

F.No. Co. 265/79/EM/99-
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Monitoring & Enforcement Division)
State Life Building, 7-Blue Area,
Islamabad

**ORDER UNDER SECTION 265 OF THE COMPANIES ORDINANCE, 1984 IN THE MATTER OF
DIAMOND INDUSTRIES LIMITED.**

M/s. Diamond Industries Limited (hereinafter referred to company) had been brought into existence for the purpose of setting up an industrial plant for the manufacture of foam products in the Industrial Estate of Ghadoon Amazai, NWFP. After having got incorporated and registered under Companies Ordinance it sought public subscription and then got listed on KSE, LSE & Islamabad Stock Exchanges, so as to provide trading of its securities. The paid up capital of the company as on 30.06.99 was Rs. 90 million. The financial statement relevant to the period 30.6.99 reflected negative figures. This state necessitated scanning and examination of the financial statement which was carried on for the earlier years. Such searching enquiry led to the conclusion that the company earned net profit amounting to Rs. 31.509 million during the year ended 30.6.95 and paid dividend only in that year but subsequently skipped over without any payment of dividend in the years of 1996, 1997, 1998 & 1999. The position with regard to profit/loss during the proceeding 4 years is as follows:-

Year Ended	Net Loss (Rs. in million)
30.06.1996	78.753
30.06.1997	(20.560)
30.06.1998	(21.759)
30.06.1999	(5.788)

2. In addition to the non-payment of dividend for all the abovementioned 4 years the company was found involved in a few other illegalities and irregularities. These lapses were put together and a Show Cause Notice was

issued on 11.09.1999. A reply was also filed and the appointment of Inspector was made to carry out the investigation of the affairs of the company with a view to bring the realistic state of affairs into limelight in strict observance of the requirement of the law laid down in the Companies Ordinance.

3. The company then filed appeal before the Appellate Bench of the Commission which was accepted on the technical grounds in the following words without adverting to the merits or passing an order leading to adjudication on any of the issues:-

"After hearing the parties and having gone through the contents of the show cause notice and the impugned order passed by the Commissioner (E&M), we are of the opinion that the impugned order has not been confined to the issues raised in the show cause notice dated 11.09.1999".

4. A fresh show cause notice was then issued because public interest providing protection to the investors and creditors cannot be spared so far as the dictates of the Companies Ordinance circumscribe. This notice incorporated the following illegalities and irregularities:-

- a) Non-declaration of dividend for all the 4 years mentioned above.
- b) Mismanagement of the affairs of the company i.e. absence of sound business principles and pursuit of imprudent commercial practices.
- c) Incurring heavy expenditure on advertising a trade name registered in name of an associated company.
- d) Flow of resources from the company to the subsidiary company located in Azad Kashmir.
- e) Deviation from the core business specified in the objects Clause of the Memorandum.

5. The company filed its reply vide its letter No. DII/CS/087/564, dated August 19, 2000 whereby they controverted all the allegations taking the plea that the illegalities and irregularities as highlighted in the show cause notice do not empower the Commission to appoint an inspector under section 265 of the Companies Ordinance, 1984. the case was fixed for hearing but the representative of the Company Mr. Saleem Ahsan argued that the Hon'ble Appellate Bench of Securities and Exchange Commission of Pakistan has already set aside the earlier order made on same points/matters and neither could be reopened. He argued that the Second Show Cause Notice was contradictory to the procedure laid down by law. He then requested adjournment which was granted and the case was fixed for 3.10.2000 and Mr. Saleem Ahsan again appeared and argued the case repeating the same averments as are admitted in the written arguments filed in response to the show cause notice. After giving anxious consideration to the facts the following position emerges as to the affairs prevailing in the company.:-

- 1) The action of the Commission in the issuance of Show Cause Notice after remand by the Appellate Bench does not suffer from any legal defect as the issues involved were not adjudicated by the Appellate Bench in its order and the cause of grievance has been of recurring impact of continuous grievance.
- 2) The company's defence so far as location of the industrial undertaking in the Ghadoon Amazai, Industrial Estate is concerned cannot be made the basis of excusing the illegalities because the exemption was withdrawn in 1991 and finally adjudicated by the Supreme Court of Pakistan in the 1998. The company sought public subscription and paid dividend with heavy amount in 1995 and kept the member deprived of any reasonable return on their investment in the subsequent annual periods i.e. 1996, 1997, 1998 & 1999. The explanation cannot be, therefore, be accepted and the plea is rejected having no relevance to the actual state of affairs. This

offer further indicates that the reliance of the company on the withdrawal by the Government is without any supportive substance.

