Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division

[Islamabad]

Before Rashid Sadiq, Executive Director

In the matter of
M/S QUALITY STEEL WORKS LIMITED

Number and date of notice	EMD/233/249/2002 dated April 08, 2002
Date of final hearing	June 24, 2002
Present	Dr. Mohammad Azam Chaudhry, advocate

ORDER UNDER SECTION 265 OF THE COMPANIES ORDINANCE, 1984

The case before me pertains to the proceedings initiated in terms of show cause notice issued to M/S Quality Steel Works Limited (the "Company") under Section 265 of the Companies Ordinance, 1984 (the "Ordinance") which deals with investigations into affairs of the companies.

2. In order to dispose of the aforesaid matter, it is necessary to go into the background facts leading to the issue of show cause notice to the Company by the Enforcement and Monitoring Division of this Commission. The Company was

incorporated in 1954 under the Companies Act, 1913 (now the Companies Ordinance, 1984). Its shares are listed on Stock Exchanges in Pakistan. It was privatized by the Government and handed over to the present management in the year 1993. The main object of the Company is to manufacture and sell re-rolled products, fabricated, bright shafting and galvanized material. The manufacturing facility of the Company is located at Manghopir Road, Karachi.

3. The Company has not held its Annual General Meetings (the "AGM") for the calendar years 1999, 2000 and 2001 and neither had it presented therein its annual audited accounts for the year ended June 30, 1999, 2000 and 2001 as required under the mandatory provisions of Section 158 and 233 of the Ordinance till the issue of show cause notice i.e., up to April 08, 2002. The Company also failed to comply with the statutory requirements of holding of election of directors, appointments of its Chief Executive and the statuary auditors. The latest available financial statements of the Company at the time of issue of show cause notice were for the year ended June 30, 1998, which portrayed a dismal financial position of the Company. It appeared that the Company was in a downward spiral since privatization and apparently no step had been taken by its management to reverse the trend of losses and put the company back on the recovery path. The Company also failed to rectify the above-mentioned grave irregularities in the affairs of the Company. Even the directions of the Commission given in its Order dated August 20, 2001 to hold its overdue Annual General Meetings for the calendar years 1999 and 2000 were not complied with and the Company had failed to honor the commitment made by its Chief Executive to hold overdue AGMs by December 31, 2001. The shareholders of the Company have no means to know the true picture of the state of the Company's affairs. They were not given any information for a long period of time against their statutory rights given to them by

the Ordinance to receive annual and interim accounts and other information about the affairs of the Company. Moreover, the non-holding of AGMs for three consecutive years had also deprived its shareholders from their statutory rights to attend and speak in the AGM, which is the only forum where they can discuss and vote on important matters like consideration of annual accounts, appointment of auditors, election of directors etc. These facts presented a gloomy picture about the state of the Company's affairs and were, *prima facie*, indicative of the complete disregard to the mandatory requirements of the Ordinance and the directions of the Commission.

4. The auditors of the Company namely, M/S Ford Rhodes Robson Morrow, Chartered Accountants, issued ***disclaimer of opinion*** in their report on annual accounts of the Company for the year ended ***June 30, 1998***. They signed this report on August 04, 1999. The disclaimer of opinion was issued because of the significance of the following matters:

i) Non-verification of mark up accrued on redeemable capital, finance lease obligations and overdue installments in respect of finance leases.

ii) Non-verification of advance against equity from a financial institution and long term advances and deposits, trade debts and advances to suppliers, compensatory rebates and claims due to lack of confirmations.

iii) Non-provisioning of mark up on loans amounting to Rs. 140.346 million, which would have converted the net profit of Rs. 6.505 million into loss of Rs. 30.983 million for the year ended June 30,1998 and

accumulated losses would have increased by Rs. 140.346 million as on that date.

iv) Failure of the management to make arrangement for the physical verification of stocks amounting to Rs. 228.696 million and cash count at the year-end. (The present management discontinued this compulsory requirement since 1996).

v) Non-provisioning against doubtful trade debts, compensatory rebates, claims and earnest money.

vi) Non-amortization of leasehold land.

5. It was also noticed that the auditors of the Company in their aforesaid report dated August 04, 1999 have also observed that ***a significant number of transactions relating to various expenses and receipts were on cash basis. Moreover, the Company had not obtained insurance cover for fixed assets. The auditors have termed this as an indication of poor internal controls, which could result in loss to the Company.*** These serious observations by the auditors of the Company indicated imprudent management of affairs and it appeared that the Company was not being run as a corporate body in accordance with the requirements of law.

6. The auditors have also raised their doubts about the Company's ability to continue as a going concern in view of the accumulated losses, which were more than 12 time of its equity. **It was noted with great concern that the audit reports in the post-privatization period contained serious qualifications and**

reservations of the auditors of the Company so much so that they preferred not to express an opinion on the accounts for the year ended June 30, 1998.

7. It was further discovered from the perusal of the accounts and also observed by the auditors in their aforesaid report that the Company had recommended and subsequently paid dividend to its shareholders although there were huge accumulated losses and the profit for the year was subject to serious qualifications by the auditors on account of inadequate provisions in respect of several liabilities pertaining to the financial charges, doubtful debts and receivables, amortization of leaseholds etc. The profit reported in the accounts of the Company would in fact have converted into substantial losses if the aforesaid provisions had been made. The dividend *prima facie* was paid out of capital by the Company in violation of the provisions of Section 249 of the Ordinance, which requires that "no dividend shall be paid by a company otherwise than out of profits of the company."

8. The directors' report attached to the accounts for the year ended June 30, 1998 also suffered from several legal infirmities, as it did not fully explain the auditors' qualifications and serious observations contained in their report on the said accounts. Thus, the directors have, *prima facie*, failed to give the information required under Section 236 of the Ordinance for appreciation of the affairs of the Company by its members.

9. Looking at the financial position, the Company, as of June 30, 1998, had accumulated losses to the tune of Rs. 214.309 million against its paid up capital of Rs. 17.717 million. Its current liabilities exceed its current assets. The loans were not being serviced and the lenders were forcing for payments of overdue

installments of their loans. These facts and figures clearly demonstrated that the financial position of the Company, *prima facie*, was such as to endanger its solvency. The deteriorating financial position of the Company, as reflected from its latest available financial statements was a cause of great concern.

10. The Company's share of Rs. 10.00 was being quoted on stock exchanges at around Rs.4.00 per share at the time of issuance of show cause notice, reflecting the week financial position of the company. The investors appeared to have lost confidence in the management, as there was no buyer of its share even at such a low price. Although the low value of the share of the Company on the exchanges could be attributed to the recession in the stock markets, but it also reflected dismal performance of the Company and the conduct of its directors towards its shareholders viz-a-viz serious observations of auditors, non-holding of election of directors, non-appointment of Chief Executive, non-holding of AGM for the years 1999, 2000 and 2001, the ambiguity created due to non-preparation of annual and interim accounts and non-presentation of the same to its shareholders.

