



Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director (CSD)

In the matter of

D.M. Textile Mills Limited

Number and date of SCN: CSD/ARN/81/2015-1595-1601, dated May 7, 2015
Date of hearings: (i) July 2, 2015; and (ii) February 22, 2016
Present: (i) Mr. M. Javed Panni; (ii) Mian Habibullah, CEO

ORDER

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

This order shall dispose of the proceedings against the following directors including the chief executive (the "respondents") of D.M. Textile Mills Limited (the "Company"):

1. Mian HabibUllah, Chief Executive
2. Mr. Hussain Ahmed Ozgen, Director
3. Ch. Mohammad Yasin, Director
4. Mr. Hussain Ahmad Qureshi, Director
5. Syed Obaid ul Haq, Director
6. Rao Khalid Pervaiz, Director
7. Mr. Shahid Aziz, Director (NIT's Nominee)

The proceedings against the respondents were initiated through show cause notice (the "SCN") dated May 7, 2015 under 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, 2014 submitted with the Commission in pursuance of section 233 of the Ordinance revealed that during the year the Company entered into a settlement agreement ("Agreement A") with NIB Bank Limited ("NIB"), and resultantly NIB granted following relief to the Company (*note 5.1 to the Accounts*):

- i. Long term financing and short term borrowings including related mark-up are reduced to Rs121.087 million.
- ii. Remaining balance is interest free and repayable in 100 monthly instalments.

It was further stated in the aforesaid note that in case of default by the Company, the Agreement A or any of its arrangements shall stand cancelled / withdrawn and consequently, the Bank will be entitled to recover outstanding amount as per book of ledger. The Company in the Accounts recorded the effect of the Agreement A in the following manner:



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- i. Remaining balance of loan (*which is interest free*) has been stated at present value using effective interest rate of 9.42%; and
- ii. A gain of Rs126.998 million on settlement of borrowings has been recorded in income statement (*note 31*).

As disclosed in note 5.1 to the Company's Accounts for the half year ended December 31, 2014 ("Half Yearly Accounts"), the Company entered into another settlement agreement ("Agreement B") with NIB for settlement of entire outstanding amount of Rs109.087 million against sale of a piece of land (6 *Kanal*) and the amount was classified under current liabilities, while transfer of land and other formalities were under process. The aforesaid recognition of entire amount of relief as income appeared to be premature because the necessary ingredient of 'sufficient degree of certainty' for recognition of income on rescheduled loan was missing, as per the Conceptual Framework for Financial Reporting (the "Framework") (*reference para 4.47 and 4.48*). Resultantly, the liabilities and income of the Company were, *prima facie*, understated and overstated respectively, thereby rendering the Accounts to be, *prima facie*, misstated.

3. Moreover, an amount of Rs51.150 million had been appearing in the Company's Accounts since the year 2006. In the Accounts for the year 2014, it was stated to be full consideration given by the Company as advance for purchase of property comprising a house situated at House No. 8, Street 7, F 8/3, Islamabad, (the "Property"), which could not be transferred in the Company's name due to incomplete legal formalities. In respect of the Property, the Commission vide order dated November 29, 2007 had imposed a penalty of Rs100,000/- on each of the Company's director except nominee director of the NIT for contravention of section 196(2) (j) of the Ordinance and also issued directions under section 473 to get the Property transferred in the name of the Company within thirty days from the date of Order. During the year ended June 30, 2014, the board of directors ("BOD") of the Company in the meeting held on April 23, 2014 resolved that the right in the Property comprising a house, along with fixtures and fittings to be offered to the chief executive on the basis of "first right of refusal" at the fixed floor price of Rupees 75.00 million (*reference note 15 to the Accounts*) and accordingly agreement was executed with the chief executive. The Chief Executive Officer ("CEO") of the Company filed an application under section 484 of the Ordinance to the Commission against the order dated November 29, 2007, however, the order was upheld after review. The CEO then filed an appeal before Rawalpindi Bench of the Lahore High Court (the "Court") that granted a stay order to suspend the operation of above said impugned



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order of the Commission. On a subsequent application moved by the Commission to vacate stay granted by the Court against the Commission's order, the Court vide its interim order dated February 10, 2015, inter alia, directed that "*meanwhile, the property of the Company shall not be transferred/alienated in any form or manner whatsoever*".

