to come up with any concrete plans to arrest declining performance and to bring back the Company on the revival path. The Directors' Reports also did not provide sufficient

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justification/explanation with reference to qualifications/observations of the auditors.

13. As regard to the qualification on the status of books of accounts kept by the Company, the Directors' Report for the year 2001 categorically and unequivocally admitted that proper records and books of accounts were not maintained. The relevant excerpts from the Directors' Report is reproduced as follows:

Quote

“As explained there were no commercial activity of the Company during the period under review, limited staff is working in company's Head Office, as such books could not be maintained in organized form up to the expectation of the Auditors.”

Unquote

14. By not maintaining proper records and books of account and providing the same to the auditors of the Company has in effect deprived the shareholders from statutory right to receive balance sheet and profit and loss accounts reflecting a true and fair state of the Company's affairs. This also denies the shareholders of the Company of their only independent impartial insight into its affairs and that too in a situation where the Company has been incurring losses since the public has invested money in the Company through public issue of its shares.

15. The continuous decline in the performance of the Company coupled with financial irregularities discussed above gave rise to apprehension that the affairs of the Company were not being conducted in accordance with sound business principles and prudent commercial practices and were being conducted in a manner oppressive to its members and to deprive them of the reasonable return on their investment. This state of affairs also reasonably suggested that the results of the

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Company might not be negative just because of the general recession in the industry but there could be some other reasons including deliberate attempts on the part of the management to siphon off funds of the Company.

16. In view of the aforesaid situation, a notice dated June 21, 2002 was issued to the Chief Executive of the Company calling upon him as to why inspector, under Clause (b) of Section 265 of the Ordinance should not be appointed to investigate into the affairs of the Company.

17. The Company did not respond to the aforesaid show cause notice. In order to provide another opportunity to the management of the Company, to present its submissions, the case was re-fixed on July 11, 2002. But again, the Chief Executive, in person or through any authorized representative, failed to show up on the said date. The unresponsive attitude of the management of the Company towards the Commission leads me to believe that they have nothing to argue in their defense. I, therefore, proceed to adjudicate this case on its merits.

18. The continuous deteriorating performance after the public issue of shares, the use of moneys raised from public to make payment of dividend to sponsors/directors and to repay amounts due to associated undertakings, additional borrowings to pay sponsors loans, which in fact was dividend declared before public offer and converted into sponsors' loans, failure to maintain proper and true accounts, contraventions of the mandatory provisions of the Ordinance and other irregularities highlighted in the preceding paragraphs amply demonstrate that the business of the Company is being conducted in a manner oppressive to its members.

19. Minority shareholders are the medium, which could genuinely contribute towards economic growth through their savings if those are channelised for productive purposes giving them reasonable returns and assuring the safety of their investments. The minority shareholders to whom the directors owe fiduciary

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obligations are without any return for the last several years. The funds raised from the general public for repayment of loans were not used for the said purposes and instead were utilized for payment of outstanding dividend to sponsors and for reducing the amounts payable to associated companies. Moreover, additional funds were raised from banks for repayment of sponsors' loans. This has resulted in pressure on the Company's liquidity and resultant losses in period subsequent to public issue of shares. Viewed with the dismal state of affairs of the Company and the fact that no concrete revival plans are being provided by the Company, which would enhance any future dividend prospects it would not be incorrect to infer that the affairs of the Company have been so conducted or managed as to deprive the members thereof of a reasonable return.

20. It is the statutory right of the members to receive annual balance sheet and profit and loss account, which must reflect true and fair state of affairs of the Company. Moreover, the directors are duty bound to attach a Directors' Report with such balance sheet under Section 236 of the Ordinance. The qualifications of auditors in their reports on the accounts for the years 1998 onwards and more particularly disclaimer of their opinion on the accounts for the year ended June 30, 2001 are *prima facie* evidence that the directors have failed to transmit annual accounts to the shareholders of the Company in accordance with the requirements of law. The Directors' Reports also failed to give sufficient information to the shareholders, which they reasonable expect from the directors under the relevant provisions of the Companies Ordinance. The foregoing clearly indicates that the shareholders of the Company have not been given all the information with respect to its affairs, which they might reasonably expect. Also the right of information has been given special status in the law by providing that the refusal of information would be an act, which could activate the machinery of investigation.

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21. The irregularities pointed out in the preceding paragraphs, the continuous losses, non-maintenance of proper books of accounts, contraventions of the mandatory provisions of law and unresponsive attitude of the directors towards the Commission reasonably suggest that the affairs of the Company are not being managed in accordance with the sound business principles and prudent commercial practices.