11. The aforesaid state of affairs of the Company gave rise to the apprehensions that the affairs of the Company were not being conducted in accordance with good management policies and prudent commercial practices. The corporate irregularities as highlighted in the previous paragraphs were of serious nature as pointed out above and necessitated further enquiries into the affairs of the Company. It was in these circumstances that the Commission apprehended that the affairs of the Company were being conducted in a manner oppressive of its members and to deprive them of a reasonable return. *Prima facie*, this was a case where the company was managed in a manner, which was prejudicial to the interest of the minority shareholders of the Company.

12. Consequently, a notice dated April 08, 2002 was served on the Company and its Chief Executive calling upon them to show cause in writing as to why an inspector under Clause (b) of Section 265 of the Companies Ordinance, 1984 (the "Ordinance") should not be appointed to investigate into the affairs of the Company.

13. The Company responded to the show cause notice vide its letter dated April 15, 2002. In order to give the Company an opportunity of being heard and of making representation, a hearing of the case was fixed on June 05, 2002, which was attended by Dr. Mohammad Azam Chaudhry, advocate on behalf of the Company. On the said date, he informed that he had been recently engaged to represent the Company in this case. The case, therefore, was adjourned to June 24, 2002 to provide adequate time to the Learned Counsel for preparation of reply to the show cause notice.

14. On the date fixed for hearing, the Learned Counsel for the Company has contested the issues raised in the show cause notice and also filed a written reply. He briefed about the position of the Company by stating that the Company was technically insolvent when Privatization Commission handed over this unit to the present management. The present management made huge investment in the Company to ensure its solvency and survival. He also stated that during the last two years under the Government control, the Company has incurred losses to the tune of Rs. 148.471 million, while in the following eight years under the present management, the net losses were restricted to only Rs. 104.670 million. In the post privatization period, the Company earned profit during the years ended June 30, 1995 and June 30, 1998. Administrative expenses were reduced from Rs. 13

million to Rs. 7 million only. This, he stated, was the unassailable evidence of the management's prudent business practices and it had been ensured that the solvency of the Company was not put to any danger. The management has also been able to pay off PICIC loans and significantly reduced the loans of ABL. He stated that this was the only mill producing electrification towers and structure in Pakistan based on the demands by WAPDA and the Company has a better future due to massive plan of Government of Pakistan for electrification and likely demand to be generated from Afghanistan. While resisting the show cause notice, he made the following submissions:

i) The show cause notice was issued on the insistence/complaints of the ex-owners of the Company.

The Learned Counsel has argued that the Company has the "impression" that the show cause notice has been issued on the insistence/complaints of the ex-owners of the Company. He also stated that the ex-owners who do not hold more than 4% of the total paid up capital of the Company, have been filing complaints against the Company on various forums. No investigation could be initiated on their complaint, as they do not hold more than 4% of the total voting power. The show cause notice, therefore, was not maintainable.

ii) The staggering losses are not attributable to the present management.

The Learned Counsel has attributed the losses to the unwise and imprudent business practices of ex-owners of the Company. He was of the view that the responsibility for the accumulated losses cannot be put on the present

management. He also pointed out that the present management has reduced administration expenses substantially.

iii) The business of the Company has never been conducted in a manner oppressive to its members

The Learned Counsel has stated that the business of the Company has never been oppressive to its members. Moreover, the members have never complained in this regard and the impression of the Commission is without any basis and justification.

iv) The Company has not deprived its shareholders of reasonable returns and the shareholders are not aggrieved by non-payment of dividend

In this respect, the plea of the Learned Counsel is that the members have never complained about the non-declaration of dividend. The Company declared cash dividend in 1999. He was of the view that the members were more interested in the solvency and financial health of the Company rather than dividend. He further made a comparison of the general public shareholdings, which he stated was only 17% compared to the present management shareholdings of 58%. He, thus, concluded that when the shareholders were not aggrieved, it is unjustified for the Commission to issue show cause notice on this ground.

v) ***There has been no complaint from any shareholders about the information with respect to its affairs.***

The Learned Counsel has forcefully resisted this issue and stated that no shareholder has ever complained that he has not been given the information required by him.

vi) The Commission has not laid out any "sound business principles and prudent commercial practices"

It has been contended that the Company earned profit twice after its privatization and declared dividend once. The Company has repaid some of the loans and efforts were being made to pay off the others. This, the Learned Counsel stated, was achieved by following sound principles and prudent commercial practices. He also argued that the Commission has not announced any 'sound principles and prudent commercial practices', which the companies should follow.

vii) The financial position of the Company is not such as to endanger its solvency.

In this regard, the Learned Counsel stated that the Company was insolvent at the time of its privatization. The present management has invested huge investments to improve its position. He contended that the Company's financial position is not such as to endanger its solvency.

viii) The Company has no control over its share price.

As regards the low price at which the Company's shares are being quoted on the Stock Exchanges, the Learned Counsel argued that stock market quotations fail to reflect correctly the financial health of corporate bodies. Moreover, volatile stock market was beyond the control of the Company. Even the shares of the companies, which were earning profits and have huge reserves, are being quoted below par value.

ix) The Company is placed on the defaulter counter of KSE on account of non-holding of AGM.

As regard to the placement of the Company on the Defaulters Counter, it was contended that it was on account of non-holding of AGMs. The Learned Counsel assured that the Company shall fulfill all its statuary obligations within nine months and its position on the stock exchange will be restored by the year-end. Subsequently, however, the Company contended that its name is not in the list of 85 companies put on defaulter counter. A press clipping of daily Business Recorder dated June 29, 2002 was also placed on record. On the basis of the said press report, the Learned Counsel asserted that the Company is not on the defaulters counter of KSE.

x) Investigation would defeat the very purpose for which the Ordinance was enacted.

In this respect, the Learned Counsel for the Company stated that appointment of inspectors would violate Section 24-A of the General Clauses Act, 1987 and it would defeat the very purpose of the enactment of the Ordinance. According to him in pursuance of the Ordinance, which states in its preamble that the purpose of the enactment is healthy growth of corporate enterprises, protection of the investors and creditors, promotion of investment and development of its economy, the Company deserves lenient treatment. Initiation of investigation, heavy penalties, prosecutions of sick units are measures to defeat the very purpose for which the Ordinance was enacted.

xi) The investigation shall push the Company for liquidation.

The Learned Counsel submitted that the appointment of inspector would simply strangulate the Company as it shall push the Company for liquidation and thereby deprive the shareholders from getting single penny out of their investment.

xii) The investigation would defame the Company and demoralized the management

The Learned Counsel has contended that the appointment of inspector is likely to defame the Company; scare away its potential customers; break the financial back of the Company; terrorize the creditors; and demoralize its present management by pulverizing their efforts to pull the Company out of hot waters.

xiii) The basis of formation of opinion has not been disclosed.

The Learned Counsel for the Company has argued that according to Clause (b) of Section 265 of the Ordinance, the Commission must form an opinion that circumstances as enumerated in sub-clauses (i) to (vii) exist for appointment of inspectors. According to him, the Commission has not disclosed to the Company as to what basis, the Commission has formed the opinion to appoint inspectors. He has also stated that rule of natural justice i.e., the right to know the case against you should be applied to the process of taking a decision to appoint inspector. Accordingly, he concluded that the Company and its directors have been unconstitutionally deprived of their right to know on what basis and by relying on which documents, the Commission has formed the said opinion.

