

SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
Enforcement & Monitoring Division
7th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad

Before Rashid Sadiq, Executive Director

In the matter of
M/s. Ghani Glass Limited

Number and date of notice

EMD/233/585/2002
June 18, 2002

Date of hearing

June 25, 2002

Present

Mr. Abdul Ghaffar,
Chief Financial Officer

Order

This is a case where no return on investment in associated company was being received in violation of the provisions of Clause (b) of proviso to Sub-section (1) of Section 208 of the Companies Ordinance, 1984 (the "Ordinance").

2. The relevant facts of this case, briefly stated, are that the balance sheet and profit and loss account for the year ended June 30, 2001 of M/s. Ghani Glass Limited (the "Company") received by the Commission pursuant to the provisions of Sub-section (5) of Section 233 of the Ordinance were examined and it was transpired that the Company has provided loans amounting to Rupees 49.935 million to its associated undertaking namely M/s. Ka'as ul Musaf'fa (Pvt) Limited (hereinafter called as the "associated company"). The scrutiny of the record further revealed that the Company has passed a special resolution in its 7th Annual General Meeting held on January 29, 2000 to extend short term loans up to Rupees 50 million to associated company from time to time at such mark up/profit rate, which shall not be less than the borrowing cost of the Company.

3. The auditors' report on the aforesaid accounts signed by auditors of the Company namely, M/s. Rahim Iqbal Rafiq & Company, Chartered Accountants on December 05, 2001 contained the following reservation:

Quote

“Without qualifying our opinion, we draw attention to note 13.1 and 24.1 whereby no return on investment in associated company has so far been received, which though being at par with its much higher current account balance, yet the ultimate risk or return on such investment cannot presently be determined.”

Unquote

4. Furthermore, Note 13.1 to the aforesaid accounts contained the following information in respect of the loans provided by the Company to its associated company:

Quote

This represent short-term loan extended to associated company. The loan continues to be without interest as the company did not incur any borrowing cost in line with its explicit policy of not engaging in interest-based transactions. It, however, expects to receive benefit in the shape of dividend from its investment in the said company.

Unquote

5. The directors' report attached to the aforesaid accounts suffered from legal infirmity, as it did not provide any explanation on the reservation of the auditors as required by the provisions of Section 236 of the Ordinance.

6. The aforesaid circumstances, *prima facie*, suggested that the Company has violated the provisions of Clause (b) of proviso to Sub-section (1) of Section 208 by not taking any return on its loans to associated company. This necessitated further examination of the matter.

7. Consequently, a notice dated June 18, 2002 was issued to the Chief Executive and Directors of the Company to show cause as to why penal action may not be taken against them under Sub-section (5) of Section 208 of the Ordinance for violating the mandatory provisions of the Ordinance.

8. In response to the aforesaid show cause notice, Mr. Abdul Ghaffar, Chief Financial Officer of the Company appeared before me on June 25, 2002 and argued the case

on behalf of Directors and Chief Executive of the Company. He contended that no return was received from the associated company because there was no borrowing cost of the Company. He also averred that the Company is a shareholder of associated company to the extent of 42.86 % and the Company would benefited from the dividend to be received on the equity investment in associated company. He also stated that both the companies are showing good results and there are reasonable prospects for increase in their profitability in future. The Company has paid 115% cash dividend to its shareholders in the last two years. He, however, agreed that return on loans advanced by the Company to its associated company would be recovered, which for the year ended June 30, 2001 would not be less than 15.86%. It was also indicated that this return would increase to around 20% during the year ending June 30, 2002. Subsequently, the Company has also submitted an undertaking to receive return on its loans to associated company. The directors and Chief Executive of the Company have also requested for a lenient view of the default and provided assurance that they would ensure the compliance of the provisions of the Ordinance in future.

9. After having considered the arguments of the representative of the directors and Chief Executive of the Company and also having examined documents of the Company on record and produced before me, I am of the opinion that the Company cannot provide loans to its associated company without any return thereon. The provisions of Clause (b) of proviso to Sub-section (1) of Section 208 are mandatory and require that the return on loans shall not be less than the borrowing cost of the Company. The aforesaid provisions of law is reproduced hereunder:

“the return on investment in the form of loan shall not be less than the borrowing cost of the company”.

