Corporate Supervision Department
Company Law Division

Before Tahir Mahmood – Commissioner (Company Law Division)

In the matter of

Mount Fuji Textile Mills Limited

Number and date of notice:	EMD/242/K/630/2013-1605 dated August 27, 2014
Date of hearings:	November 19, 2014 and June 23, 2015
Present:	Mr. Mahmood Rafi, the Authorized Representative

ORDER

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

This order shall dispose of the proceedings initiated against the directors including chief executive (together referred to as the "respondents") of Mount Fuji Textile Mills Limited (the "Company"). The proceedings were initiated against the respondents through show cause notice ("SCN") dated August 27, 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 annual audited financial statements ("Accounts") of the Company for the year ended June 30, 2012 submitted with the Commission in pursuance of section 242 of the Ordinance revealed that the Company had accounted for investments amounting to Rs222.473 million (2011: Rs209.526 million) in shares of quoted companies at cost (*Reference note 4 to the Accounts*). The treatment was not in accordance with the requirements of Accounting and Financial Reporting Standards ("AFRS") applicable to Medium Sized Entities ("MSEs") which require such investments to be carried at fair value. The Company did not disclose its policy regarding investment in quoted shares under "Significant Accounting Policies" forming part of the notes to the Accounts. The financial impact of the aforementioned contravention with the requirement of AFRS by the Company appeared to be material as the Company had not stated the investments in quoted shares at fair value and, therefore, had not accounted for the loss of Rs70.85 million from investment during the year ended June 30, 2012. This resulted in misstatement of Accounts of the Company. Consequently, the SCN was issued to the respondents under section 492 read with section 476 of the Ordinance.

3. In response to the SCN, the Company Secretary on behalf of the respondents, submitted reply dated September 20, 2014. A brief of the submissions in respect of the contents of the SCN is as under:

> *"Referring to the observation regarding "Section 16.3 of AFRS applicable on MSE's, it is clarified that owing to booming market prospects, the investment made were reported on cost instead of fair value with positive anticipation. However, the divergence from section 16 of AFRS was taken care of in subsequent reporting. Furthermore, we will ensure meticulous compliance as per Commission's observation and express our regrets for non-compliance made unintentionally in Annual Audited Accounts for the year ended June 30, 2012."*

The case was fixed for hearing on November 19, 2014 and on behalf of the respondents Mr. Mahmood Rafi appeared before the Head of Department, Corporate Supervision Department *(previously Enforcement Department)*, who was the authorized adjudicating officer at that time. Mr. Rafi accepted the default and requested to take a lenient view. Subsequently, due to revision in delegation of powers of the Commission, the respondents were provided another opportunity of hearing. The respondents opted for rehearing of the case and were again represented by Mr. Mahmood Rafi in hearing before the undersigned on June 23, 2015. Mr. Rafi mainly reiterated the earlier written submissions and requested for a lenient view on the grounds that the non-conformity with requirements of the law was due to an inadvertent omission and was not willful. He further reiterated that the omission had been rectified in the next year's accounts of the Company.

4. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance and AFRS.

Section 16 ***'Investments'*** of Accounting and Financial Reporting Standards ("AFRS") applicable on MSEs states as under:

'Subsequent Measurement of Investment'

> *"16.3 After initial recognition, an entity shall measure investments at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following investments:*
>
> *(a) held-to-maturity investments, which shall be measured at amortised cost using the effective interest method; and*
>
> *(b) investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which shall be measured at cost."*

'Gains and Losses'

> *"16.9 A gain or loss arising from a change in the fair value of an investment shall be recognised as follows.*
>
> *(a) A gain or loss on an investment classified as at fair value through profit or loss shall be recognised in profit or loss."*
>
> *(b) A gain or loss on an available-for-sale investment shall be recognized directly in equity, through the statement of changes in equity, except for impairment losses and foreign exchange gains or losses, until the investment is derecognised, at which time the cumulative gain or loss previously recognised in equity shall be recognised in profit or loss. However, interest calculated using the effective interest method is recognised in profit or loss.*

Section 492 of the Ordinance states as under:

> *"**Penalty for false statement.** - 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."*