15. The Learned Counsel has also referred to the following guidelines issued by the Company Law Board of India to the departmental officers under Section 235 and 237 of the Indian Companies Act, 1989 (similar to Section 263 and 265 of the Companies Ordinance, 1984) which may generally form the pre-requisite for ordering of an effective investigation under the aforesaid sections:

(i) Whether an inspector can bring to light any major contravention of company law or any other law on the basis of which necessary corrective or remedial measures can be applied.

(ii) Whether the application of such measures alone will be enough to lend succour to the aggrieved parties, where necessary, to set right the affairs of companies so as to bring them in conformity with the accepted principles and standards of good and efficient management; and

(iii) Whether the allegations bring out, clearly or by implication, a charge of irregular accounting, the truth of which can be established only by analysis of the books by a qualified chartered accountant.

His stand was that no objective would be achieved by instituting an investigation. Moreover, the remedies to unhealthy situations and general contraventions of law can be found elsewhere.

16. I have considered the arguments advanced by the Learned Counsel for the Company as dilated in the preceding paragraphs and have also examined the records by myself and my views on each of the issues raised by the Learned Counsel are as under:

i) Whether the show cause notice has been issued on the complaint of the ex-owners of the Company?

The argument of the Learned Counsel that the show cause notice has been initiated on the complaint of ex-owners of the company is absolutely incorrect and devoid of any force. A bare reading of the show cause notice could easily reveal that it has been issued under Clause (b) of Sub-section (1) of Section 265 of the Ordinance. These proceedings have been initiated exercising *suo moto* powers available to the Commission under the aforesaid provisions. Here it would be beneficial to discuss the scope of the jurisdiction of the Commission to initiate investigations. Section 263 to 282 of the Ordinance are grouped under the head 'Investigation and Related Matters." Section 263 gives powers to the Commission to appoint inspectors on the application of requisite number of members or the Registrar. Section 264 prescribes the manner of making application under Section 263. The members can approach the Commission to appoint inspectors and the Commission after being satisfied that all the requirements of law are fulfilled can initiate investigations. The Commission is bound to appoint inspectors under Clause (a) of Sub-section (1) of Section 265 when a special resolution is passed by a company for investigation of its affairs or when the Court directs the Commission to appoint inspectors to investigate the affairs of a company. Under Section 265, the Commission can also initiate *suo moto* investigations to investigate into the affairs of the companies There are, thus, three different ways by which a shareholder can get the affairs of a company investigated. If requisite number of members is available, then application can be made under Section 263 of the Ordinance. If the evidence of mal-practices and mis-management are available but the requisite number of members could not be managed for filing

application under Section 263, the shareholders can bring the evidence before the Commission and depending on the merit of the evidence provided, the Commission can initiate *suo moto* investigation under Clause (b) of Sub-Section (1) of Section 265 of the Ordinance. Thirdly, the inspectors could also be appointed through the Court or on passing of special resolution by the members of a company. The argument of the Learned Counsel that the Commission cannot initiate investigation on the complaint of shareholders is, therefore, not sustainable. I am of the considered view that the Commission has the discretion to appoint inspectors in such cases exercising *suo moto* powers under Clause (b) of Section 265 of the Ordinance. As regard to his other plea that ex-owners were complaining against the Company, I am of the opinion that it is the statutory right of every shareholder to approach the Commission for re-dressal of his / her grievances and such rights cannot be curtailed on the wishes of anyone including the companies and their managements as it would defeat the very purpose of the Ordinance. In view of the aforesaid discussion, the show cause notice does not suffer from any legal defects so as to adversely affect its maintainability. The objection of the Learned Counsel, therefore, is not accepted.

ii) Whether staggering losses as of June 30, 1998 are attributable to the ex-owners?

Now, I come to the next submission of the Learned Counsel. His stance is that the staggering losses are attributable to the unwise and imprudent business practices of the ex-owners of the Company. It is, therefore, necessary for me to look at the financial position of the Company before and after its privatization. Before its privatization, the Government of Pakistan directly or indirectly owned this Company. During the years ended June 30, 1986 to June 1990 when the Company

was under Government control, the Company declared dividends of 15%, 20%, 40%, 35%, 25%. No dividend was declared during 1991 and 1992 due to losses. The administration expenses of the Company for the years ended June 30, 1986, 1987, 1988, 1989, 1990, 1991 and 1992 were Rs. 5.164 million, Rs. 5.209 million, Rs. 5.998 million, Rs. 6.427 million, Rs. 6.976 million, Rs. 8.566 million and Rs. 9.096 million respectively and the same were increased during post privatization period to Rs.10.623 million in the year 1993, Rs. 13.726 million during 1994, Rs 14.700 million during 1995 where after these started reducing in subsequent years, i.e. from 1996 to 2000. Now comparing these facts and figures with the post privatization performance, it is revealed that during the post privatization period i.e., from 1993 to 2000, the Company suffered losses to the tune of Rs.187.006 million. The actual losses during the post privatization period are much more if effect of inadequate provisions pointed out by the auditors is considered. As opposed to this the Company under the Government management has made profit of Rs. 34.506 million during the period 1986 to 1990. During the years 1991 and 1992, the losses have been attributable mainly due to delay in privatization because of stay granted by the Supreme Court on a petition of ex-owners of the Company. The said delay adversely affected the productivity, as the employees were demoralized in the prevailing atmosphere of uncertainty. Without commenting on the reasons for losses in these years, I am of the view that the above stated facts demonstrate that the Company has suffered tremendous losses during post privatization period, which cannot be attributed to the ex-owners. It is not understandable as to how the Learned Counsel attributed these losses to the previous owners when the current management is running the affairs of the Company since 1993. In these circumstances, it is all the more necessary to have a independent enquiry to ascertain the correctness of the assertions made by the Learned Counsel regarding huge losses suffered by the Company during post

privatization period. As regards to the argument regarding the reduction of the administration expenses, this also does not help the Learned Counsel in view of the figures of administration expenses during the said period, which amply demonstrate that the administration expenses in fact increased during the post privatization period from Rs.9.096 million in 1992 to Rs. 14.700 million in 1995 wherefrom these were reduced in subsequent years, the latest being Rs.6.3 million in the year 2000. The figures of expenses for the years 2001 and 2002 are not available as the Company has not yet prepared and circulated its annual accounts for these years required in terms of the statutory provisions of Section 233 of the ordinance. In view of whatever has been discussed above, the arguments of the Learned Counsel on both accounts do not carry any force.

iii) Whether the business of the Company was being conducted in a manner oppressive to its members?

