



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director

In the matter of

Island Textile Mills Limited

Number and date of notice: CSD/ARN/514/2017-534-40 dated September 25, 2017
Date of hearing: February 21, 2018
Present: A. K. Brohi & Company and M/s Khalid Anwer & Co.
(Authorized Representatives)

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 the Chief Executive (*the "Respondents"*) of Island Textile Mills Limited (*the "Company"*) through show cause notice dated September 25, 2017 (*the "SCN"*) issued under the provisions of Section 492 read with Section 476 of the Companies Ordinance 1984 (*the "Ordinance"*).

2. Brief facts of the case are that review of the annual audited accounts of the Company for the year ended June 30, 2016 (*the "Accounts"*) revealed that the Company carried out revaluation exercise during the year in respect of leasehold land, building on leasehold land, plant and machinery and electric installations. Note 2.2 and 3.1 to the accounts revealed that the Company carried leasehold land, building on leasehold land, plant and machinery and electric installation at revalued amounts being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses, if any. The Company has not incorporated the impact of upward revaluation in respect of the related assets in the accounts based on prudence.

3. Note 4.3 to the Accounts states that:
"During the year revaluation exercise has been carried out in respect of Leasehold land, Building on leasehold land, Plant and machinery and Electric installations by an independent valuer. The management has not incorporated the impact of upward revaluation on the basis of prudence."

4. The Company was advised to provide explanation for not accounting for the revaluation surplus/deficit resulting out of revaluation during the year, which was in violation with the requirements of International Accounting Standard (IAS) 16, 'Property, Plant and Equipment', despite the fact that the Company is carrying these fixed assets at revalued amounts, as per its policy stated at Note 3.1 to the accounts which mentions that:

"Leasehold land, buildings on leasehold land, plant and machinery and electric installations are stated at revalued amount being the fair value at the date of revaluation, less subsequent accumulated depreciation and impairment losses, if any. Revaluations are performed with sufficient regularity so that the fair value and carrying value do not differ materially at the reporting date".



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5. The Company replied vide its letter dated June 30, 2017 as under:

"... Revaluation exercise was carried during the year 2016 in respect of lease hold land, building on lease hold land, plant and machinery and electric installations by independent valuer M/s M.K. Associates. On the basis of prudence the management deferred the impact of upward revaluation. However, the same was incorporated subsequently in half yearly accounts for the period ended December 31, 2016. The same has also been disclosed in note 5.2 of the half yearly accounts...."

6. In view of the reply of the Company, it appeared that the Company has contravened the requirements of IAS-16, in annual accounts for the year ended June 30, 2016 and subsequent quarterly accounts for the period ended September 30, 2016, as stated below:

- a) Fixed and total assets are understated;
- b) Surplus on revaluation of property, plant and equipment is understated;
- c) Deferred tax liability has been understated;
- d) The Company has not charged incremental depreciation in the annual and subsequent quarterly accounts for the period ended September 30, 2016;
- e) Depreciation expense would have been different had the company taken the impact of revaluation in its annual and quarterly accounts.

7. The Company in its account for the year ended June 30, 2016 and quarter ended September 30, 2016 *prima facie* misstated which made the directors of the Company liable to the penalty as stated under section 492 of the Ordinance. Therefore, the SCN was issued to the Company under Section 492 of the Ordinance to show cause in writing within fourteen days from the date of this notice as to why penalty may not be imposed on you for contravening the afore-referred provisions of the Ordinance.

8. The Respondents submitted the reply to the SCN through M/s A. K. Brohi & Co. Legal Consultant and Advocates, their Authorized Representatives vide letter dated October 24, 2017. Brief of the reply is as follows:

- The Company had been recording capital work in progress on both of its units i.e. Unit 1 and Unit 2. On August 31, 2015, the Company transferred a new manufacturing unit consisting of plant and machinery and electric installation costing Rs 3.191 billion pertaining to Unit 2 from capital work in progress to property plant and equipment. This represented a major addition to the plant and machinery account during the year ended June 30, 2016.
- The creditor(s) of the Company thereafter had requested the same to carry out a revaluation exercise. As a part of the revaluation exercise, the valuation also took into account the Unit 2, which in the Company and its auditor's opinion, did not seem to be reasonable given that it had been commissioned



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only 10 months earlier. It was not expected that a significant change in its fair value had occur during such a short period of time.

- The Company is in practice to carry out revaluations after a period of four or five years so as to ensure that the carrying amount is not materially different from the fair value as required by IAS 16.
- It may be noted that the last revaluation has been carried out on June 30, 2012, and the policy suggested that the next revaluation was due in 2017.
- In order to comply with the requirements of IAS 16, the company had to revalue an entire class of building, plant and machinery during the revaluation exercise. Therefore, in the Company as well as its auditor's opinion it was not appropriate to record a gain on revaluation on Unit 2, which had been operational for only ten months by the year-end. Thus, it was decided to defer the revalued amount in financial statements until Unit 2 would be operational for at least a period of one whole year.
- That during the half year ended as on December 31, 2016, the Unit 2 has been in operation for around more than a year i.e. 16 months and the valuation cycle was completed i.e. greater than 4 years. The valuation was once again updated through a certificate from the same valuer who had confirmed that there was no considerable change in the fair market value.
- In case the impact of revaluation had been incorporated in the financial statements from April 18, 2016 (date of valuation report), excess depreciation amounting to Rs 3.4 million and net of tax amounting to Rs. 2.4 million would have been charged to profit and loss account, which is not material to the financial statements.
- Auditors advised the Company not to account for such revaluation in the financial statements.

9. Considering the reply of the Respondent, hearing in the matter was fixed for February 21, 2017, which was attended by the Mr. Habib Kazi and Mr. Faran Khan of the Authorized Representative along with Mr. Farooq Advani, Company Secretary and Mr. Muhammad Hussain, AVP Corporate Affairs of the Company respectively. During the hearing, the

Authorized Representatives put forth the reiterated the arguments as were given in the written submissions earlier.

10. In terms of the Commission's notification SRO 751 (I)/2017 dated August 2, 2017, the powers to adjudicate cases under Section 492 of the Ordinance have been delegated to the Executive Director (Corporate Supervision Department).

11. I have analyzed the facts of the case, relevant provisions of the Ordinance, and submissions made by the Respondents. I hereby tend to concur with the submission made by the Authorized Representatives during the hearing proceedings. The argument of the Authorized

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Representatives are justified on the grounds that Unit 2 had been commissioned only 10 months before the reporting date i.e. June 30, 2016 and no significant change in revaluation amount was expected in the fair value of Unit 2 during this short period of time. In order to comply with the requirements of IAS 16, it was required to revalue the entire class of building and plant and machinery during the revaluation exercise, and it was not appropriate to record surplus on revaluation on Unit 2, which had been operational only for a 10-month period. The impact of revaluation exercise, if incorporated in the accounts, in terms of the excess depreciation is not material in nature being less than 2% of the total depreciation charged to the financial statements. I have seen that the Company is following the practice to carry out revaluations after a lapse of 4 to 5 years as per the requirement of law. The last revaluation had been carried out on June 30, 2012 and next revaluation was due in 2017. I have observed that another full scope valuation of Land, Building, Plant and Machinery and Equipment has been conducted and as certified by the valuer, as on December 31, 2016, there was no considerable change in the fair market value of the fixed assets. In view of the foregoing, I conclude the proceedings against the respondents without any adverse order.

Abid Hussain

Executive Director

Corporate Supervision Department

Announced:

March 13, 2018

Islamabad