SECP

Before Mr. Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

Masood Spinning Mills Limited

Number and date of notice:	EMD/242/M/15/10-218-224 dated September 30, 2014
Date of hearings:	November 26, 2014 and March 30, 2015
Present:	Mr. M. Amin Pal, Executive Director

ORDER

UNDER SECTION 492 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceedings initiated against all the directors including the Chief Executive (the "respondents") of Masood Spinning Mills Limited (the "Company") through show cause notice ("SCN") dated September 30, 2014 issued under the provisions of section 492 read with section 476 of the Companies Ordinance 1984 (the "Ordinance").

2. The brief facts of the case are that examination of the annual audited financial statements for the year ended June 30, 2013 (the "Accounts") of Masood Spinning Mills Limited (the "Company") revealed that, M/s Mushtaq & Co. Chartered Accountants has audited the Accounts of the Company for the period under review and qualified the Audit Report in the following manner:

> *"Company has not accounted for fair value gain amounted to Rs85,564,386 on investment at fair value through profit or loss classified under other financial assets in note 22 of the financial statements. Had the company accounted for fair value gain on investment, the profit for the year would have been higher by Rs85,564,386, consequently carrying value of investment and unappropriated profit would have been increased by the same amount".*

The Company vide letter dated May 26, 2014 while responding to the Commission's letter dated April 24, 2014 stated that the Company had significant amount of investment in shares as at June 30, 2013 in comparison of prior years. The re-measurement on June 30, 2013 would have impact of Rs85.6 million on the value of short term investment and unrealized gain, therefore, it was not considered to recognize such gain in the financial statements. The current treatment has no impact on the understandability of the financial statements for its users. The treatment was followed by the management after considering their prior experience as since many years, management of the Company has been placing its assets in the form of investments in quoted shares. Huge downward price fluctuation of shares was observed in 2008 and on the contrary the materially upward prices in 2013 have been observed which was considered as temporary. Considering these observed facts and experiences, while finalizing the accounts for the year ended June 30, 2013 management was of the view that current market price increase is also abnormal and not a permanent phenomenon. Therefore, management decided that the investment in quoted shares should not be re-measured to fair value as at June 30, 2013. Further, despite being a significant item in the balance sheet of the Company, the valuation of 'Short Term Investment' were not likely to influence the economic decisions of users, since all of them were completely aware of it. The matter of recognizing was also discussed in BOD meeting and adequately disclosed in the Director's Report.

3. Since the reply of the Company was not found to be satisfactory, therefore, the SCN was issued on September 30, 2014 advising the respondents to explain their position within 14 days from the date of the notice as to why penal action may not be taken against them for the alleged contravention of provisions of section 492 of the Ordinance. In response to the SCN, the Company Secretary vide letter dated October 9, 2014 requested to provide an opportunity for a hearing which was held on November 26, 2014. The respondents through their counsel Mr. Wasif Majeed, also submitted a written reply dated November 24, 2014 whereof they raised preliminary objections that the Company is not a listed Company and in terms of delegation of powers of the Commission vide notification No. SRO 706(I)/2011, the Executive Director / Head of Department was only given powers to adjudicate defaults under section 492 of the Ordinance, only for listed companies. It was also stated by the respondents that in terms of section 476 of the Ordinance, imposition of fine under any provision of the Ordinance has to be preceded by adjudication. They also raised objection that there has not been any breach of provisions of section 492 of the Ordinance which applies when the statement is false or incorrect in any material particular or there is an omission of any material fact knowing it to be material and since the respondents adequately disclosed the matter of revaluation in the Accounts, therefore, it cannot be construed that any information provided by them was false or incorrect. In respect of merits of the case, the respondents submitted as under:

i. Presentation of general purpose financial statement involves estimates and judgment regarding application and selection of accounting policies according to applicable financial reporting framework and the respondents applied their judgment based on experience that stock market position at the year's end was temporary and investments at fair value will not present the true financial position of the Company. There was no ill intention involved to present false, misleading or incorrect information. The matter was fully disclosed under note no. 22.1 to the Accounts that were discussed and approved by the Company in annual general meeting.

ii. Accounts along with directors report completely present fair view of the Company with all disclosures and only presentation mode has been changed due to abnormal stock market volatility.

iii. The rational decision has been taken in good faith without any malafide and complete impact has been disclosed without any concealment.

iv. The matter pertains to the year 2013, however, in the year 2014 since the market has remained stable, the management has reviewed its previous judgment and accounting policy has been fully complied in the Accounts for the year ended June 30, 2014.

4. After revision of delegation of powers of the Commission through notification SRO 154(I)/2015 dated February 19, 2015, the case was fixed for hearing on March 30, 2015. In the hearing Mr. Muhammad Amin Pal, executive director of the Company appeared before the undersigned on behalf of the respondents and mainly reiterated earlier stance. A brief of respondents' submissions is as under:

(i) The Company is an unlisted company and there are total of 14 shareholders who belong to the same family and no outside shareholding is involved.

(ii) The Commission has imposed penalty under section 492 and 476 in many cases that involved bad intention, however, in the instant case no intention was involved to present false, misleading or incorrect financial statements. The decision was made with good intention to present more fair and correct position by not recognizing unrealized gain that was uncertain and the matter was fully disclosed in the note no. 22.1 of the Accounts that were approved by shareholders in the AGM without objection.

