



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Company Law Division
(Enforcement Department)

Before Abdul Rehman Oureshi, Commissioner

IN THE MATTER OF

M/s Service Industries Textiles Limited

Number and date of notice	No.EMD/233/190/2002-4952 dated February 07, 2003
Date of final hearing	November 10, 2003
Present	<i>On Behalf of the Company:</i> Mr. Ralph Nazirullah, Company Secretary Mr. Ibrahim Hanif Malik, G.M. Finance

ORDER

Under Section 265 of the Companies Ordinance, 1984

This order shall dispose of the proceedings initiated against M/S Service Industries Textiles Limited (the “Company”) under the provisions of Section 265 of the Companies Ordinance, 1984 (the “Ordinance”) through a show cause notice dated February 07, 2003.

2. The Company was incorporated in 1962 as a private company and subsequently converted into a public limited company in 1970. The Company is listed on the Karachi and Lahore Stock Exchanges. Its paid up capital is Rs.44,491,590 divided into 4,449,159 ordinary shares of Rs.10 each.

3. The background of this case is that while examining the financial statements of the Company for the year ended September 30, 2001, it was observed that the accumulated losses of the Company stood at Rs.422.072 million resulting into negative equity of Rs.342.580 million and its current liabilities exceed the current assets by Rs.167.767 million while the current ratio has reached to the level of 0.23:1 as on that date. Besides, comparison of the financial statements for the year 1996 to 2001 also reflected that the performance of the Company is in downward spiral and there were many inconsistencies in its operating results. Further the Company has not

declared any dividend for the last several years except a nominal 5% dividend to the minority shareholders in the year 2000. The Ordinary share of Rs.10/- each of the Company was being quoted at Rs.0.65 on January 30, 2003 at the Karachi Stock Exchange.

4. The auditors of the Company have shown serious concerns regarding the preparation of accounts on the going concern assumption as accumulated losses of the Company exceeded its paid up capital by Rs.342.58 million and the current liabilities exceeded the current assets by Rs.167.77 million and subsequent un-audited quarterly accounts for the quarter ended March 31, 2002 also reported losses. Furthermore the auditor have raised concern on the notice of the Habib Bank Limited sent to the Company to settle the outstanding loan balance within 10 working days otherwise the bank shall have the right to initiate legal proceedings for recovery of the amount including winding up of the Company and that the Company has not reclassified the long term portion of the facilities amounting to Rs.10.896 million and has disclosed the same as long term liability. The auditors had not received confirmation from the Company's legal advisors in respect of the status of the cases against the Company and the likely outcome. The auditors therefore emphasized that in the absence of any significant concessions from the lenders and inability of the Company to arrange fresh financing, the Company would not be able to settle its liabilities in the normal course of business therefore they are not satisfied as to the appropriateness of the going concern assumption and adjustments in this regard may be required to the recorded asset amount and classification of liabilities. Financial statements do not disclose this fact. The auditors have also qualified their report regarding the recording of a rebate amounting to Rs.71.1 in the financial statements for the year ended September 30, 2001. The rebate has been agreed by UBL through an agreement with the Company on July 14, 2002 for restructuring of the outstanding demand finance and mark up through creation of new demand finances aggregating to Rs.160 million and such a rebate is only to be effected after complete adjustment of balances of demand finances. Further the auditors did not received response from the Bank for confirmation of liabilities and other relevant information. Moreover the auditors qualified their report regarding the fairness of the carrying value of the assets of the Company, as the Company has not revalued its assets subsequent to initial revaluation as required by IAS-16. Due to the above matter the auditors have given an adverse opinion on the accounts of the Company for the year ended September 30, 2001 and stated that the balance sheet, profit and loss

account, cash flow and statement of changes in equity together with notes forming part thereof do not conform with the approved accounting standards as applicable in Pakistan and do not give the information required by the Companies Ordinance, 1984 in the manner so required and respectively do not give true and fair view of the state of the Company's affairs as at September 30, 2001 and of the loss, its cash flows and changes in equity for the year ended September 30, 2001.

