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**SECURITIES & EXCHANGE COMMISSION OF PAKISTAN**  
(Monitoring & Enforcement Division)  
NIC Building, Jinnah Avenue, Blue Area  
Islamabad

**IN THE MATTER OF ELAHI COTTON MILLS LIMITED**

**ORDER UNDER SUB-SECTION (5) OF SECTION 208 OF THE COMPANIES ORDINANCE, 1984 IN THE MATTER OF MR. MEHBOOB ELAHI, CHIEF EXECUTIVE, MR. MEHFOOZ ELAHI, MR. MEHMOOD ELAHI, MR. ABDUL RASHEED, MR. MASOOD SAEED, MR. NAVEED AKHTAR, MR. FARRUKH AHMED AND LT. CDR. (RETD) MOHAMMAD AZAM, DIRECTORS OF M/S. ELAHI COTTON MILLS LIMITED**

Date of final hearing	December 13, 2000
Present	Mr. Mehboob Elahi, Chief Executive, Mr. Abdul Qadeer, FCA of M/s. S.M Masood & Company, Chartered Accountants, Islamabad.

Brief facts of the case are that from the published financial statements of M/s. Elahi Cotton Mills Ltd for the year ended 30-09-1999 it was revealed that company had advanced an amount of Rs. 27 million to its associated company namely Taxila Cotton Mills Ltd. whereas its own paid up capital stood at Rs. 13 million with negative equity of Rs.39.001 million. The investment appeared to be in violation of sub-section (1) of section 208 of the Companies Ordinance, 1984 which provides that a company shall not make any investment in any of its associated company except under the authority of a special resolution which shall indicate the nature and amount of investment and terms and conditions attached thereto. The investment further appeared to be in violation of the proviso (a) to sub-section (1) of Section 208 ibid which says that the aggregate investment in associated companies shall not exceed thirty per cent of the paid up capital plus free reserves of the investing company at any point of time unless relaxation is granted by Federal Government. The aforesaid violations of law attracted penal provisions of sub-section (5) of section 208 which provides that if a default is made in complying with the requirements of section 208 every director of the company who is knowingly and willfully in default shall be liable to a fine which may extend to one million rupees and, in addition, the directors shall jointly and severally

reimburse to the company any loss sustained by the company in consequence of the investment which was made without complying with the requirements of this section. Accordingly a show cause notice for violation of section 208 was issued to the Chief Executive of the Company on 30<sup>th</sup> September, 2000, which was responded by Mr. Mahfooz Elahi, a director of the company on behalf of Chief Executive, who furnished explanation as follows:

**QUOTE**

“That during the year ended on 30.9.99, no investments in associated companies were made. Investment in associated companies as on 30.9.98 were Rs.23.172 million whereas these were Rs.27.433 million as on 30.9.99. The increase of Rs.4.261 million during the year was due to charging of markup as per section 208(1)(b) of the Companies Ordinance, 1984 which was not less than the borrowing cost of the company. The company has made investments of Rs.6.876 million in 1997 which were increased to Rs.23.172 million in 1998. These investments were made mainly in Texila Cotton Mills Limited due to fire occurred at Mills during the year ended on 30.9.97 where several casualties took place and the machinery was damaged and the insurance company did not respond timely in compensation of the claim. These payments were actually made on behalf of Associated Company.

That in the past, the associated companies as well as Directors had been supporting financially to the company without charging mark up in order to meet the working capital requirements and smooth flow of the affairs of the company.  
meet the working capital requirements and smooth flow of the affairs of company.

However, for compliance of Law, the company is recovering its investments made in its associated companies. The half-yearly accounts for the period ended on 31.3.2000, show that the investments have been reduced to Rs.12.387 million, a reduction of Rs.15.046 million during the six month period which is 55% of its investments during this period. The company is making arrangements to have the entire amount recovered within this financial year i.e. year ending 30<sup>th</sup> September, 2000.”

