Before Javed K. Siddiqui, Executive Director (CL)

in the matter of
Diamond Industries Ltd.

Number and date of notice	No. EMD/233/595/2002-6612-6618 dated March 04, 2005
Date of hearing	May 06, 2005
Present	***On Behalf of the Company:*** i) Mr. Nazir Ahmed; Company Secretary ii) Mr. R. R. Alvi, Advocate iii) Mr. Hameed Khan, FCA
Date	May 25, 2005

Order

Under Section 208 of the Companies Ordinance, 1984

This order shall dispose of the proceedings initiated through Show Cause Notice No. EMD/233/595/2002-6612-6618 dated March 04, 2005 against Diamond Industries Limited (the "Company") under the provisions of Section 208 of the Companies Ordinance, 1984 (the "Ordinance").

2. Brief facts of the case are that during examination of annual accounts of the Company for the year-ended June 30, 2004 it was observed that an amount of Rs. 35.231 million (2003; Rs. Nil) is due from associated companies and shown under current assets. The maximum balance due from the associated companies as at the end of any month during the year was Rs. 39.197 million (2003; Rs. 4.856 million). It was further observed that no interest has been accrued on this loan.

3. The Company was asked vide our letter no. EMD/233/595/2002/3726 dated December 21, 2005, to explain the above transaction with the associated company in context of Section 208 of the

Ordinance. The Company, vide its letter dated December 23, 2005 asked for some time to reply the letter of the Commission in view of unavailability of Chief Executive due to death of his paternal uncle and the Company Secretary due to performance of pilgrimage. The same was allowed and the Company was advised to reply on or before February 07, 2005. On this date, the Company again requested to a time of four days to reply the Commission's letter due to sickness of the Company Secretary after his return from Saudi Arabia. The Company, finally explained the transaction vide its letter dated February 10, 2005, that

> ***Quote***
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> *"The amount of Rs. 35.23 million shown in note 14 of the financial statements is not an investment and does not fall under the ambit of loans and advances & equity etc., because the above mentioned aggregate balance relates to business transactions with Diamond Polymer (Pvt.) Ltd. (DPPL). It is clarified that these transactions were of normal trade credit and were got adjusted in the subsequent period."*
>
> ***Unquote***

4. Ledger copies of current accounts of the Diamond Polymer (Pvt.) Ltd. (the "associated company") in the books of the Company, furnished with the above-referred letter, were examined and it was noticed that in the beginning of the year, the amount of Rs. 34.263 million was shown as due to the associated company and during the year the funds were transferred to the associated company in bits and pieces leading to an accumulated balance of Rs. 35.256 million, predominantly as "advances against goods".

5. The businesses of the Company and associated company were compared and it was noticed that the primary business of the Company was manufacture and sale of foam, foam products and various industrial chemicals/chemical binders, used in textile, leather and wood industries; the foam unit of the Company has been closed since 1997. The primary business of associated company is manufacture and sale of foam. From this information, it appears that there is no common business material or goods which the Company might be selling to the associated company thus generating normal business transactions and giving normal trade credit.

6. Consequently, a Show Cause Notice (the "Notice") was issued to the Chief Executive and directors of the Company on March 04, 2005 that why a penalty as provided under Section 208 of the Ordinance may not be imposed on them for violation of Section 208. The company replied to the Notice vide its letter dated March 17, 2005 and stated that the Company has complied with the provisions of Section 208 of the Ordinance by passing a resolution under Section 208 of the Ordinance for making investments in associated company in November 26, 1996. This resolution has legalized the entire transaction with the associated company. The same is considered valid because no objection was raised by the then CLA.

7. In order to give an opportunity to the management of the Company to clarify their position, a hearing was fixed for April 12, 2005. The Company requested to adjourn the hearing and stated that their authorized representative, Mr. Abdul Hameed Khan, FCA is not available on this date due to his professional occupation. The adjournment was granted and the hearing was re-fixed for May 03, 2005, while explicitly explaining that in case the hearing is not attended by the Company's representative, the matter shall be decided on the merits and record available. The Company again requested for adjournment due to "serious ailment" of their representative, Mr. Abdul Hameed Khan, FCA, who, being a fellow chartered accountant, recently visited me and left his business card**.** I called him to enquire about his health. Much against contention of the Company about his "serious ailment" he was found to be working in his office, though he informed me that he has an upset stomach and has just arrived in the office. In the interest of natural justice, no order was passed against the Company despite their absence from the hearing. To provide another opportunity, the hearing was re-fixed for May 06, 2005. It was informed that this is a final opportunity of hearing and the case shall be decided on merits, in case the hearing is not attended.