22. The recovery suits filed by the lenders in the Court of law indicates that the lenders have lost confidence in the management of the Company. The equity of the Company has turned into negative due to accumulated losses and its current liabilities exceeded its current assets. Viewed with the fact that the production has been suspended and that there are no sales for the six months ended December 31, 2001, the Company seems to be in dire financial straits and on the brink of collapse. This, therefore, clearly suggests that the financial position of the Company is such as to endanger its solvency.

23. In view of the foregoing discussion, it can be legitimately inferred that the directors have failed to protect the interest of the shareholders. It is, therefore, the responsibility of the Commission to ascertain factual position through competent inspector(s) whose report can bring to light as to whether the affairs of the Company were managed in conformity with the accepted principles and standards of good and efficient management. The Commission can protect the interest of the investors only through timely initiating a fact-finding exercise.

24. For the reasons recorded above and on the basis of material available on record, I am fully satisfied that the circumstances exist, which warrant action under Section 265 of the Ordinance. In my opinion, these circumstances *prima facie* suggest that:

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- a. The business of the Company is being or has been conducted in a manner oppressive to its members;
- b. The affairs of the Company has been so conducted or managed as to deprive the members thereof of a reasonable return;
- c. That the members of the Company have not been given all the information with respect to its affairs, which they might reasonably expect;
- d. The affairs of the Company are not being managed in accordance with sound business principles or prudent commercial practices; and
- e. The financial position of the Company is such as to endanger solvency;

25. I, therefore, in exercise of the powers conferred on me under clause (b) of Section 265 of the Ordinance, hereby appoint Mr. Rizwan Bashir, FCA of M/s Hassan Farooq Rizwan & Co., Chartered Accountants 10-A Wahdat Road, Lahore to act as Inspector to investigate into the affairs of M/s Adil Polypropylene Products Limited on a remuneration of Rs. 200,000/- to be paid by the Company.

26. Without limiting the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of all the records and books of accounts, furnish a report, *inter alia*, on the following matters:

- a) Reasons of heavy losses sustained after public offering. Whether these losses were due to mismanagement imprudent policies or some other reasons.
- b) Utilization of funds raised through public offer.

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- c) Whether or not the Company has kept proper records as required by Section 230 of the Ordinance.
- d) Compliance with the provisions of Section 234 relating to disclosure of information.
- e) Diversion of funds to unauthorized objects.
- f) Sales / revenues of the Company with particular reference to prices of the comparable units.
- g) Transactions with associated undertakings during the year 1994 to 2001.
- h) Investigation of cash transaction made by the Company with particular reference to unusually huge amounts being transacted and/or items incurring repeatedly without proper documentation.
- i) Investigation of Expenditures incurred by the Company with particular reference to the following:
 - Expenditures versus sales /revenues/production
 - Energy consumption versus capacity utilization
 - Expenses of the Company versus expenses of the comparable companies
 - Expenditure analysis in terms of:
 1. Organization
 2. Personal
 3. Production

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4. Selling overheads

5. Financial charges

- j) Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.
- k) Reasons for the failure of the Company in context to:
- Over capitalization
 - Bad management practices
 - Leakage of sales
 - Over spending in expenditures
 - Assessment of capital expenditures of the company in respect of Company's requirements.
 - Excessive borrowings
- l) Determination of any false and incorrect statement in directors' report.
- m) Compliance with statutory requirements in the operation of the Company.
- n) To report any lapses or other delinquency detected during the course of investigation.
- o) In-efficiencies in production.
- p) In-out record of the Company particularly relating to sales and purchases.
- q) Statutory books including particularly minutes books of the Board and general body meetings.

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- r) To suggest future course of action in the interest of the shareholders of the Company.
- s) Results of circularization to lenders, legal advisors, trade debts, advances, receivables and bank balances as at June 30, 2002.
- t) Whether or not dividend for the year 1997 has been paid by directors from their own resources.

27. The inspector shall submit his report along with supporting documents to the Commission, highlighting violations of the relevant provisions of the Ordinance, within sixty days from the date of this order.

28. The inspector, for the purpose of his investigation, shall have the same powers as are vested in a Court under the Code of Civil procedure, 1908 while trying a suit in respect of the matters enumerated under Section 266 of the Ordinance and every proceeding before the inspector shall be deemed to be judicial proceeding within the meaning of Section 193 and 228 of the Pakistan Penal Code, 1860. Any contravention or non-compliance with any orders, direction or requirement of the inspectors shall entail the consequences under the Code of Civil Procedure, 1908 and Pakistan Penal Code, 1860.

29. It shall be the duty of all the officers, employees and agents and other persons having dealing with the Company to provide all assistance to the inspector in connection with the investigation, and any default whereof shall be punishable under Section 268 of the Ordinance.

RASHID SADIQ
Executive Director (Enforcement & Monitoring)

Announced
August 06, 2002
ISLAMABAD