The directors of a company occupy a fiduciary position in relation to its shareholders. They are required to conduct the affairs of a company in a prudent manner in the overall interest of the Company and its stakeholders. Where the directors who were entrusted with the affairs of a company violate the mandatory statutory requirements and commit serious irregularities, the interest of the Company is jeopardized and consequently the interest of its shareholders is affected. As the directors have shown complete disregards to the provisions of law and have infringed the shareholders rights, it can safely be assumed that they have done nothing during last several years to protect the interest of the shareholders of the Company. Their conduct with regard to management of the affairs of the Company, therefore, is oppressive to its members. The market value of their investment had seriously diminished due to the imprudent manner in which the

directors of the Company conducted the business of the Company. Moreover, they have deprived the shareholders from their rights to receive annual and interim accounts and other information. Even they did not hold election of directors at due time. The serious qualifications of the auditors in successive years that most of the transactions conducted were on cash basis further reinforce these views that directors have acted contrary to the provisions of law and against the interest of the shareholders. In view of the foregoing, I am of the view that the business of the Company is being conducted in a manner oppressive to its shareholders. The argument of the Leaned Counsel as regard to the conduct of business of the Company, therefore, cannot be sustained. On this issue, the Learned Counsel has also taken the position that there was no complaint from any member of the Company. This submission is in total contradiction to his earlier stance that these proceedings have been initiated on the complaints of the shareholders of the Company.

iv) Whether the shareholders were deprived of reasonable return on their investments?

The Company has not paid any dividend to its shareholders since its privatization in 1993 except in 1999, which too was seriously objected to by way of several qualifications regarding non-provision of expenses and liabilities, which would have turned the profit into substantial losses. Therefore, it is justifiable to infer that the Company has deprived its shareholders from reasonable return for a long period of time. As regard the argument that the present management holds 58% of the total shares as against 17% by the minority shareholders, I am of the view that majority cannot suppress the minority even if it is 17% or for that matter a holder of a single share in a company, just because of it's superiority in terms of sheer

numbers. Moreover, the institutions including NIT hold around 25% of the shares of the Company. NIT in fact has complained against the alleged irregularities, mismanagement and non-payment of dividend. There had also been complaints from some shareholders regarding the corporate irregularities leading to mismanagement of affairs, which ultimately culminated into staggering losses in the post privatization period. In the light of the aforesaid discussion, I am of the opinion that shareholders of the Company have been deprived of a reasonable return on their investment and the present management cannot escape their liability in this regard. There is no doubt that the shareholders are very much interested in the financial health of the companies but at the same time they also expect a reasonable return on their investments, which in this case has been almost zero in the post privatization period. Deteriorating financial position and consequently non-payment of dividend for a long period of time could be a reason for mismanagement. It is one of the functions of the Commission to conduct investigations into the affairs of the Companies wherein the mismanagement or oppression is apprehended. This has, therefore, been specifically provided as a ground to activate the machinery of investigation. In view of the above, the presumption of the Learned Counsel that the shareholders were not aggrieved is not based on facts and, therefore, is not sustainable.

v) Whether the Company has provided all the information to its members?

The Learned Counsel has contended that there was no complaint from any shareholder that the Company had not provided them any information. It has also been contended that the shareholders have never complained about the affairs of the Company. In this regard, it has been noted that the Commission had received

complaints from some of the shareholders of the Company regarding the conduct of its affairs the most recent being the one received from NIT, which is stated to be holder of about 10% of the total share capital of the Company drawing the attention of the Commission towards the following grave irregularities:

- Failure to hold AGM since 1999;
- Notices of 45th and 46th overdue AGMs held on July 30, 2002 were not sent to members 21 days before the date of AGMs;
- Non-holding of election of directors;
- Appointment of auditors for 1999 and 2000 without shareholders approval;
- Non-verification of receivables and liabilities by the auditors;
- Non-verification of huge stocks of Rs 205.517 million;
- Understatement of liabilities to the extent of Rs 207.452 million;
- Passing of resolution against the requirements of Section 160 and 196 of the Companies Ordinance, 1984; and
- Serious qualifications of auditors on the annual accounts for the years 1999 and 2000;

In addition to the above and the fact that no accounts have been sent to shareholders subsequent to the year ended June 30,1998 and no AGM has been held since calendar year 1998 as a result of which the shareholders were not given information, which is their statutory right under the Ordinance needs to be kept in mind. Given these facts, I do not agree with the arguments of the Learned Counsel that the shareholders have been given all the information, which they reasonably expected from the Company. Due to this delay the auditors M/S Ford Rhodes Robson Marrow have also resigned and M/S Rao & Co. were appointed by the

Board of Directors to conduct the previous audits. The shareholders have received the annual accounts for the year 1999 and 2000 only recently. Moreover, the annual accounts of the Company for the year ended June 30, 2001 and 2002 along with directors' and auditors' reports have not yet been transmitted to the shareholders. This clearly demonstrates that the Company has failed to provide reasonable information to all its shareholders.

vi) Whether the affairs of the Company were managed in accordance with sound business principles and prudential commercial practices?

It has been held by the Superior Courts that the term 'affairs of the company' is a fairly wide term, which includes any contravention of law and the conduct of the directors. It also includes maintenance of books of accounts in terms of Section 230 and 234 of the Ordinance. These provisions have been made to protect the interests of minority shareholders. The argument of the Learned Counsel that the Company was managed in accordance with the sound business principles and prudent commercial practices is without any force as this could not be substantiated by the directors conduct, which reflects gross irregularities in managing the affairs of the Company. The sound business principles and prudent commercial practices constitute the principles and practices generally adopted by the corporate sector in the conduct of affairs of the companies. These principals and practices have been adopted and are being practiced by the corporate sector the world over. ***The Company has been conducting its most transactions in cash as reported by the auditors***. It has failed to make arrangements for physical verification of stocks, which is a compulsory requirement. It has failed to hold AGM and present its accounts to the shareholders. It has committed several other corporate irregularities. As far as repayment of the loans is concerned as per the

account for the year 1992, the total loans amounted to Rs.306.555 million whereas on June 30,1998 the same stood at Rs.515.382 million as per audited accounts for that financial year. These facts, in my view clearly indicate that the directors have failed to manage the business of the Company in accordance with the sound business principles and prudent commercial practices.

vii) Whether the financial position of the Company is such as to endanger its solvency?

I have carefully considered the arguments advanced by the Learned Counsel for the Company and have also examined the 'operational plan and future prospects' placed on record. The said plan neither speak about the future profitability, the source of funding necessary to run the project nor does it gives any realistic forecast about the Company's operations, its sale and profitability. The various liquidity ratios indicative of the financial position of the Company based on the figures as appearing in the published accounts indicate deep liquidity crisis that the Company is facing. Moreover, the published accounts of the Company, as detailed in the later part of this order, suffered from serious qualifications/observations with particular reference to non-provision of expenses, non-recognition of liabilities and non-accrual of mark-up on short and long term loans. The recovery suits filed by the lenders indicates their loss of confidence in realization of their loans and is indicative of the dire solvency crisis the Company is facing. The Company had even not paid listing fee of the stock exchange due to which it has been placed on the defaulter's counter. The Company has not been able to present the latest financial position, as its accounts for the years 2001 and 2002 have not yet been prepared. It is apprehended that the Company has failed to maintain proper books of accounts for these years. In the absence of concrete future plan of

action and in the presence of huge accumulated losses, which far exceeds the equity of the Company and pending suit for recovery of loans against the Company, the financial position of the Company, in my opinion remained extremely weak and appears to be such as to endanger its solvency.

viii) ***Whether the Company has control over its share price***

Although the rock bottom price of the share of the Company could be reflective of the general recession in the stock markets but the dismal performance of the Company, its flagrant violation of the Ordinance, suppression of the minorities and their statutory rights particularly to receive annual and interim accounts and other reports and to attend and vote in the AGM had also affected its share price. If the affairs of the Company have been run in accordance with sound business principles and prudent commercial practices and shareholders were adequately remunerated, there could be no reason that the people should not have confidence in the share of the company. Volatile and instable conditions prevalent in the stock exchange might have contributed towards the low market price of the Company's scrip, however, the loss of confidence and the fact that there is no buyer of its share in the market are directly attributable to the way the business of the Company is being managed by the directors of the Company.

ix) Placement of the Company on defaulters counter of Karachi Stock Exchange.

