Before Ali Azeem Ikram, Executive Director/HOD (Adjudication-I)
In the matter of Safa Textiles Limited

Date of Hearing	January 8, 2020, January 22, 2020, January 31, 2020, February 19, 2020

Order-Redacted Version

Order dated February 28, 2020 was passed by Executive Director/Head of Department (Adjudication Department-I) in the matter of Safa Textiles Limited. Relevant details are given as hereunder:

Nature	Details
1. Date of Action	Show cause notice dated March 01, 2019
2. Name of Company	Safa Textiles Limited
3. Name of Individual*	The proceedings were initiated against the directors of the Company i.e. Safa Textiles Limited
4. Nature of Offence	Violations of sections 196 and 492 of the Companies Ordinance, 1984 (the "Ordinance")
5. Action Taken	Key findings were reported in the following manner: I have analyzed the available information, following issues were reported, which were sufficient to demonstrate that Accounts 2016 were *prima facie* false or incorrect or omitted material facts in relevant disclosures, in terms of section 492 of the Ordinance, due to significance of these issues and materiality: (i) Use of going concern assumption was inappropriate due to outstanding liabilities of Rs. 519.75 million vis-à-vis total assets amounting to Rs. 193 million and there did not exist avenues for retiring the said obligations. The Company also incurred gross loss of Rs. 5.74 million and net loss of Rs. 24.77 million during the period ended December 31, 2016.

	Moreover, there did not exist a business revival plan and the Company had leased out its sizeable part i.e. 65% of building and was earning nominal revenues of Rs. 7.02 million. The Company's cutting, making and trimming operations were completely closed and no effort was on card to revive the business operations. (ii) The Company also recorded an excess mark-up of Rs. 12.25 million in Accounts 2016 i.e. 6.32% of total assets, against its liabilities due to NIB Bank Limited. (iii) It failed to record provision for doubtful receivables in respect of Halifax and Sam Rizvi which amounted to Rs. 8.98 million (i.e. 31.72% of total receivables) despite no indication of recoverability. (iv) Carrying amount of plant & machinery as at June 30, 2016 was Rs. 51.6 million. Due to the reason that its sizeable part was leased out, and 227 out of 492 manufacturing machines were found in idle and in rusty conditions, which constituted approximately 55% of plant & machinery, and despite clear indication of impairment, no impairment in terms of requirements of IAS 36 was recorded in the books of the Company. (v) The Company also reported its advances of customers of Rs. 7.69 million as non-current liability despite no substantiating grounds in terms of paras 69 and 73 of IAS-1. (vi) In Accounts 2016, number of employees were reported 90, as against mentioned in auditor's report as 11, and as per payroll of June 2016 were 138. (vii) Purchases from related parties were disclosed in Accounts 2016 as Rs. 20.06 million, whereas per ledger provided to inspection team, the same were only of Rs. 3.07 million. The auditor also confirmed that purchases from related parties were amounting to Rs. 3.12 million. (viii) The cash flow statement disclosed repayment of long term loan amounting to Rs. 110 million, which was

	not paid rather it was reclassification adjustment and was incorrectly presented in cash flow statement, so an amount of Rs. 110 million was not reported correctly in cash flow statements, being part of Accounts 2016. (ix) The vehicles having carrying value of Rs. 5.584 million, which were shown in fixed assets register and of the amount of Rs. 6.584 million as disclosed in Accounts 2012, were not in possession of the Company and thereafter no disposal was recorded in the books of the Company. As per information provided to inspection team the aforesaid vehicles were disposed by the chief executive. (x) The Company in financial year 2015 disclosed addition of Rs. 3.590 million. As per available record, three vehicles i.e. Toyota Corolla bearing registration number ASN 138, Toyota Corolla bearing registration number ASY 372, Toyota Corolla bearing registration number AUD 281 and Toyota Hilux Pickup bearing registration number KS 9349, purchased for which an amount of Rs. 3.590 million was disclosed as addition of vehicles. However, the same vehicles were not in possession and control of the Company, rather the aforesaid vehicles were in the names of either Mr. Syed Tariq Hussain, chief executive and in the name of Mr. Adnan Imam, director. Hence, the amount of property, plant & equipment disclosed for the aforesaid vehicles in financial year 2016 were not substantiated with corresponding record of possession and control of such vehicles. Moreover, disclosures in as per requirements of fourth schedule of the Ordinance for assets not in the possession and control of the Company was made. (xi) The Company in its subsequent interim accounts for the six months period ended December 31, 2016, had written off stock in trade amounting to Rs. 6.20 million, whereas stock in trade as of June 30, 2016 was

	Rs. 7.69 million. Write off of stock in trade of 6.20 million (80.67% of stock in trade) transpires that the same amount was not truly reflected in Accounts 2016; (xii) Related party transactions of purchases were not correctly reported in Accounts 2016. 2. In view of the aforesaid, the Company's Accounts 2016 were false and incorrect in material particular as it omitted material disclosures and also made departure from the requirements of IAS 1 and IAS 36, which was not acceptable. To mention, relevant paras of IAS 1 and IAS 36 are reproduced as below, in terms of which current liabilities cannot be disclosed as non-current and impairment of assets is required when there exists indications: Para (69) of IAS 1 (presentation of financial statements): *An entity shall classify a liability as current when:* *(a) It expects to settle the liability in its normal operating cycle;* *(b) It holds the liability primarily for the purpose of trading;* *(c) The liability is due to be settled within twelve months after the reporting period; or* *(d) It does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). Terms of liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.* Para (73) of IAS 1 (presentation of financial statements): *If an entity expects, and has the discretion, to refinance or roll over obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation*

	as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current. Para (9) of IAS 36 (impairment of assets): *An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.* 3. I would like to highlight that the provisions of section 196 of the Ordinance empower the directors to manage the affairs of the Company in the best interest of the shareholders. The directors therefore are expected to discharge their statutory duties with responsibility and care and act in fiduciary capacity, to exercise their powers derived from constitutive documents and the Ordinance. The role of directors is therefore of utmost importance and in terms of the Ordinance they are required to exercise their collective wisdom through passing resolutions. In the instant case, the Company, however not furnished relevant evidence of compliance in terms of section 196(2)(j) of the Ordinance for acquisition and disposal of its plant & equipment, which comprised of vehicles of Rs. 3.59 million, acquired in financial years 2014 and 2015, and disposal of various vehicles for mentioned financial years, which were found in the names of individuals rather in the name of the Company, and it transpired that chief executive disposed of these vehicles. 4. In view of the foregoing, I am therefore of the view that in terms of section 492 of the Ordinance, Accounts 2016 were materially misstated and incorrect as it omitted material facts in disclosures. I am also of the view that the Respondents made non-compliance with the provisions of section 196(2)(j) of the Ordinance. The Respondents, are therefore liable for penalties to

	be imposed. I, therefore, in terms of section 196(4) and section 492 of the Ordinance, hereby impose aggregate penalty of Rs. 360,000/- (Rupees Three Hundred and Sixty thousand only) for contravention of aforesaid requirements of the Ordinance, on the Respondents. Nothing in this Order may be deemed to prejudice the operation of any provision of the Act providing for imposition of penalties in respect of any default, omission or violation of the Act. Penalty order dated February 28, 2020 was passed by Executive Director (Adjudication-I).
6. Penalty Imposed	A penalty of Rs.360,000/- (Three Hundred and Sixty thousand only) was imposed on the Respondents.
7. Current Status of Order	No Appeal has been filed by the respondents

Redacted version issued on August 25, 2020 for placement of website of the Commission.