The Company in the Half Yearly Accounts while disclosing the status of the case in the Court under note 9, stated that the Court had granted a stay order to suspend the operation of above said impugned order of the Commission. However, the fact relating to the Court's interim order dated February 10, 2015 and status of Company's compliance with the aforesaid order was not disclosed in the Half Yearly Accounts, which were authorized for issuance on February 23, 2015. Hence, a material fact was, *prima facie*, omitted and not disclosed in Half Yearly Accounts.

4. Consequently, the SCN was issued to the respondents whereby they were called upon to show cause in writing as to why penal action may not be taken against them for the aforesaid contraventions of the law. In response to the SCN, the chief executive of the Company through letter dated May 16, 2015 requested for extension of fourteen days in time for submission of reply. The extension was granted till June 4, 2015. In response to the SCN, Mr. M. Javed Panni, submitted reply dated June 4, 2015 on behalf of respondents. With reference to contents of the SCN, a brief of submissions of the respondents is produced below:

(a) Gain on settlement of borrowings:

- Gain on settlement of borrowings amounting to Rupees 126,997,676 comprises of:
(amounts in Rs.)

Excess mark-up provided for in books of account	85,057,299
Fair value adjustment in accordance with IAS 39	41,940,377
TOTAL	126,997,676

- Settlement Agreement A with NIB was signed on 27 December 2013. It included suit amount of Rs178.805 million including mark up of Rs36.103 million, for recovery of which the Bank had filed suit in the Lahore High Court Lahore. In view of prudence the Company continued booking markup, which at time of settlement accumulated to Rs121,160,299 i.e. Rs85,057,299 in excess of the suit amount that was recognized in Agreement A.
- As per the first settlement agreement with the Bank, Settled Amount was only Rs121.087 million comprising of principal outstanding. Hence, based on a duly executed and in-force first settlement agreement with the Bank and keeping in view the balance of mark-up



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payable as per books of the Bank, the Company wrote-back the mark up amounting to Rupees 85.057 million that was no more payable.

- The clauses relating to default by borrower are an integral part of every banking agreement and do not qualify for disclosure as contingent liability, as possibility of an outflow of resources embodying economic benefits is remote. As of 30 June 2014, the Company was well covered to avoid default as it had surplus valuable land which can be used as debt asset swap. The debt asset swap was made with the Bank on 30 December 2014.
- The relevant paragraph of the Conceptual Framework for Financial Reporting that you have quoted substantiates Company's accounting treatment Para 4.47 and Para 4.48 with emphasis on "recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities" and "recognition as income to those items that can be measured reliably and have a sufficient degree of certainty". (Para 4.47 & 4.48 of Framework)
- Fair value adjustment in accordance with IAS 39 of Rupees 41,940,377 was strictly in accordance with provisions of IAS 39 as the settlement agreement was duly executed on 27 December 2013. As regards the second settlement agreement with NIB Bank Limited dated 30 December 2014 (debt asset swap agreement), it was duly executed on 30 December 2014. The only pending legal formalities were activities subsequent to sale deed which are customary to such sales. The Company did not derecognize the land (part of debt asset swap) in its Half Yearly accounts, it only presented it as non-current assets classified as held for sale in accordance with IFRS 5. Similarly, liability of the Bank was presented as a current liability in accordance with IAS 1.

(b) Transfer of right in the Property:

- The Honorable Court has not ordered reversal of any previous transactions which have been executed with proper approval of BOD regarding the Property. Further, it is the prime reason and matter of disagreement between the Company and the Commission for which case is pending for adjudication before the Honorable Court.
- As far as disclosure about the events occurring after balance sheet date is concerned, only those events are required to be disclosed which indicate a **material change in circumstance** prevailing at the balance sheet date.
- In the light of consultations with legal advisors, management believes that there was no material change in circumstances which would have affected the economic decision of its shareholders.
- As the matter is pending in Honorable High Court, Company's management reiterates that it will stand compliant with the decisions of superior judiciary.