10. The aforesaid provisions of law were brought about through Finance Act, 1995 to prohibit the provisions of mark up free loans to associated companies. In my view, the spirit of the aforesaid provisions of law is that the companies must receive return on their investments in associated companies. The reference to borrowing cost has been made to set a benchmark for the determination of rate of return to be received on loans to associated companies. Advancing of loans without any return amounts to passing of undue benefit to the associated company, which is a loss to the lending company and its shareholders. The law, therefore, does not envisage loans without any return to associated companies.

11. In the case in hand, the Company has passed a resolution for extending loans to associated company at mark up/profit rate, which shall not be less than the borrowing cost of the Company. As the Company had no loans, therefore, it was wrongly presumed that the Company could provide loans without any return to its associated company. The provision of loans without any return thereon indicates that the directors have acted in the interest of associated company where they alongwith their family members hold more than 57% of the total paid up capital of the associated company. Thus, this is a case where the directors

holding interest in more than one company have tried to pass on the benefits to one company at the cost of shareholders of other company. The default, therefore, is considered to be willful which attracts the penal provisions of Sub-section (5) of Section 208 of the Ordinance.

12. I have noted that the Company has promptly acted and has undertaken to rectify the default by charging return on loans to its associated company. It has also been sufficiently demonstrated that the profitability of the company would increase substantially in future. According to the record, the Company has paid cash dividend @ 60% and 55% in the year 2000 and 2001 respectively, which indicates that the Company is adequately rewarding its shareholders. The sales of the associated company has also depicted substantial increase from Rs. 72.920 million in the year 2000 to Rs. 451.870 million in the year 2001 with tremendous improvement in the bottom-line i.e. from a loss of Rs. 15.165 million sustained in 2000 to a profit of Rs. 25.454 million in 2001. The Company is, therefore, expected to earn a reasonable dividend on its equity investments in the associated company. The return on loans, therefore, was also expected to increase in future due to increase in profitability of the associated company. As the directors and Chief Executive of the Company have acted reasonably and positively on initiation of these proceedings and have also assured that they would ensure strict compliance of the provisions of the Ordinance in future, therefore, I take a lenient view of the default and instead of imposing the maximum fine of Rs.1,000,000/- prescribed by Sub-section (5) of Section 208 of the Companies Ordinance, 1984 imposed a token fine of Rs. 15,000/- (Rupees Fifteen Thousand Only) on each of the directors including the Chief Executive of the Company for violation of the provisions of Clause (b) of proviso to Sub-section (1) of Section 208 of the Ordinance.

13. The Company is directed to recover the return on loans for the year ended June 30,2001 and for the period ended March 31, 2002 within one month from the date of this Order. A certificate from auditors should be furnished to this Commission within seven days of the recovery along with detail working of the return recovered from the associated company. The recovery of return in future may be made quarterly.

14. The following directors/Chief Executive are directed to deposit the fine amounting to Rs. 135,000/- (Rupees One Hundred And Thirty Five Thousand Only) in aggregate within 30 days of the date of this Order in the designated Bank Account of Securities and Exchange Commission of Pakistan.

- (i) Mr. Aitzaz Ahmad Khan
- (ii) Mr. Imtiaz Ahmad Khan
- (iii) Mr. Muhammad Ahmad
- (iv) Mr. Anwaar Ahmad Khan
- (v) Mr. Aftab Ahmad Khan
- (vi) Mrs. Ayesha Aftab
- (vii) Mr. Atique Ahmad Khan
- (viii) Hafiz Avais Ghani

(ix) Mr. Junaid Ghani

15. Before parting with this Order, I would like to make an observation. Para-11 of 4th Schedule to this Ordinance requires specific disclosure and reasons alongwith nature of interest of directors in case loans or advances has been granted or debt allowed on terms softer than the generally prevalent in trade or any relief or concession allowed in the matter of interest, repayment, security or documents. The accounts of the Company failed to provide the aforesaid information. The audit report is also silent on this issue. In fact, the auditor report stated that the accounts give the information as required by the Ordinance in the manner so required. The concerned officer of this Office is, therefore, directed to examine this issue and take up this matter with the auditors of the Company.

16. The Directors and Chief Executive are also advised to ensure the strict compliance with the provisions of Section 236 and 234 of the Ordinance in future.

RASHID SADIQ

Executive Director (Enforcement & Monitoring)

Announced.
June 27, 2002
Islamabad.