**“UNQUOTE”**

2. The reply furnished by the Chief Executive was not found satisfactory and, therefore, the case was fixed for hearing on 30-10-2000. On the date of hearing Mr. Mahboob Elahi, the Chief Executive of the company appeared

himself and repeated the arguments already advanced in writing by Mr. Mahfooz Elahi. He admitted that he as well as other directors of the company were well aware of the provisions of section 208 ibid but reiterated that the investment was made in the said associated company in extremely pressing circumstances because of fire in the said mills due to which operations of the mills had come to halt. He stated that in these circumstances Elahi Cotton Mills Ltd. was forced to make payments on behalf of the associated company to save that company. He stated that now the company is recovering the amount and requested the Commission to take a lenient view as after incidence of fire there was no other alternative with the management of group but to immediately inject funds from this company into that associated company to save that company from total collapse.

3. Since other directors of the company also appeared to be a party to this willful default of law and allowed transfer of company's funds (which itself was in bad financial shape and appeared to be suffering from acute deficiency of the working capital due to which it could not purchase raw material timely and not only suffered from heavy losses but had to close down its operations partially) a show cause notice to all the directors of the company namely Mr. Mahfooz Elahi, Mr. Mahmood Elahi, Mr. Abdul Rasheed, Mr Masood Saeed, Mr. Farrukh Ahmed and Lt.CDR (R) Mohammad Azam was issued on October 31st, 2000 and hearing in the matter was fixed on 10-11-2000 which, on the request of the directors, was adjourned to 13-12-2000.

4. The Chief Executive of the company Mr. Mahboob Elahi appeared before me on 13-12-2000 alongwith Mr. Abdul Qadeer, FCA who represented Mr. Abdul Rasheed, Mr. Farrukh Ahmed, Mr. Naveed Akhtar, Mr. Mehmood Elahi and Mr. Mahfooz Elahi. They, besides verbal explanations, submitted explanation in writing vide their letters dated Nil as under:-

- a) that during the year ended on 30.9.1999 no investment in associated undertakings was made. The increase of Rs. 4.261 million for the year ended on 30.9.1999 was due to charging of mark up.
- b) that a sum of Rs. 17.5 million loan, taken from Muslim Commercial Bank has been adjusted by then associated undertaking which had increased to Rs. 19.50 million as on 30.9.1999, which was not incorporated in the books of accounts due to omission.
- c) that the balance amounts relating to normal business was not investment which could not be paid by

the associated company due to fire.

- d) that in the past of associated companies as well as directors had been supporting financially to the Company without charging of mark-up in order to meet the working capital requirements and smooth flow of the affairs of the Company.
- e) That for compliance of law, the company has recovered the entire amount during the period ended on 30.9.2000.

5. Mr. Abdul Rasheed, Mr. Farrukh Ahmed and Mr. Naveed Akhtar in their separate letters took the position that they are employee directors and do not involve themselves, in day to day business activities of the company. Mr. Naveed Akhtar further informed that he was elected as director of the company on 24.4.1999 in place of Mr. Masood Saeed.6. In the meantime a letter from LT CDR (R) Mohammad Azam, the nominee director of ICP on the board of the company, was received in which he informed that the minutes of the Board of Director's meeting held on March 8, 1999 were not recorded accurately by the company Secretary. He stated that in the said board's meeting he had pointed out that the company is violating the provisions of section 208 of the Companies Ordinance, by advancing loans its associated company.

7. For clarification of statement referred in para 4 (c) above, the Chief Executive of the company was asked to provide the copies of ledger accounts relating to associated undertaking which has been maintained in the company's ledger. On the scrutiny of these ledger accounts it was found that none of the transaction relate to the normal trade business and instead most of the payments to the associated undertaking were made through the cheques.