5. The auditors of the Company have also qualified their report for the year ended September 30, 2000 raising serious doubts on the ability of the Company to continue as a going concern in future. Moreover the auditors qualified the transaction of sale of machinery having book value of Rs.120 million, sold at Rs.27 million only, thus incurring a significant loss on this sale and further stated that appropriateness of price in the absence of evidence pertaining to market value could not be verified. The auditors also qualified their report stating that the Company does not have any policy with regard to the frequency of revaluation of its assets and due to adverse financial position in the absence of recent revaluation it is difficult to ascertain whether or not the fixed assets are stated at appropriate values. The auditors also could not verify the accuracy of consumption in the absence of proper record and control weakness on purchases and issuance of the raw material. The Auditors further qualified that the Company is making certain payments in cash, which is against the provisions of the Income Tax Ordinance, 1979.

6. Further the Auditor of the Company apart from qualifying their report on the going concern issue have also qualified their opinion on the consumption and valuation of stocks in the financial statements for the year ended on September 30, 1999.

7. The management sold sizable part of the undertaking without shareholders approval and in violation of the provisions of Sections 160 and 196 of the Ordinance for which fines were imposed on the directors of the Company as they could not satisfy the Commission on the transparency of the sale of machinery i.e. 18,700 spindles during the financial year ended on September 30, 2000. It was further noticed that the Company could not replace the machinery as approved by the board of directors of the Company in their meeting held on May 11, 1999.

8. The Company failed to provide certain information regarding production record for the year 1999 and 2000 to the Commission, which was demanded, vide letters dated February 21, 2002 and March 13, 2002 respectively.

9. The Commission also received a complaint from NIT nominee director pointing out that the Company did not send to him the notice of the board's meeting held on May 19, 2001 for approving the annual accounts of the Company for the year ended on September 30, 2000 and subsequent half yearly accounts deliberately, trying to keep an elected director completely unaware about the affairs of the Company.

10. The Company neither held its AGM nor has circulated annual accounts for the year-ended September 30, 2002 and has not circulated quarterly accounts for the quarters ended March 31, 2003 and June 30, 2003 depriving the shareholders from the financial information about the affairs of the Company.

11. The above facts reflects that the that the financial position of the company is such as to endanger its solvency, that the business of the company is being conducted with intent to defraud its creditors and members in a manner oppressive to its members, that the persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance, breach of trust towards the company and its members, that the member of the company have not been given all the information with respect to its affairs which they might reasonably expect, that the affairs or the company are not being managed in accordance with sound business principles or prudent commercial practices and that the affairs of the company have been so conducted or managed as to deprive the members thereof of a reasonable return. A show cause notice under Section 265 of the Ordinance, was therefore, issued on February 07, 2003.

12. In reply to the aforesaid show cause notice, the authorized representative of the Company vide his letter dated April 04, 2003 stated that the Company's accumulated losses have been reducing year by year due to improvement in efficiency and quality of yarn. It was further stated that the main reason of better achievement is rightsizing of the plant by way of disposal of nearly