5. I have analyzed the facts of the case, the relevant provisions of the Ordinance, requirements of AFRS and the arguments put forth by the respondents. I have observed that as per requirements of the Ordinance and the AFRS quoted in the preceding paragraphs, the Company's Accounts for the year ended June 30, 2012 were misstated. My conclusion in this regard is based on the following:

a) The Company failed to disclose its policy regarding investment in quoted shares under 'Significant Accounting Policies', forming part of the notes to the Accounts.

b) The Company failed to comply with requirements of AFRS as it had accounted for investments amounting to Rs222.473 million (2011: Rs209.526 million) in shares of quoted companies at cost instead of fair value, in contravention with the requirements of Para 16 of AFRS applicable to MSEs.

c) As a result of aforesaid contravention with applicable AFRS, the loss amounting to Rs70.85 million was not accounted for in the Accounts causing misstatement in the Accounts.

d) The aforesaid non-compliance with requirements of AFRS had material impact on the Accounts of the Company due to following factors:

   i. Correct accounting treatment in line with requirements of AFRS was not adopted.

   ii. An amount equal to Rs70.85 million being loss on investments that were required to be carried at fair value was not recognized in profit & loss account or equity causing misstatement in the respective heads.

   iii. The amount of misstatement is 8.06% of the sales, 5.39% of total assets and 16.78% of the unadjusted equity (net assets) and, therefore, has material impact.

Moreover, in respect of the respondents' submission regarding rectification of default in the subsequent Accounts for the years ended June 30, 2013 and June 30, 2014, I have observed that the Company classified the investments in quoted shares as "available for sale" and has stated them at fair value. The resultant loss due to change in fair value has been recognized under the equity as per requirements of the AFRS. However, despite material decrease in price of quoted shares, the Company has not recognized the impairment losses in the profit and loss accounts against the requirements of section 16 of AFRS. Moreover, while restating the figures of investment in quoted shares to apply the requirements of AFRS in Accounts for the year ended June 30, 2013 and June 30, 2014, the Company has not meticulously followed the requirements of section 12 of the AFRS: *Accounting Policies, Changes in Accounting Estimates and Errors*. It has failed to apply the corrections retrospectively in respect of all the relevant reported figures and proper disclosures have not been made.

6. I deem it necessary to make some observations on the importance of correct reporting in the financial statements of companies. The financial statements are the most important source of reliable information for the shareholders. The financial statements not only show the financial position and performance of the company but also show the results of management's stewardship of resources entrusted to it. The investment decisions of the shareholders are based on the information presented to them in financial statements. Incorrect presentation of the said information could adversely affect their judgment. Therefore, correct reporting in the financial statements in line with applicable financial reporting framework is of utmost importance. In addition to their responsibilities of overseeing and managing affairs of the Company, directors

also have fiduciary duties towards the Company and its shareholders. They are, therefore, liable to a higher level of accountability which requires them to be vigilant and perform their duties with care and prudence. It is directors' responsibility to oversee the functioning of the company, to keep it appropriately staffed and organized to ensure due compliance of law and applicable financial reporting framework. In this context the respondents cannot absolve themselves of their statutory duties regarding correct reporting in the financial statements of the Company.

7. In view of the foregoing, I have concluded that the Accounts of the Company for the year ended June 30, 2012 have been materially misstated and the respondents are liable to fine in terms of section 492 of the Ordinance. Accordingly, in terms of powers conferred by section 492 of the Ordinance, I hereby impose an aggregate fine of Rs105,000/- (Rupees one hundred five thousand only) on the respondents, as per following details:

Name of Respondents	Total
1. Mr. Ahmed Ashraf	Rs15,000
2. Mr. Abdul Latif Ashraf	Rs15,000
3. Mrs. Sarah Latif	Rs15,000
4. Mrs. Rahat Ashraf	Rs15,000
5. Mr. Mohammad Ashraf	Rs15,000
6. Mrs. Shazia Ashraf	Rs15,000
7. Mr. Shehzad Ashraf	Rs15,000
TOTAL	**Rs105,000**

It has been informed that Ms. Khairun Nisa, one of the respondents has passed away on June 14, 2015; therefore no adverse order is passed against her.

The respondents are directed to deposit the aforesaid fines in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty days from the receipt of this Order and furnish receipted vouchers for information and record, failing which proceedings under the Land Revenue Act, 1967 will be initiated which may result in the attachment and sale of movable and immovable property.

Tahir Mahmood
Commissioner (Company Law Division)

Announced:
July 6, 2015
Islamabad