(iii) Accounts present fair and complete view of the Company's affairs and no malafide is involved to deceive shareholders.

(iv) The management having reviewed it's judgment has complied with the accounting policy in the Accounts for the year ended June 30, 2014.

(v) The amount involved is not material as compared to total assets worth Rs2.5 billion and turnover of Rs5 billion of the Company.

The respondents also referred to a case law PLD 1967 SC 530 pertaining to Income Tax Ordinance. It was, inter alia, held that *every default without any ulterior design and malafide intention on the part of a person would not equate with the express default as used in strict legal sense. The word default in legal terminology necessarily imports on elements of negligence or fault and means something more than mere non-compliance.*

The respondents referred to the recent stock market scenario of substantial decline in the index causing huge losses to investors and stated that their point of view for not recognizing unrealized gain in Accounts 2013 is further supported by this.
Based on the above submissions the respondents requested for a lenient view.

5. Before proceeding further, it is necessary to advert to the following relevant provisions of section 492 of the Ordinance, which states as under:

> *" Whoever in any return, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of accounts, application, information or explanation required by or for the purposes of any of the provisions of this Ordinance or pursuant to an order or direction given under this Ordinance makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material, shall be punishable with fine not exceeding five hundred thousand rupees."*

International Financial Reporting Standard IAS 39-*Financial Instruments: Recognition and Measurement*) states as under:

Para 45: *For the purpose of measuring a financial asset after initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 9:*
(a) financial assets at fair value through profit or loss;
(b) held-to-maturity investments;
(c) loans and receivables; and
(d) available-for-sale financial assets.

These categories apply to measurement and profit or loss recognition under this Standard. The entity may use other descriptors for these categories or other categorizations when presenting information in the financial statements. The entity shall disclose in the notes the information required by IFRS 7.

Para 46: *After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:*

(a) loans and receivables as defined in paragraph 9, which shall be measured at amortized cost using the effective interest method;

(b) held-to-maturity investments as defined in paragraph 9, which shall be measured at amortized cost using the effective interest method; and

(c) investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost.

6. I have analyzed the facts of the case and after considering the relevant provisions of the Ordinance, requirements of IFRS and the arguments put forth by the respondents, my observations are as under:

a) The Company failed to comply with requirements of IFRS as it has not accounted for fair value gain amounted to Rs85,564,386 on investment at fair value through profit or loss classified under other financial assets in the Accounts.

b) As a result of the aforesaid non-compliance, the profit for the year ended June 30, 2013 has been understated by Rs85,564,386 and carrying values of investment and unappropriated profit have also been understated by the same amount.

c) The aforesaid non-compliance with requirements of IFRS have material impact on the Accounts of the Company due to following factors:

   i. Correct accounting treatment in line with requirements of IFRS was not adopted
   ii. Profit for the year ended June 30, 2013 was overstated by ~ 22%
   iii. Un-appropriated profit has been understated by ~5.5%
   iv. Value of 'investments at fair value through profit and loss' has been understated by ~ 15%

d) The Company is a public company and is required to follow IFRS as are notified by the Commission in the official gazette under section 234 of the Ordinance and there is no contradiction in IFRS regarding treatment of fair value gain on 'investment at fair value through profit or loss' in terms of International Financial Reporting Standard IAS 39- *Financial Instruments: Recognition and Measurement*. The Company should have followed the requirements of applicable IFRS in its entirety instead of choosing for partial compliance by deviating from following the requirements in respect of non-recognition of fair value gain on 'investment at fair value through profit or loss'.

e) The preliminary objections regarding delegation of powers of the Commission stand resolved after revision of delegation of powers in terms of SRO 154(I)/2015 dated February 19, 2015 and the case has been properly adjudicated and hearing opportunity provided in terms of applicable legal provision.

f) The case law referred to by the respondents primarily relates to interpretation of default for the purpose of Income Tax Ordinance, whereas the instant case is for alleged violation of provisions of section 492 of the Companies Ordinance, 1984. Non-compliance with the requirements of notified IFRS, as highlighted in the preceding paragraphs, despite there being no contradiction in the provisions of the IFRS, is sufficient to establish default as the non-compliance has been due to an avoidable cause and there was nothing hindering the management from applying its stated accounting policy in line with applicable IFRS.

I also take cognizance of the fact that the management has adopted the correct accounting treatment in line with the applicable IFRS and has realized the fair value gain on 'investment at fair value through profit or loss' in the subsequent Accounts for the year ended June 30, 2014. However, the comparative figures for the year ended June 30, 2013 have not been restated.

7. For the foregoing reasons, I am of the view that the provisions of section 492 of the Ordinance have been violated. However, in view of submissions by the respondents, the fact that the Company is an unlisted company with its entire shareholding owned by 14 shareholders belonging to the same family and compliance by the Company with the applicable IFRS in the subsequent Accounts for the year ended June 30, 2014, instead of imposing fines, I hereby conclude the proceedings with a stern warning to the respondents to be careful in future and ensure meticulous compliance with applicable legal provisions and financial reporting framework.

Tahir Mahmood
Commissioner (Company Law Division)

Announced:
April 20, 2015
Islamabad