40 years old obsolete machinery and modernizing of the remaining machinery due to which performance in 2001 compared with previous 4-5 years shows a reasonable improvement which is evident from reduction in accumulated losses and improvement in equity, sales, net profit and current ratios. Thus the Company is not in a downward spiral. That the reduction in installed capacity of plant, due to sale of 18700 inoperative spindles which were 40 years old, converted the Company's unit into a profitable unit from sick unit. Despite the Company's utmost efforts to get these updated for the operation, the same were unable to find the spare parts due to outdated/obsolete model of the machinery. This effected the Company's efficiency. Therefore, disposal of the said spindles enabled the Company to update the remaining machinery in order to get the improved results; otherwise the unit would have been closed in 1999. There was positive improvement in the financial results of the Company for the year ended September 30, 2001. That the auditors have reported no falsification, misappropriation, fraud or dishonesty on the part of directors, therefore, there exists merely difference of opinion between auditors and directors and it does not attract any penal provisions under the Co. Ordinance, 1984. That there is no laid down principle for the fixation of the frequency of revaluation of fixed asset and it depends on circumstances under which revaluation is carried out. That the fact that the Company is not a going concern is not an appropriate assumption considering the Company's inability to arrange fresh financing as the company is operative and continues to be so far 17 months following 30 September 2001 and the perception of the auditors was different from the directors mainly due the Company's long-term liabilities towards UBL and HBL. Further the matter of restructuring with both the aforesaid banks has now been resolved. That the assertion that the company has sold its plant and machinery for Rs.27 million instead of Rs.120 million, which was the written down value of the said property, is ill founded as the sale of the machinery was to enable the company to balance, modernize and rehabilitate the remaining machinery in order to improve the overall efficiency and has resulted in Company's profits after 10 years. As regards the qualification of the auditor on the sale of machinery, it is stated that sale and purchase of absolute machinery is dealt with in the unrecognized sector, it is generally finalized after verbal inquiries from different dealers and according to normal practice, it is not possible to provide quotation or other evidence regarding sale of old and obsolete machinery. As regard the issue that the written down value of the disposed machinery was Rs.120 million, this appears to be incorrect and unsubstantiated, because had the revaluation done in 1995 of the disposed off

assets not been taken into account, there would have been a profit of Rs.11 million. In fact, the revaluation was carried out five years earlier when the assets were operative but at the time of disposal these were non-operative and obsolete. Thus written down value cannot be considered for ascertaining the profit or loss on disposal of revalued obsolete assets. That the Company has kept all the records regarding the purchase and issuance of raw material as required under the Ordinance and other relevant laws. Moreover, the same could be verified from the sales tax and bank records. That the allegation that the cash payments made by the Company are in violation of the Income Tax Ordinance, 1979 is also erroneous and based on misinterpretation of the law and circumstances of the case. The suppliers, as a general practice demands payments through travelers cheques, which are routed through cashbook and the income tax authorities recognize such payments and there is no risk of penalties that can be incurred by the Company. Further the Company has kept all the books of accounts as required under Section 230 of the Ordinance, which has also been confirmed by the auditors in their report.

13. A date of hearing in the matter was fixed on November 10, 2003 on which Mr. Ralph Nazirullah, Company Secretary and Mr. Ibrahim Hanif Malik, G.M. Finance appeared before me and they stated that the Company has entered into an agreement with National Bank of Pakistan for BMR financing amounting to Rs.31 million and there is a proposal to replace another 11,520 old spindles through this arrangement. They further intimated that audited accounts of the Company for the year ended September 30, 2002 could not be finalized by the auditors and as a result neither the annual general meeting could be held nor quarterly accounts for the subsequent periods were prepared and circulated. The Company's representative failed to furnish any satisfactory explanation on the following issues:

- Transaction relating to sale of assets (18,700 spindles) made by the Company in the year 2000.
- Surplus on revaluation of fixed assets created in the year 1995 was correct, just and fair
- Confirmation from the National Bank of Pakistan regarding the BMR agreement.

14. Although the representatives of the Company requested for deferring the matter for two years however they subsequently agreed for appointment of inspector on the specific issues relating to above.