In order to address this issue, an enquiry was made to Karachi Stock Exchange in response to which the Commission was informed that the Company has been put on defaulters counter for non-payment of Annual Listing Fee to the Karachi Stock

Exchange. The listing regulations of the Karachi Stock Exchange stipulates that a company may be placed on the defaulters counter for any of the following contraventions:

- Its share is quoted below 50% of the face value for three (3) consecutive years.
- It fails to pay dividend for a period of five (5) years.
- It fails to hold Annual General Meeting for a continuous period of three (3) years
- It fails to pay listing fee and penalty imposed thereof for a period of two (2) year.

The Company is still on defaulter's counter of the Stock Exchange as confirmed by the Karachi Stock Exchange. This could lead to de-listing of the Company from the stock exchanges and in consequence its winding up under Clause (g) of Section 305 of the Ordinance. The contention of the Learned Counsel that the Company is not on defaulters counter, therefore, is not based on facts.

x) ***Whether the Investigation would defeat the very purpose of the Ordinance?***

Section 265 of the Ordinance gives the powers to the Commission to appoint inspectors to investigate into affairs of the Companies in different set of circumstances. The corporate sector is a class, which has control over enormous resources of a country. If its abuses go unchecked, it would defeat the very purpose of the Ordinance. The contention of the Learned Counsel that initiation of an investigation would defeat the purpose of the Ordinance is, therefore, repelled.

In my considered view, this would advance the purposes of the Ordinance. It has been the endeavor of the Commission to exercise extreme caution and exercise powers reasonably, fairly and justly and for the advancement of the purposes of the Ordinance as stipulated in Section 24-A of General Clauses Act, 1897, which provides that:

Quote

> *"24-A. Exercise of power under enactments: (1) Where, by or under any enactment, a power to make any order or give any direction is conferred on any authority, officer or person, such power shall be exercised reasonably, fairly, justly and for the advancement of purposes of the enactment."*

Unquote

In view of the aforesaid, the apprehension of the Learned Counsel does not appear to be valid.

xi) Whether the investigation would push the Company for liquidation?

In this respect, I am of the view that the apprehension of the Learned Counsel is without any basis. Investigation is a fact-finding exercise to reach the truth of the matter. In this case the Company has not maintained its books of account and consequently accounts were not prepared and provided to the shareholders as required under the mandatory provisions of the Ordinance. The Company has also defaulted in holding of AGM and election of directors. Although the accounts for the years 1999 and 2000 have now been presented after considerable delay, the

accounts for the year ended June 30, 2001 and 2002 are still pending. The investigation can in fact be helpful in highlighting the areas, which need improvement, and the management can benefit from it. I, therefore, do not agree to the contention of the Learned Counsel that the investigation would push the Company for liquidation.

xii) Whether the investigation would defame the Company?

I have given careful considerations to the arguments of the Learned Counsel in this respect. I am, however, of the view that if the reputation of the Company or of a person is kept in view, then on the basis of such apprehension no action could be taken against the persons who violate the provisions of law or who commit an offence. As already said, the investigation into affairs of the Company is in the nature of a fact-finding exercise and is neither a punishment nor a penalty. It is not a judgment because it is only after the conclusion of the investigation that the Commission could take any action and that too after providing opportunity to the persons responsible for default. Thus, the question of defamation, because of initiation of investigation, does not arise at all.

xiii) Whether the basis of forming of opinion was required to be disclosed in the show cause notice?

In this respect, it is evident that the show cause notice was issued after finding the grave irregularities and violation of the provisions of the Ordinance. These issues were adequately raised in the show cause notice and are in fact the basis on which proceedings were initiated against the Company. The show cause notice was

issued to give an opportunity to the Company to respond to the issues raised therein. It is only on the basis of the arguments of the Company and the examination of the information and other documents placed on record that an opinion is formed as to whether circumstances existed for ordering an investigation into affairs of the Company. The argument of the Learned Counsel on this account is totally misconceived and is of no avail. I have no cavil with the rules of natural justice that before taking any action against any person prejudicial to him/her interest, he must be given an opportunity to defend himself/herself. This has also been specifically provided under Section 265 of the Ordinance and the Securities and Exchange Commission of Pakistan Act, 1997. In this regard, there has been no violation of principles of natural justice. The Company was given adequate opportunity to defend the case against it. The issues raised in the show cause notice were sufficiently discussed in the hearings. Thus, the rule of natural justice was duly followed during the proceedings of this case.

17. After carefully examining the contentions of the learned Counsel for the Company, as discussed in the preceding paragraphs, I deem it necessary to look at the performance of the Company during post privatization period. This is important because the Learned Counsel has forcefully averred that the Company was insolvent before privatization and its performance in the post privatization period has improved.

18. The Privatization Commission of the Government privatized this Company on April 10, 1993. The financial position of the Company before privatization, on the basis of audited financial statements, can be summarized as under:

	1992*	1991	1990	1989	1988	1987	1986
	Rupees in thousands						
Sales	182,271	232,055	263,732	254,434	210,354	173,267	103,275
Cost of sales	203,035	201,521	225,056	222,146	181,500	157,762	100,319
Gross Profit/(Loss)	(20,764)	30,534	38,676	32,288	28,854	15,577	11,256
G P/(G L) to sales %	-11%	13%	14%	13%	14%	9%	10%
Financial Charges	33,076	19,277	13,076	8,805	6,580	6,150	3,655
Other income	271	311	769	742	1,157	796	1,431
Net Profit/(Loss) *	(66,762)	(3,776)	8,233	8,662	8,569	3,279	1,638
Earnings Per share	(37.68)	(2.13)	4.65	4.89	4.38	1.85	0.92
Current Ratio	0.88	1.14	1.29	1.46	1.4	1.67	2.3

** The financial results for the year ended June 30, 1992 do not reflect the true state of affairs of the Company as its operation during the said year was effected due to the ongoing privatization process as stated by the directors in their report to the shareholder for the said year*

19. The Company's performance post privatization i.e. from 1993 to 2000, on the basis of the audited financial statements, is summarized as under:

	***2000**	***1999**	**1998**	**1997**	**1996**	**1995**	**1994**	**1993**
	Rupees in thousands							
Sales	234,437	243,698	275,616	181,166	216,626	97,270	109,701	136,389
Cost of sales	243,540	241,939	266,034	151,716	199,690	104,994	131,586	172,364
Gross Profit/(Loss)	(9,103)	1,759	9,582	29,450	16,936	(7,724)	(21,882)	(35,975)
G. P. ratio %	-4%	1%	3%	16%	8%	-8%	-20%	-26%
Financial Charges	19,569	12,410	21,107	42,148	24,300	3,477	43,049	62,306
Other income	3,599	6,302	29,049	7,370	8,370	37,746	8,223	14,746
Net Profit/(Loss)	6,689	(13,463)	6,505	(19,943)	(11,316)	6,570	(79,644)	(81,709)
Earning Per Share	0.38	(0.76)	3.67	(11.26)	(6.39)	3.71	(44.95)	(46.12)
Current Ratio	0.98	0.96	0.99	0.97	0.90	0.92	0.85	0.59

** The account for these years were received after substantial delay. This has been discussed in detail in Para 26 of this Order.*

20. As the audit reports in the post privatization period contained serious qualifications, therefore, in order to fully understand their impact, it is also necessary to:

i) Discuss the circumstances leading to the resignation of the auditors of the Company namely M/s M/S Ford Rhodes Robson Morrow, Chartered Accountants; and

ii) To review the audit reports in the post privatization period particularly reports on the accounts for the years ended June 30, 1995 onwards.

(i) I would first take up the issue of resignation of auditors. M/S Ford Rhodes Robson Morrow, Chartered Accountants, were appointed as auditors of the Company by the shareholders in the Annual General Meeting of the Company held on September 10, 1998. The management failed to have the accounts of the Company for the years ended June 30, 1999, 2000 and 2001 audited within the stipulated time. In fact, when eventually the management did approach the auditors of the Company, M/S Ford Rhodes Robson Morrow, Chartered Accountants, in the month of March 2002, for audit of the aforesaid accounts, the auditors citing practical difficulties, due to lapse of considerable time, in assuring an opinion on the accounts, conveyed their inability to perform the audit and resigned as statuary auditors of the Company. Since this was an important development, therefore, the contents of the letter dated March 22, 2002 of auditors, to the extent relevant, are reproduced hereunder:

Quote

"Since there is a considerable time lag between June 30, 1999 and the present time, approximately over three and a half year, the above requirements would require enormous audit time and efforts and pose substantial practical difficulties for us about our opinion on the accounts of the Company for the above referred year.

In view of the above we would inform you that we have decided to resign as the statuary auditors of the Company for the year ended June 30, 1999 and regret any inconvenience to you in this matter."

Unquote

It can very easily be seen that the above statement of the auditors also reflects the gross negligence of the directors to get its books of account audited well in time by the auditors appointed by the shareholders. Therefore, the directors are, responsible for the resignation of M/s Ford Rhodes Robson Morrow & Company, a member firm of Ernest and Young appointed by the shareholders as auditors of the Company in the annual general meeting held on Septmeber10, 1998.

Subsequently M/s Rao & Company, Chartered Accountants were appointed by the directors as auditors of the Company and were entrusted with the task of auditing the accounts of the Company. The audit report on the accounts for the year ended June 30, 1999 also contained almost the same qualifications as were expressed by M/S Ford Rhodes Robson Morrow, Chartered Accountants, in their report on the accounts for the year ended June 30, 1998 and thus M/S Rao & Company,

Chartered Accountants preferred to issue a *disclaimer of opinion.* However, this was not the case in the subsequent year ended June 30, 2000 when several qualifications were removed without any reasons. The audit depends on the integrity and independence of the auditors. It has been held that where there is a doubt that statuary auditors are under some obligation to the management and not acting independently, this could *prima facie* be a case for investigation. In this case, it appears that the auditors, namely M/S Rao & Co., might have discharged their responsibilities during the course of audit too indulgently.

(ii) Now, I come to review the audit reports on the accounts in the post privatization period. The following are the observations of the auditors in their reports on the accounts for the years 1995 to 1997, which led to qualifications of the said reports and those of rather serious nature raised in the reports on the accounts for the years 1998 to 2000, which led to disclaimer of opinion by the auditors:

- The agreement in respect of restructuring of secured short-term finances, proposed in 1994 into long term loans has not been signed to date and expired on January 31, 1996. ***If the said arrangement is not finalized the current liabilities will increase by Rs. 176.364 million, Rs. 152.844 million and Rs. 150.244 million in the years 1995, 1996 and 1997 respectively.***

- The confirmations/verification in respect of the following balances were not received:

	2000	**1999**	**1998**	**1997**	**1996**	**1995**
	Rupees in Millions					
Mark-up accrued on	0.344	0.344	0.344	0.604	-	-

redeemable capital						
Overdue installment in respect of finance lease	0.286	0.286	0.286	1.066	-	-
Advance against equity	-	18.761	18.761	18.761	18.761	18.761
Advances & Deposit	2.054	2.054	2.054	3.536	-	-
Trade Debts	95.957	48.919	80.635	-	-	-
Advances to suppliers	1.831	1.128	1.434	-	-	-
Compensatory Rebates	-	12.734	12.734	-	-	-
Claims	-	1.618	1.618	-	-	-
Long term loan	-	-	-	163.343	165.943	165.943
Short term loan	-	-	-	30.0	30.0	-
C.E.D & S.T. & L.T. secured loans	-	-	-	6.293	-	-
Advance against equity from prospective shareholders	-	-	-	15.569	-	-

- Mark-up on long-term, unserviceable loans and short term loans was not accrued in the years 1995 and 1999, ***thereby overstating the profit/ understating the loss for the said years***.

- Stock count and physical verification of inventory and counting of cash in hand was observed partially by the auditors during the years under review. ***In the years 1995 to 2000 closing inventory and cash in hand to the extent given below remained unverified***:

	2000	**1999**	**1998**	**1997**	**1996**	**1995**
	Rupees in Millions					
Stock in Trade	156.816	205.517	228.696	311.339	66.765	2.952
Cash in Hand	0.046	0.019	0.024	0.327	-	-

- ***Provisions against the following heads of accounts were not made thus the profit/loss incurred by the Company was over/under stated:***

	2000	**1999**	**1998**	**1997**	**1996**	**1995**
	Rupees in Millions					
Trade Debts	16.996	16.812	16.625	14.969	11.026	10.970
Compensatory Rebate	-	12.734	12.734	11.079	11.079	11.079
Earnest Money	1.150	1.150	1.150	-	-	-
Claims	-	1.618	1.618	1.618	1.618	1.618
Others	-	-	1.960	-	-	-
Aggregate Provision	**18.146**	**32.314**	**34.087**	**27.666**	**23.723**	**23.667**

- ***The Company did not amortize its leasehold land thereby understating the loss incurred/overstating profit made by the Company in the year 1995 to 2000.***

In addition to the aforesaid matters the auditors in their report on the accounts for the year ended June 30, 1995 have also drawn attention towards the fact that the financial statements have been prepared on going concern basis, the validity of which is dependent on the successful outcome of the management's efforts to secure and reschedule financing facilities and to obtain further orders. In view of the losses and shortfall in net current assets, in the event of non-realization of Company's plans, this basis would be invalid and provisions would have to be made for any loss on realization of the Company's assets, which might arise.