8. It has not been denied by the Chief Executive and other directors that they were aware of the requirement of Section 208 of the Companies Ordinance, 1984 at the time of making investment in associated undertaking in violation of section 208 ibid, The arguments of three directors namely; Mr. Abdul Rasheed, Mr. Farrukh Ahmed and Mr. Naved Akhtar that they were employee directors and were not a party to this daring violation of law cannot be accepted as they had consented to be director of the company and are legally responsible for their acts as directors of the company. They till the date of this Order are holding the position as directors of the company,

hence guilty of the violation in question. However, proceedings against Mr. Naveed, director, are hereby dropped as he was elected in place of Mr. Masood Saeed on 24.04.1999. Separate proceedings against Mr. Masood Saeed, ex-director of the company shall be initiated for his involvement in the default. The explanation of NIT nominee Lt. CDR (Retd) Muhammad Azam that he has been raising the issue of violation of section 208 is accepted but he will be warned for not raising the issue in time. In future such explanations by the nominee directors at the later stage may not be accepted by the Commission.9. In view of the above discussion and taking into consideration all relevant facts and circumstances of the case the default is found willful in case of Mr. Mehboob Elahi, Chief Executive, Mr. Mahfooz Elahi, Mr. Mehmood Elahi, Mr. Abdul Rasheed and Mr. Farrukh Ahmed, directors and demands imposition of maximum penalty as provided under sub-section (5) of section 208 of the Companies Ordinance, 1984 which provides penalty upto Rs. 1,000,000/- (Rupees one million). But in view of the facts that company has subsequently recovered/is recovering the amount, lenient view is taken and a penalty of Rs. 300,000/- (Rupees three hundred thousand) is imposed on Mr. Mehboob Elahi, Chief Executive of the Company, who is mainly responsible for the defaults. As regards other directors namely Mr. Mahfooz Elahi and Mr. Mehmood Elahi little more lenient view is taken and a penalty of Rs. 200,000/- (Rupees two hundred thousand) is imposed on each of them. As regards employee directors Mr. Abdul Rasheed and Mr. Farrukh Ahmed, taking further lenient view, a penalty of Rs.100,000/- (One hundred thousand) is imposed on each of them with a warning that in future if they fail to fulfill their responsibilities and duties, they will be penalized like other ordinary directors.

10. Mr. Mehboob Elahi, the Chief Executive, Mr. Mahfooz Elahi, Mr. Mehmood Elahi, Mr. Abdul Rasheed, and Mr. Farrukh Ahmed, directors of the company are directed to pay penalty amounts from their own resources and deposit the same in the following head of accounts within 30 days of the date of issue of this Order:-

**“Account No. 50019-6  
Habib Bank Ltd.,  
Corporate Branch,  
Blue Area, Islamabad.**

11. The statements of three directors namely Mr. Abdul Rasheed, Mr. Farrukh Ahmad and Mr. Naveed Akhtar that they were employee directors having no role in decision making of the company is a cause of concern for me as it indicates the manner and style in which the affairs of this listed company are being run. The board of directors

in this company appears to be a dummy board. This matter however, will be dealt with separately during the proceedings under section 265 of the Companies Ordinance which were started in the case of this company for bad performance, non-payment of dividend to the shareholders and alarming inconsistencies in the working results but were adjourned for sometime on an indication of the management of the company to pay some return to its shareholders in near future. That decision to adjourn the proceedings needs review due to aforementioned statements of the three directors and NIT's nominee director.

12. In addition to the above, in terms of sub-section (5) of section 208 ibid., the Chief Executive and the other directors are held jointly and severely responsible to reimburse to the company the consequential losses sustained by the company as a result of this investment due to which the company suffered from acute working capital deficiency and could not even timely purchase raw material, had to close its operations partially and suffered from heavy losses as admitted by the Chief Executive during the course of proceedings and as mentioned in the directors report to the accounts for the year ended on 30.09.1999 for which some reputed firm of Chartered Accountants will be engaged to determine the loss so caused to the company.

**(M. Zafar - ul - Haq Hijazi)**  
**Commissioner (Enforcement)**

**Announced.**  
December 20, 2000.