- 3) Increasing heavy expense on advertising and usage of trade mark is not a fact which can be dealt with in a lenient manner because there does not exist any agreement between the owner of the trade mark and the users. In the absence of such authority the expenditure on trade mark by the company may be termed as unauthorized expenditure incurred by the company.
- 4) The company has allowed to float its resources in a different concern which is situated in the territory of Azad Jammu and Kashmir. In this company M/s. Diamond Industries Ltd., have reduced interest i.e. a sizeable part of shareholding has been captured separately by directors of this company. This behavior of the Director also makes the appointment of an Inspector desirable not only in public interest but also to protect the interests of the investors and creditors.
- 5) It is admitted that the Chief Executive of the company and that of the company located in A.J.K is the same individual. This is violation of section 203 of the Companies Ordinance, 1984. The action of the Chief Executive needs proper probe so that the fiduciary behavior could be suitably investigated and inquired into.
- 6) It has been found that the company has made deliberate departure from the principal business activity as stand defined in detail in the objects clause. The representative could not explain the genuineness of this investment which is practically violation of the requirements of section 220-224 read with section 208 of the Companies Ordinance, 1984. The Commissioner (SM) has also noted this serious illegality with recommendation for suitable action against the company for this lapse of law.

7) The company has informed that the management share is 75% and that of the general public 25%. This abnormally wide cleavage of interest creates genuineness in the appointment of Inspector because apparently the case looks like oppression of the majority on the minority liable to be proceeded against the company under section 290 of the Companies Ordinance, 1984.

6. Therefore, I, in the public interest and in exercise of powers conferred by section 265 of the Companies Ordinance, 1984 (XLVII of 1984) hereby appoint M/s. Hussain Chaudhary & Co., Chartered Accountants, 25-E, Main Market, Gulberg-II, Lahore to act as an Inspector to investigate into the affairs of M/s. Diamond Industries Limited on remuneration of Rs. 100,000 to be paid by the company.

7. Without in any way limiting to 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 furnished reports, inter-alia, on the following:-

- i) Reasons of heavy losses after 1997 and impact of concessions withdrawn by the Government in regard to Gadoon Amazi Industrial Estate, NWFP.
- ii) The matter of heavy expenditure on advertising a trade name not registered in name of the company may be examined. Expenditure incurred by other company to build this trade mark be ascertained giving an opinion that what may be the value of trade mark and to what extent it should be owned by the respective companies.
- iii) The reason of not setting up a wholly owned subsidiary company to be examined, to what extent facilities and assets belonging to this company have been used for setting up project of subsidiary

company. The Inspector will have to analyze the whole situation to determine that to what extent this decision has been in interest of shareholders of the companies.

- iv) Inspector will examine transactions with associated companies and the 'true relationship' between this company and other associated companies so as to report whether or not the transactions have been at arm's length/relationship has not been contrary to the investment of the shareholders of this company. the Inspector will also inspect the position with regard to compliance of section 203 of the Companies Ordinance, 1984 by the companies of this group.
- v) Whether or not proper records have been kept by the company as required by section 230 and section 234 of the Companies Ordinance, 1984.
- vi) Whether or not any adequate system of internal controls has been existing so as to prevent misappropriation and misapplication of Company's assets.
- vii) Whether or not some effective budgetary and cost control system existed. Whether or not proper inventory system was maintained and stocks, stores raw material and finished goods qualitatively reconciled and have been correctly valued, provision against dead stocks, show moving spare and stores have been made and the production and wastage rates are comparable with other unites. The purpose of building huge raw-material, stocks to be examined and reported.
- viii) Whether or not expenses, have been properly incurred, sanctioned vouched and allocated.
- ix) Ascertain the frequency of meeting of board of directors, role of non-executive and executive directions, the overall comprehension of board of directors, their experiences/ability to run the business in which company is engaged.

- x) Compliance with statutory requirements in the operations of the company indicating that the business was conducted and expenditure were incurred in accordance with the objects and for purpose of the company.
- xi) Lapse or other delinquency detected during the course of investigation.
- xii) A report on the departure from the core business activity by making investments in violation of the requirements of sections 220-224 read with section 208 of the Companies Ordinance, 1984.

8. The Inspector shall submit a detailed report alongwith supporting documents/evidence to the Commission (in quadruplicate) within 60 days from the date of this order.

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

Announced:
October 12, 2000.