Similar observations have also been made in auditor's report on the accounts of the Company for the year ended June 30, 1996, whereas, the following observations were added to the ones in 1995 and 1996 in the auditor's report on

the accounts for the year ended June 30, 1997. Moreover, the going concern observation was rephrased to read as under:

Quote

"Pending finalization of rescheduling/restructuring arrangements current maturity of term loan has been understated whereas the amount of long-term loan understated.

A number of transactions relating to various expenses and receipts are on cash basis. Further, the Company has not obtained insurance cover in respect of the fixed assets during three years under review. In our view, if better internal control was instituted the result could have been better."

Unquote

The auditors in their report on the accounts for the year ended June 30, 1998, have, in addition to the observation in the report on the accounts of the Company for the year 1997, also draw the attention of the shareholders in the following manner:

Quote

"The lapse of the extension, up till November 14, 1996, given by financial institutions for restructuring/rescheduling of financing facilities. The said date has not been further extended neither have the loans been

rescheduled/restructured. If the same is not revised the Company's current liabilities would increase on account of liquidity damages."

Unquote

The audit reports on the accounts for the years ended June 30, 1999 and 2000 were received subsequent to the issue of show cause notice. The auditor's report on the accounts for the year ended June 30, 1999 while further adding to the above referred issues states that:

Quote

"The NDFC have filed a recovery suit against the Company in the Sind High Court, the recoverable amount claimed by NDFC is less than amounts shown in the accounts of the Company except for the liquidity damages. The adjustments of these figures have not been made by the Company in its books of accounts.

If the Company made the adjustments in accordance with the recovery suit of NDFC, the total bank liability will increase by Rs. 207.452 and simultaneously the loss for the year and accumulated loss would be increased by the same amount."

Unquote

The auditor's report on the accounts for the year ended June 30, 2000 persisted with the going concern issues highlighted by the auditor's in their reports on

accounts for the year ended June 30, 1997. However the issues raised in the audit report on the accounts for the year ended June 30, 1999 have not been repeated instead the following paragraph had been added:

Quote

> *"The NDFC have filed a recovery suit against the company in High Court of Sindh, the recoverable amount by NDFC is less that the amounts shown in accounts of the company except for liquidity damages. The adjustment of these figures has been made by the company in its books of accounts as prior year adjustment."*

Unquote

21. The audit reports on the accounts of the post privatization period and before privatization make an interesting reading. The auditor's report on the accounts of the Company for the year ended June 30, 1990 is free of any qualification/observation. However, the report on the accounts of the Company for the year ended June 30, 1991 had been qualified on the basis that the compensatory rebate amounting to Rs. 36.704 million remained unconfirmed. Moving forward, it is revealed that the audit report on the accounts of the Company for the year ended June 30, 1992 had been qualified on the basis of non-confirmation/non-verification of compensatory rebate claim of Rs. 43.425 million, creditors amounting to Rs. 28.351 million, deposits amounting to Rs. 1.985 million, trade debts amounting to Rs. 13.402 million and other receivables amounting to Rs.1.618 million.

22. Examining the audit report in light of the management's contention that the Company was insolvent at the time of privatization one cannot help but notice that the auditor's started drawing attention of the shareholders towards of the validity of the going concern assumption in the post privatization years. They had expressed no such apprehension in the prior years.

23. With regards to the physical verification of stocks, it can be seen that auditors undertook physical verification of the stock in trade in the years prior to privatization. It can be inferred that the exercise was undertaken with the facilitation of the then management. However, in the post privatization era, the auditor's, as is evident from the paragraphs above, have been unable to observe physical count and verification of stock in trade. The director's in their reports to the shareholders in various years, in the post privatization, have contented that the stock taking was rendered impossible due bulk of inventory and lack of weighing facilities in the mills premises. It needs to be seen as to how the same auditors were able to perform a task under one management but could not do so under the tutelage of the other. In view of this matter alone, it became all the more necessary for the Commission to have an independent and impartial assessment of the financial position of the Company in particular and that of the conduct of its affairs in general for the years 1992 onwards.

24. It is clear from the above discussion that the performance of the Company post privatization has deteriorated substantially so much so that the auditors have raised qualification on going concern and the non-verification of the assets and liabilities. Moreover, the lack of internal control and conducting of most transactions in cash basis indicated that the Company was not being run as a corporate entity. This observation made by the auditors in their reports on the

accounts of the Company of the post privatization period is a matter of grave concern. The bulk of the transactions in the Company, receipt and payment, are on cash basis, which is in contradiction with all generally accepted principles of running a corporate body. In the years prior to privatization the auditor's had made no such observation in the reports on the accounts of the Company.

25. Since last reporting to the shareholders on the accounts for the year ended June 30, 1998, the directors have not given any information to the shareholders so much so that the shareholders were even deprived of their statutory rights to receive the annual and half yearly accounts, auditors and directors' reports. The directors have also failed to inform the members of the Company about their strategy to reverse the declining trend in order to secure their investment and to retain their confidence in the management of the Company. The directors' reports for the years 1995 to 1998 did not contain any information and explanation in regard to the auditor's observation on going concern assumption in their audit reports. The directors' reports also failed to provide information about defaults in payment of debts and reasons thereof. Moreover, these reports also did not give any reasonable indication of the future prospects of profits, if any. The directors have failed to even give the bare minimum information in their reports as required under Section 236 of the Ordinance. It may, however, be noted that the Company held it's next AGM on July 30, 2002 presenting the accounts for the years ended June 30, 1999 and 2000 before the shareholders. The reliability of the aforesaid accounts is susceptible, as auditors have refrained from giving an opinion regarding their fairness and truthfulness. The audited annual accounts for the year ended June 30, 2000 received from the Company with a delay of almost six months report a gross loss of Rs. 9.103 million. It has, however, reported a net profit of Rs. 6.689 million after making prior period adjustment for Rs. 40.274

million and by not making provisions amounting to Rs. 18.146 million. The Company has not been able to get requisite funding from the financial institutions for its profitable operations. The auditors have again drawn attention of the members of the Company towards preparation of accounts on going concern basis which was dependent on the successful negotiations with the banks for deferment of immediate liabilities and re-structuring of the long and short term loans and generation of sufficient liquid resources to fulfill its financial obligations. This has raised substantial doubt as to the Company's ability to continue as a going concern.

26. There is another interesting fact that has come to light during the course of our deliberations with the Company and its authorized representatives. In a reply, though not related to this particular show cause notice, the Company had contended that it was unable to hold AGMs timely and prepare accounts for the years 1999 and 2000 because of the fact that mills were closed and the entire staff laid off. However, the accounts for the years 1999 and 2000 now presented to the shareholders and the Commission indicate sales turnover of Rs. 243.698 million and Rs. 234.437 million respectively. While studying these figures in the light of the aforesaid contention of the Company, it not understandable as to how such huge sales and production was affected in the absence of any work force.

27. It was further noticed that the Company has issued a notice in the press regarding disposal of a piece of land owned by it. It was apprehended that the Company had embarked upon the sale of its assets instead of preparing its over due accounts for the years 1999, 2000 and 2001, holding of overdue AGMs and rectifying other serious irregularities committed in the affairs of the Company.

Further probe in the issue revealed that the sale was being carried out by the bank, which had lien over it, to recover its outstanding dues.

