Corporate Supervision Department
Company Law Division

Before Abid Hussain – Executive Director (CSD)

In the matter of

Ghani Automobile Industries Limited

Number and date of notice: CSD/ARN/280/2015-3523-3532, dated March 7, 2016
Date of hearings: May 4, 2016
Present: Mr. Hafiz M. Imran Sabir, Company Secretary

ORDER

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

This order shall dispose of the proceedings initiated against the following directors including the chief executive (the "respondents") of Ghani Automobile Industries Limited (the "Company"):

1. Mr. Imtiaz Ahmad Khan, Chairman
2. Mr. Aftab Ahmad Khan, CEO
3. Mr. Anwaar Ahmad Khan
4. Mrs. Reema Anwaar
5. Mrs. Ayesha Aftab
6. Mr. Junaid Ghani
7. Mr. Obtaid Ghani
8. Mr. Jubair Ghani
9. Ms. Zahra Aftab
10. Dr. Amjad Aqeel

The proceedings against the respondents were initiated through show cause notice (the "SCN") dated March 7, 2016 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 audited financial statements of the Company for the years ended June 30, 2015 ("Accounts 2015"), filed with the Commission under section 233 of the Ordinance revealed that the Company has recognized 'Discount on Issue of Shares' amounting to of Rs150,000,000 (2014: Nil) as 'Non-current Assets' in the balance sheet. Note 11 to the Accounts further disclosed, as under:

> *"Discount on Issue of Shares: The Company has issued thirty million ordinary shares of Rs.10 each at 50% discount in accordance with the provision of sections 84 and 86 of the Ordinance. The discount on issue of shares shall be amortized over a period of five years starting from December 2015 to December 2020."*

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Review of the interim accounts the period ended September 30, 2015 ("Quarterly Accounts") revealed that the Company amortized the 'Discount on Issue of Shares' by Rs5 million reducing it to Rs145,000,000 and the amortization was charged to Statement of Comprehensive Income.

3. The aforesaid treatment of recognizing the 'Discount on Issue of Shares' as an asset and amortizing it through Statement of Comprehensive Income was, prima facie, in contravention with the requirements of applicable International Financial Reporting Standards ("IFRS") including the International Accounting Standards ("IAS"), in terms of which the Company was required to charge the amount of 'Discount on Issue of Shares' directly to the equity and show it as a deduction from equity. Due to the aforesaid accounting treatment adopted by the Company in contraventions with requirements of IFRS, the Accounts 2015 of the Company have been, prima facie, misstated and effect of misstatement was material, as stated below:

Particulars	Amount actually reported	Amount if correctly reported	Amount of Misstatement	Misstatement as % of Correct amount
Shareholders' Equity	367,330,723	217,330,723	150,000,000	69%
Non-Current Assets	211,171,246	61,171,246	150,000,000	245%

The Company also, prima facie, failed to account for the directly attributable transaction costs in relation to issue of shares as a deduction from equity (net of any related income tax benefit) and give separate disclosure of such costs was also required. Moreover, due to the charging the amortization on 'Discount on Issue of Shares' through Statement of Comprehensive Income, in contravention with the requirements of IFRS, the total comprehensive loss reported in the Quarterly Accounts for the quarter ended September 30, 2015 was understated by Rs5 million.

4. Consequently, the SCN was issued to the respondents whereof they were called upon to explain their as to why penal action may not be taken against them under section 492 of the Ordinance for the aforesaid, prima facie, misstatements in the respective Accounts 2015 and the Quarterly Accounts. In response to the SCN, the company secretary through reply dated March 21, 2016 stated as under:

"The classification of "Discount on Issue of Shares" as Non-current Assets in Annual Accounts 2015 and its amortization through Statement of Comprehensive Income in interim accounts for the first quarter ended September 30, 2015 was inadvertent which was neither intentional nor willful. The Company had no mala fide intention in this unintentional mistake. The company

has subsequently rectified the error by making correct entries in the ledger which will be reflected in third quarter accounts with comparative figures duly restated. We further assure you to be careful in future."

5. Subsequently, the case was fixed for hearing on May 4, 2016 and Mr. Hafiz M. Imran Sabir, the company secretary appeared before the undersigned on behalf of the respondents. He mainly reiterated his earlier stance as per the written submissions and requested for a lenient view. He provided a copy of the quarterly accounts for the period ended March 31, 2016 and stated that the erroneous accounting treatment of recognizing the discount on issue of shares as a deferred cost was rectified by the Company in those accounts.

6. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance, IASs:

Section 492 of the Ordinance, 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."

IAS 1 - Presentation of Financial Statements

109. Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.

IAS 32 – Financial Instruments: Presentation

37. An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognized as an expense.

IAS 38-Intangible Assets *(Para 8)*

An *asset* is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

An *intangible asset* is an identifiable non-monetary asset without physical substance.
Monetary assets are money held and assets to be received in fixed or determinable amounts of money.