5. A hearing in the matter was held on July 2, 2015 and Mr. M. Javed Panni, appeared on behalf of the respondents and made submissions in writing mainly reiterating the earlier written



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submissions. Later on through letter dated December 9, 2015, Mr. M. Javed Panni informed that he was no more representing the respondents in the subject matter. Subsequently, another hearing in the matter was held on February 22, 2016 and Mr. Mian Habibullah, the chief executive appeared before the undersigned. He mainly reiterated the earlier stance as per written submissions. In respect of settlement agreements with NIB and recognition of gain on reversal of liability he further stated that the subsequently the loans of NIB was settled in full and reconciliation of the settlement will be provided to the Commission. In respect of omission of disclosure regarding status of the Property and the Court's interim order, he stated that the Court through the interim order held the Property of the Company shall not be alienated, but the Court's interim order did not affect the already transferred property. He stated that since the Property was already transferred, therefore, its status was not affected by the Court's order and, hence disclosures were not considered necessary in the interim accounts. He stated that the Property was acquired by the Company for use by its chief executive and post facto approval of the shareholders' was also obtained to this effect. The Property was acquired by the Company through payment of amounts in installment to Mr. Naeem Ahmed, who had acquired it from previous owner through power of attorney and its title was not transferred to him. The title of the Property was in the name of a previous owner who was a member of stock exchange and was later sued by the stock exchange for his alleged default and the Property was also attached in this regard. There were several litigations in courts in respect of the Property and therefore its title could not be transferred to the Company.

6. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance and International Accounting Standards ("IAS") notified by the Commission:

IAS 10 - *Events after the Reporting Period*, requires the reporting entities to update the disclosure about conditions at the end of the reporting period.

19. *If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information.*

20. *In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the reporting period, even when the information does not affect the amounts that it recognises in its financial statements.....continued*



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Para 17 of IAS 1- Presentation of Financial Statements, inter alia, require the companies to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

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."

In terms of the Commission's notification SRO 1003 (I)/2015 dated October 15, 2015, the powers to adjudicate cases under section 492 of the Ordinance have been delegated to the Executive Director (Corporate Supervision Department).

7. I have analyzed the facts of the case, relevant provisions of the Ordinance and IASs and the arguments put forth by the respondents and my observations are as under:

(a) Gain on settlement of borrowings:

- Perusal of Accounts for the year ended June 30, 2015 reveals that the Company has settled entire outstanding loans due to NIB. Pursuant to the agreement with NIB, outstanding liabilities have been settled against 6 Kanal piece of land of the Company. The Company has the Buy Back Option during the buy-back period of three years to buy back the property from the bank at market value prevailing at that time. Further, both the Bank and the Company have withdrawn all the pending litigations against each other. In view of subsequent settlement of entire outstanding loans of NIB by the Company and withdrawal of the court cases with NIB, it appears that the Company has successfully settled the liabilities without violating the terms and conditions of the settlement agreement.



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- It appears just to assume that it was probable at that time that the Company had the capacity at that time to fulfill its obligations and settle the loans with NIB. It means there was a degree of certainty to recognize the gain on settlement at the relevant time when the Settlement Agreement with NIB was executed.

(b) Disclosure regarding the Property:

In respect of omission of material disclosure with regard to the status of the Property it is relevant to peruse the facts that have transpired in this regard:

- As per information received from the Capital Development Authority ("CDA"), the Property has already been transferred in the name of Mr. Main Habibullah, the chairman and the chief executive of the Company on February 20, 2014 through a court decree.
- Perusal of the record also revealed that a civil suit was filed by Mr. Mian Habibullah, the chief executive of the Company, against Mr. Neem Ahmed son of Muhammad Yousuf and the CDA on March 28, 2012. It is worth mentioning that the Company was not even made a party in the said suit. The suit was got decided vide judgment and decree dated January 26, 2013. Consequently, the Property was transferred in the name of Mr. Mian Habibullah, the chief executive of the Company.
- It appears that the entire process has been manipulated in a collusive manner. The reasons that the respondents had been continually citing for their inability to transfer the Property in the name of the Company, were all done away with when it came to transferring the very same Property in the name of the chief executive instead of the Company. This in itself is a big question mark. Moreover, the Company was not even made a party when the suit was filed in court for transfer of title of the Property in the name of the chief executive. This all shows intentional concealment of facts for personal gains by the chief executive.
- It clearly reflects that all the aforesaid developments with regard to transfer of title of property had taken place with the efforts and knowledge of the respondents, however, they failed to make any disclosures in the financial statements including the Half Yearly Accounts for the period ended December 31, 2014. The allegations levelled on the respondents through the SCN for the alleged omission of material facts by not mentioning the latest interim order dated February 11, 2015 of the honorable High Court with regard to the proceeding in respect of the Property in the Half Yearly Accounts for December 31,



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2014 is also clearly established. The material intentional omission becomes even graver in view of the facts, that the Property was got transferred in the name of the chief executive but no disclosure was given in any of the Accounts in this regard.

- It transpires that the respondents have deliberately concealed the facts regarding the status of the Property by omission of material disclosures in the financial statements of the Company.

8. I deem it necessary to make some observations on the importance of adequacy and accuracy of disclosures in the financial statements and directors' duties and responsibilities towards the Company and shareholders. The financial statements are the most important source of reliable information for the shareholders who make their investment decision based on such information. 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. Therefore, adequate and correct disclosures in the financial statements in line with applicable financial reporting framework are of utmost importance. It is the duty of the company and its directors to see that the disclosures made in the financial statements are adequate and correct and there is no omission of material facts. In addition to their responsibilities of overseeing and managing affairs of the Company, directors also have fiduciary duties towards the Company. 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. In this context the respondents cannot absolve themselves of their statutory duties regarding misstatements or omissions of material information in the financial statements. The main equitable principle applicable to directors is to avoid any possibility of a conflict of interest, without disclosures. Therefore, full and accurate disclosure of transactions that involve conflict of interest by directors is of utmost importance. All transactions with directors involve inherently higher risk of misstatements due to conflict of interest of those who are charged with the responsibility of management of the Company.

9. For the foregoing reasons and facts cited at para 7 (b) above, I am of the view that the respondents have made themselves liable by omitting the disclosures in relation to the Property in the Half Yearly Accounts of the Company for the year ended December 31, 2014. The chief



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executive of the Company in whose name the property has been transferred, being the highest level of executive management in the Company and a direct beneficiary of the transaction, is liable to the stricter fines. Therefore, in exercise of the powers conferred by section 492 of the Ordinance, I hereby impose an aggregate fine of Rs1,000,000/- (Rupees one million only) on the respondents. The respondents are directed to deposit the fines in the following manner:

Name of Respondents	Amounts in Rupees
Mian HabibUllah, Chief Executive	500,000
Mr. Hussain Ahmed Ozgen, Director	100,000
Ch. Mohammad Yasin, Director	100,000
Mr. Hussain Ahmad Qureshi, Director	100,000
Syed Obaid ul Haq, Director	100,000
Rao Khalid Pervaiz, Director	100,000
Total	1,000,000

Mr. Shahid Aziz, who is nominee of NIT on the Company's board is hereby warned to be careful in future regarding compliance with applicable legal provisions.

In view of the facts cited at para 7 (a) above, proceeding in respect of recognizing a gain on settlement of borrowings in the Account for the year ended June 30, 2014 are concluded without any adverse order.

The aforesaid fines must be deposited in the designated bank account maintained with MCB Bank Limited in the name of the "Securities and Exchange Commission of Pakistan" within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the penalties, proceedings for recovery of the fines as arrears of land revenue will be initiated. It may also be noted that the aforesaid penalties are imposed on the respondents in their personal capacity; therefore, they are required to pay the said amounts from personal resources.

Abid Hussain

Executive Director (Corporate Supervision Department)

Announced:

March 16, 2016

Islamabad