8. On the date of hearing Mr. Nazir Ahmed; Company Secretary, Mr. R. R. Alvi; Advocate and Mr. Abdul Hameed Khan, FCA appeared on behalf of the Chief Executive and directors of the Company. The Board's representatives were informed that the notice for current hearing was issued to the Chief Executive only, who has not appeared himself as he was directed to appear in person under Sub-Section (3) of Section 479 of the Ordinance. Mr. R. R. Alvi stated that the Chief Executive could not appear in person due to his preoccupation. He further submitted that sub-section (3) of Section 479 is not attracted in this case because it is attracted when the body corporate ignores the hearing notice.

9. Mr. R. R. Alvi repeated the argument that since the Company has passed a resolution for making investments in associated company, there is no contravention of Section 208 of the Ordinance. He said that a resolution, once passed, remains valid till the dissolution of the Company. At this point of time, his attention was invited to the fact that the Company has taken the plea vide their letter no. DIL/CS/076 dated February 10, 2005 that these were normal trade creditors and no investment/advances have been made by the Company. Mr. Nazir Ahmed explained that when he received Commission's examination letter, he was not aware of this resolution passed in 1996 and hence he earlier submitted that this is normal trade credit provided to the associated company. He further stated that subsequently, upon non-acceptance of this explanation by the Commission and receiving the show cause notice, he checked the record and found that the Company has already passed a resolution in this regard and submitted the same. Upon a query, he told that these are on account payments made on behalf of the associated company and no interest/markup is charged on it. When he was asked to clarify the contradiction he has made about nature of the balance due from associated company, he could not come up with any satisfactory answer and kept on debating that, as the Commission did not agree with the first explanation of the balance being in the nature of trade credit, he submitted the second explanation alongwith the copy of the resolution contending that the shareholders have approved the investment. Mr. R. R. Alvi added to it that this resolution has been passed as a measure of abundant precaution to prevent from violation of Section 208 and that many companies follow this practice. The representatives were asked that if their contention is accepted, has the Company complied with the requirements of para 2 of SRO 865(I)/2000 dated December 6, 2000? However, they were not even aware of the afore-referred SRO and its requirements.

10. At the time of hearing, the authorized representatives submitted a letter of Chief Executive of the Company with respect to the proceedings under Section 208 of the Ordinance. The Chief Executive, through his written statement submitted the following:

i. The reply to the show cause notice clearly explained the legal position for the advances extended to subsidiary company. The copy of the resolution was appended to the reply and the Commission was requested to withdraw the notice on the said basis.

ii. The hearing notice dated 30.3.2005 required us to appear for hearing and no reasons were disclosed as to why the reply to the show cause notice was not considered satisfactory, so we felt threatened by the hearing notice.

iii. Our authorized representative, Mr. Abdul Hameed Khan, FCA indicated to us his inability to appear in the hearings fixed on April 12, 2005 and May 3, 2005 due to his preoccupation and his illness, respectively.

iv. As for the hearing notice under Sub-section (3) of Section 479, he stated that the inability indicated by our representative is beyond our control. He is pre-occupied on the said date.

11. The arguments advanced by the Chief Executive and Directors through their authorized representatives have been analyzed and are discussed hereunder. The Company initially classified the balances due from associated companies as normal trade credit as reflected in the accounts for the years-ended 1995 – 1997 and 2000. This argument is invalid because:

i. The Company has no common or integrated business with the associated company in view of its closed operations of foam unit. There are no possible sale/purchase transactions which can take place between the two companies. The Company has also not shown any transactions with associated company in its annual accounts for the year-ended June 30, 2004 and the representatives have failed to explain the nature of transactions which have purportedly given rise to the subject receivables form associated company.

ii. These balances have been disclosed independently in the balance sheet of the Company under the head of Current Assets. Had they been normal trade transactions, this balance should have made a part of “Trade Debtors”.

iii. Since, consequent upon serving of notice, the Company came up with the 9 years old resolution authorizing the Chief Executive to make investments in the associated companies and has changed its contention now claiming that the amount under discussion is an investment; this balance due from associated company cannot be treated as trade debt.