28. The above stated facts and figures clearly establish that the performance of the Company has been far from satisfactory; it is in danger of being declared insolvent. Moreover, the aforesaid irregularities also bring home the fact about management's non-serious attitude towards the Company. They are not paying any heed to the issues raised by the Commission to protect the interest of minority shareholders of the Company. They have failed to act in the interest of the Company and its shareholders. This also proves that such conditions exists which fulfill the objectives that generally form the prerequisite, as referred to by the Leaned Council and reproduced in the Para 16 of this order, for an effective investigation, which can bring to light major contraventions on the basis of which corrective measures could be taken. The accounting and other irregularities could also be found by an in-depth analysis of the books of accounts in the post privatization period. The non-preparation of books and accounts, the change of Auditors, M/S Ford Rhodes Robson Morrow, who were appointed by the shareholders and appointed of M/S Rao & Co., by the Board of Directors, serious qualifications of auditors in the post privatization period also give an indication that there could be other irregularities, which could be highlighted only by a detailed examination of the books of accounts. The Company has contravened the provisions of the Ordinance, its affairs are not being conducted in accordance with sound principles and prudent commercial practices and that its true financial position can only be ascertained by a detailed examination of its books of accounts.

29. The violations regarding non-holding of Annual General Meetings, non-presentation of accounts in Annual General Meetings, failure to hold election of directors and appointment of auditors and Chief Executive in violation of the provisions of the Ordinance are of serious nature. The shareholders and other stakeholders of the Company are not aware of the true position of the state of its affairs since 1998. It would be in the interest of all the stakeholders that a fact-finding exercise is conducted through an independent inspector so that correct legal and financial position of the Company and extent of violations committed by the Company and its directors and Chief Executive are ascertained. I also take support from a recent decision of the Learned Appellate Bench of the Commission given in the case of Barex Limited Vs. Executive Director (Company Law Division), which I would like to quote hereunder:

Quote

> *"10. If a company does not hold the Annual general Meetings within the prescribed time without any special reasons, it can be inferred that the Company is not taking interest to protect the interest of its shareholders----------."*

Unquote

On the basis of the above, the Learned Appellate Bench of the Commission upheld the decision of the Executive Director (Corporate Law Division) to appoint an inspector in the interest of justice to ascertain the extent of violations committed by the appellants and in consequence the prejudice caused to the minority shareholders of the company.

30. What emerged from the above discussion is that the Company has committed serious irregularities and that the directors have not fulfilled their fiduciary responsibility towards its shareholders. 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 was seriously jeopardized by not giving them any information about the affairs of the Company for a long period of time. 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.

31. Securities and Exchange Commission of Pakistan has been established under the Securities and Commission of Pakistan Act, 1997 for the beneficial regulation of the capital markets, superintendence and control of the corporate entities and for matters connected therewith and incidental thereto. It is one of its functions to conduct *sue moto* investigations into affairs of the companies, through competent inspectors(s) if in its opinion there are circumstances suggesting one or more of the matters given in sub-clauses (i) to (vii) of Clause (b) of Section 265 of the Ordinance. The Commission is further empowered to prosecute a company or persons found guilty as a consequence of such investigations. 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 to provide for investigation into its affairs where the affairs of the company are conducted to jeopardize those interests.

32. In view of aforesaid discussion, I am convinced that the circumstances falls under Sub-clauses (i), (iii), (iv), (vi) and (vii) of Clause (b) of Section 265 of the Ordinance and that substantial and worthwhile basis exist to form an opinion warranting investigation into affairs of the Company. The aforesaid discussion also amply demonstrate that such conditions exists, which fulfills the objectives that forms the pre-requisite, as referred by the Learned Counsel for the Company, for ordering an investigation. These circumstances reasonably suggest that

Sub-clause (i) of Clause (b) of Section 265

The business of the Company is being conducted in a manner oppressive to its member.

Sub-clause (iii) of Clause (b) of Section 265

The affairs of the Company have been conducted or managed as to deprive the members thereof of a reasonable return.

Sub-clause (iv) of Clause (b) of Section 265

The members of the Company have not been given all the information with respect to its affairs, which they might reasonably expect.

Sub-clause (vi) of Clause (b) of Section 265

The affairs of the Company are not being managed in accordance with sound principles and prudent commercial practices.

Sub-clause (vii) of Clause (b) of Section 265

The financial position of the Company is such as to endanger its solvency.

33. For the forgoing reasons, I, in exercise of the powers conferred on me under Clause (b) of Section 265 of the Ordinance, hereby appoint Mr. Fazal Mahmood & Co., Chartered Accountants,147-Shadman Colony–1 ,Lahore, to act as inspector to investigate into the affairs of M/S Quality Steel Works Limited to bring into light the actual state of affairs of the Company. He will be paid a remuneration of Rs. 250,000 (Rupees two hundred fifty thousand only) to be paid by the Company.

34. Without limiting, in anyway, the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall,

after scrutiny of the entire record and books of accounts, furnish report, *inter alia*, on the following matters:

a) Reasons for incurring losses during the years 1993 to 2002. Whether these losses were due to mismanagement, imprudent policies or some other reasons.

b) Corporate irregularities other than those for which the Commission has already taken cognizance and circumstances thereto and the persons responsible for corporate irregularities.

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) 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. (A list of cash transactions to be provided to the Commission along with the investigation report).

g) Investigation of Sales / revenues of the Company with particular reference to prices of comparable units.

h) Investigation of Expenditures incurred by the Company with particular reference to the following:

- Expenditures versus sales /revenues/production
- Energy consumption versus capacity utilization
- Reconciliation of stocks and its impact on profitability
- Expenditure analysis in terms of:

    1. Organization
    2. Personal
    3. Production
    4. Selling overheads
    5. Financial charges

i) Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.

j) Reasons for the failure of the Company in context to:

- Over capitalization
- Bad management practices
- Leakage of sales/stocks
- Over spending in expenditures
- Assessment of capital expenditures of the company in respect of Company's requirements.
- Excessive borrowings

k) Determination of any false and incorrect statement in directors' report.

l) Compliance with statutory requirements in the operation of the Company.

m) To report any lapses or other delinquency detected during the course of investigation.

n) In-efficiencies in production.

o) In-out record of the Company particularly relating to sales, purchases and stocks movement.

p) Proper maintenance of statutory books including particularly minute books of Board and general body meetings.

q) Any other violation of the Companies Ordinance, 1984 or any other laws.

r) Results of circulation to lenders, legal advisors, trade debtors, advances, receivables and bank balances as at June 30, 2002

s) To suggest future course of action in the interest of the shareholders of the Company.

35. The inspector shall submit his report alongwith supporting documents to the Commission within sixty days from the date of this order. The Commission expects that the report shall be made specifically on each terms of reference along

with the names of persons responsible for any irregularities and mismanagement in the affairs of the Company.

36. 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.

37. 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.

38. Before parting with this Order I would like to express my appreciation for the valuable assistance provided to me by Dr. Azam Chaudhry, advocate during the course of proceedings of this case.

Rashid Sadiq
Executive Director (Enforcement & Monitoring)

Announced
November 04, 2002
ISLAMABAD