15. I have considered all the relevant facts, spirit of law and have also perused the documents placed before me. I have observed that the Company itself has admitted that the assets were revalued in the year 1995 resulting huge revaluation reserve on the fixed assets amounting to Rs.364.834 million and was never revised again which raise serious doubts about the present fair value of the assets. This doubt gets more strengthened from the fact that the Company has sold 18,700 spindles at Rs.27 million only having book value of Rs.120 million and admits that at the time of sale these assets were inoperative and obsolete. It is viewed that it was the responsibility of the management to review its policies and a fresh revaluation should have been conducted at the point of time when the fact of obsolescence of the assets came to their knowledge. I therefore, have serious concerns that the management has not reflected true value of the assets in their financial statements and it appears only a window dressing. Further the representative have not been able to give cogent reason nor have provided any documentary evidence reflecting that serious efforts were made to obtain best possible price from the market for sale of such assets. The board of directors in their meeting approved the sale of assets against replacement of better conditioned machinery however the management have failed to do so and could not provide any documentary evidence that efforts were made to purchase new/better conditioned second hand machinery. In view of these facts, it is necessary to investigate this transaction in order to determine whether the loss sustained on this transaction was due to mismanagement and whether the management has adopted prudent commercial practices in conducting the sale of such assets. The Company by not holding annual general meeting on time has deprived the mandatory right of the shareholders given by law with spirit to provide them a forum where they can discuss the performance of the Company with the management. Further the Company has not circulated any financial statements after December 31, 2002 and no information with respect to its affairs has been provided to the shareholders and other stakeholders. The management could not provide satisfactory reasons for the aforesaid default. The management in the meeting submitted that they have entered into a BMR agreement with National Bank of Pakistan but was not able to provide any documentary evidence in this regard.

16. In view of the aforesaid discussion, it is apparent that the Company has been unable to provide satisfactory replies to the issues raised by the Commission. It is apprehended that the affairs of the Company are not being managed with sound business principles and prudent commercial practices and the shareholders are being deprived of a reasonable return. Minority shareholders are the medium, which could genuinely contribute towards economic growth through their savings if those are channelized for productive purposes giving them reasonable returns and assuring the safety of their investments. In this case, the interest of the minority shareholders appears to have been seriously jeopardized. In the circumstances, it is 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. If the inspector holds that the directors were not responsible for the current state of affairs of the Company, the report will be helpful to them rather than detrimental to their interests. The Commission can protect the interest of the investors only through timely initiating of a fact-finding exercise.

17. It would also be pertinent to discuss here the spirit of Section 265 of the Ordinance. It is not possible for the minority shareholders to act jointly to protect their interest. Moreover, they are not able to collect evidence where management is acting prejudicial to their interest to bring the same before the appropriate forums for appropriate action. It was because of this difficulty that the legislators have enacted Section 265 of the Ordinance to prevent the managements of companies from acting in a manner prejudicial to the interest of the minority shareholders. The object of this Section, thus, is to safeguard the interest of the shareholders, creditors and those dealing with the company.

18. I, therefore, in exercise of the powers conferred on me appoint Mr. Rahim Jan, FCA of M/s Rahim Jan & Company chartered accountants, F-103, Regency Plaza, Mini Market, Gulberg-II, Lahore to act as Inspector on a remuneration of Rs.100,000/- (Rupees One hundred thousand only) to be paid by the Company

19. Without limiting the scope of investigation, the inspector shall conduct investigation on the following affairs / operations of the Company and shall, after scrutiny of all the relevant records and books of accounts:

1. Whether the management adopted a prudent course of action and has followed the best market practices while selling 18,700 spindles in the year 2000.
2. Whether the aforesaid transaction of sale of spindles was transparent. The actual amount of loss sustained on the above transaction and the names of responsible directors who were involved in this process.
3. Whether or not the Company has kept proper records as required by Section 230 of the Ordinance.
4. Whether the surplus on revaluation of fixed assets created in the year 1995 was correct, just and fair
5. To ascertain the actual reasons for non-holding of annual general meeting for the year ended September 30, 2002.
6. Whether the Company has entered into a BMR agreement with National Bank of Pakistan.
7. Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.
8. To report any lapses or other delinquency detected during the course of investigation.
9. To suggest future course of action in the interest of the shareholders of the Company.

20. 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.

21. 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.

22. 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.

Abdul Rehman Qureshi
Commissioner (CLD)

Announced
December 08, 2003
ISLAMABAD