12. In order to examine the Company’s claim that these advances are legitimately authorized by the shareholders vide the resolution passed in the Annual General Meeting (AGM) of the Company on November 26, 1996, it would be appropriate to examine the contents of the afore-referred resolution:

Quote:

RESOLVED THAT "Consent and approval of the Company be and is hereby accorded to invest in the shares/loan upto Rs. 50.00 (million) of Diamond Polymers (Pvt.) Ltd. from time to time as may deem expedient on terms and conditions not unfavorable as compared to such investments, loans, advances etc. obtained from commercial banks. It is further resolved that the Chief Executive of the Company be and is hereby authorized to negotiate and to take any and all actions as may be deemed necessary to invest/disinvest of the aforementioned share capital/loan upto Rs. 50.00 (million) or any part thereof of Diamond Polymers (Pvt.) Ltd from time to time, as may deem expedient for said consideration and/or on such terms and conditions as he may think fit on behalf of the Company. He is further authorized for such investments in Diamond Polymers (Pvt.) Ltd. in the amount which is within the limit prescribed as well as the meanings and terms of Section 208 of the Companies Ordinance, 1984."

Unquote

13. It is clear from the contents of the resolution that no material information regarding the associated company has been provided to the shareholders, rather a vague description regarding the terms and conditions regarding investment in associated company has been outlined. The resolution gives all the rights to make investments/disinvestments, terms and conditions, mode of investment/disinvestment solely to the Chief Executive of the Company, which is against the spirit of the law and good corporate governance that requires such transactions to be properly authorized by the shareholders before entering into and making material disclosures to the shareholders regarding any changes in the same. The last three lines of the above resolution are important in this respect as it sets out that all such investments be made within the meanings and terms of Section 208 of the Ordinance. However, as admitted by the Company Secretary that these advances are interest free, it is clear that the Chief Executive has acted against the resolution passed by the shareholders of the Company as well as Section 208 of the Ordinance.

14. The argument that this resolution has been passed as a measure of precaution, cannot be held valid because the Ordinance has given specific requirements regarding such investments and such resolutions are always passed for specific purpose and time limit, disclosing complete information. The above resolution is, thus, defective and cannot be considered to be according to the requirements of the Ordinance.

15. As for the written submission of the Chief Executive considering hearing notice as a threat, it is stated that the opportunity of hearing which was provided to him was his right in the eyes of law. It is an opportunity for them to further explain his position with respect to the Notice, not a threat.

16. I have analyzed the facts of the case and observed that the resolution was passed under the provisions of Section 208 of the Ordinance in the year 1996. It is therefore viewed that in the above scenario, making of investments on the basis of a 09 years old resolution cannot be treated as a valid investment. Further the investment made by the Company for the last number of years is not bringing any return to its shareholders. Moreover, in view of amendments made in the provisions of Section 208 of the Ordinance, the Company had to disclose the additional information to its shareholders as required under the S.R.O.865(1)/2000 dated December 06, 2000. No such disclosures were made which indicate that the Company has always been viewing such investment as a trade transaction. Accordingly, the Company and its management have contravened the provisions of Section 208 of the Ordinance.

17. On the basis of the above conclusion, I am of the view that the default under Section 208 of the Ordinance is willful and deliberate. However, as the Company has recovered the outstanding amount in the subsequent period, I taking a lenient view, instead of imposing a maximum penalty of Rs. 1,000,000/- on each directors, impose a fine of Rs. 250,000/- on the Chief Executive of the Company only, for the said default, as provided under Sub-Section (3) of Section 208 of the Ordinance. The other directors are reprimanded to be careful in future.

18. The Chief Executive and directors are further directed, in terms of Section 473 of Companies Ordinance, are as under:-

i. To submit a certificate from a Chartered Accountant firm having a satisfactory QCR, within 30 days from the date of this Order for calculation of return on the amounts outstanding from the associated company during the year ended June 30, 2004.

ii. The Chief Executive and directors are further called upon to recover the outstanding return as calculated above, from the associated undertaking, within 45 days of the date of this order.

iii. To pass a fresh resolution in the forthcoming AGM of the Company, if the Company intends to make investments in the associated company.

The Chief Executive of the Company is hereby directed to deposit the aforesaid fine in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with Habib Bank Limited or pay through a demand draft in the name of Securities and Exchange Commission of Pakistan within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission, failing which proceedings for recovery of the fines as an arrears of land revenue will be initiated. It may also be noted that the said penalties are imposed on the Chief Executive in his personal capacity; therefore, he is required to pay the said amounts from his personal resources.

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Javed K. Siddiqui
Executive Director (C.L)