The Conceptual Framework for Financial Reporting (the "Framework")

4.25 (b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

4.8 The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

4.44 An asset is recognized in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

4.45. An asset is not recognized in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

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 the arguments put forth by the respondents and my observations are as under:

a) In terms of provisions of the Framework and the IFRS, no concept of deferred costs exists with reference to issuance of shares at discount. To recognize a deferred cost as an asset, we have to look up for the definition of an asset and the criteria for recognition of assets in the Framework and the IFRS. As per IAS 38, an asset is a resource controlled by an enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise. IAS 38 defines an *intangible asset* as an identifiable non-monetary asset without physical substance and a *monetary asset* as the money held and asset to be received in fixed or determinable amounts of money. Since the discount on issue of shares does not fall within the definition of 'asset' and also does not meet the criteria for recognition of an asset, therefore, it cannot be recognized as a deferred cost or an asset.

b) In terms of the Framework, the expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of

liabilities that result in decreases in equity, other than those relating to distributions to equity participants. The amortization of discount on issue of shares does not meet the definition of expense either. Para 4.20 of the Framework states that although equity is defined in paragraph 4.4 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Likewise, cost of equity transactions are comprised of only those incremental external costs directly attributable to equity transactions, which would otherwise have been avoided. The transactions costs for equity transactions should be accounted for as a deduction from equity, net of any related income tax benefit. As the discount on issue of shares is not a payment, it would not fall strictly into any of these categories. Moreover, the equity should be the net amount received by an enterprise. Moreover, the IFRS do not have any concept of deferred cost / expenditure. Therefore, the discount on issue of shares should be shown as a deduction from equity and should not be recognized as deferred cost.

c) The Company's treatment of recognizing the discount on issue of shares as 'deferred cost' under the non-current assets is clearly in violation of the requirements of IFRS and the Framework. Due to this incorrect accounting treatment the 'shareholders' equity' and 'non-current assets' in the Accounts 2015 of the Company were misstated by 69% and 245%, respectively. Moreover, the statement of comprehensive income in the Quarterly Accounts was overstated by Rs5 million i.e. the amount of discount on issue of shares amortized during the quarter.

d) In terms of para 37 of IAS 32, the Company was required to account for the directly attributable transaction costs in relation to issue of shares as a deduction from equity (net of any related income tax benefit) and separate disclosure of such costs was also required under IAS 1. However, the Company did not recognize any costs associated with the issuance of shares in the Accounts 2015 in terms of applicable provisions of the IFRS and also did not give separate disclosures of such costs in terms of IAS 1.

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e) In view of the facts highlighted in the preceding paras, the Accounts 2015 and Quarterly Accounts of the Company were misstated materially. The ultimate responsibility of preparing the financial statements in accordance with the Ordinance and International Financial Reporting Standards including the IASs rests with directors who are charged with governance of the Company. The Ordinance and IFRS require that financial statements should present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses. This necessitates adequate disclosure and full compliance with all applicable IFRSs.

f) One of the main objectives and intent of section 492 of the Ordinance is to protect the users, which may include investors, shareholders, creditors, bankers, customers etc., of financial statements against misstatements so that reliable financial information which is vital for making a well informed decision is available to them. Accurate and reliable financial reporting is the bedrock upon which our markets are based. Incorrect financial information shudders the investors' confidence and erodes the integrity of the markets. For our capital markets to thrive, investors must be able to receive an unvarnished assessment of a company's financial condition. Financial statements must provide transparency for investors, and must not obscure the truth, even if that truth is inconvenient.

8. I deem it necessary to make some observations on the importance of compliance with requirements of the IFRS and the Ordinance in preparation of financial statements, adequacy and accuracy of disclosures made therein and directors' duties and responsibilities in this regard. 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. The IFRS provide basis for preparation and presentation of financial statements to ensure understandability, reliability, relevance and comparability both with the

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entity's financial statements of previous periods and with the financial statements of other entities. The IFRS also set out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. Therefore, it is of utmost importance that all the applicable requirements of IFRS are complied with in letter and spirit. 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 misstatement or 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 in the financial statements.

9. For the foregoing reasons, I am of the view that the respondents have made themselves liable for action under the provisions of section 492 of the Ordinance. However, I take cognizance of the fact that the Company in its interim accounts for the quarter ended March 31, 2016 has rectified the default by treating the discount on issue of shares as a deduction from equity instead of treating it as a deferred cost. Therefore, in exercise of the powers conferred by section 492 of the Ordinance, instead of imposing fines on the respondents, I hereby conclude the proceedings with a stern warning to the respondents to be careful in future and ensure meticulous compliance with applicable legal requirements and financial reporting framework.

Abid Hussain
Executive Director (CSD)

Announced:
June 9, 2016
Islamabad