



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Islamabad

Before Tahir Mahmood, Executive Director Enforcement

In the matter of M/s Saritow Spinning Mills Limited
for non-compliance with Section 208 of the Companies Ordinance 1984

ORDER

This order shall dispose of the proceedings initiated against the directors of M/s Saritow Spinning Mills Limited (the "Company") under Section 208 read with Section 476 of the Companies Ordinance, 1984 (the "Ordinance") through show cause notice dated October 13, 2009.

2. Annual accounts of the Company for the year ended June 30, 2008, filed with the Commission under Section 233 of the Ordinance revealed that the Company had following outstanding receivables from its associates Kohinoor Power Company Limited (KPC), Kohinoor Industries Limited (KIL) and Azam Textile Mills Limited (ATML).

Year	Azam Textile Mills Ltd. (ATML)	Kohinoor Industries Ltd. (KIL)	Kohinoor Power Co. (KPC)	Total
<i>Rs. in million</i>				
2006	31.375	-	24.468	55.843
2007	36.842	37.053	(0.154)	73.895
2008	7.526	42.089	6.597	55.84

It was further noticed that debtors' average collection period was also considerably lenient in respect of the associates. Moreover, analysis of electricity purchases from KPC and payments made there against also revealed an unusual pattern biased towards the seller. It was noticed that in two out of three years examined, the Company had been paying KPC over and above the average invoice size for that particular year. Thereafter upon repeated enquiries from the company about its transactions with associates the information demanded was finally submitted on August 20, 2009 and it was stated that:

- The Company was purchasing power from KPC against advance payment, the same has been discontinued and the outstanding balance of advance has been recovered. The balance outstanding from KPC as on 30.06.09 is for purchase of 1.2MW Diesel fired engine from KPC. The agreement with KPC was also submitted.



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- Advance to KIL is for purchase of machinery, which has also been received subsequent to the balance sheet date.
- Pricing of sale purchase transactions with associates is made at prevailing market price.

3. The reply was not satisfactory and required further explanation on the observations, consequently, a notice No. EMD/233/189/2002-608 dated October 13, 2009 under the provisions of Sections 208 of the Ordinance was served on the Company and all the directors calling upon them to show cause and to explain as to why penalty may not be imposed for the contravention of the mandatory provision of the Ordinance. The aforesaid notice was responded to on behalf of the directors of the Company vide their letter dated October 28, 2009 in which request for a personal hearing in the matter was made.

4. The case was fixed on January 15, 2010 on which date Mr. Muhammad Shamil, General Manager Finance of the Company appeared on behalf of directors to plead the case. Submissions made in respect of transactions with each associate are summarized as follows:

i) Kohinoor Power Company Limited:

It was stated that the Company has paid an amount of Rs. 10 million as security deposit to KPC as per the terms of the agreement. The amount outstanding at various points in time represents that amount. The underlying documents in support of which will be provided.

ii) Kohinoor Industries Limited:

It was submitted that the amount has been given as advance for purchase of machinery. The amount remained outstanding for a very small period as receipt of machinery began immediately after the payment was made in June 2007.

iii) Azam Textile Mills Limited:

It was submitted that the debtors' collection period is not representative of the actual invoicing and payments. A detail will be submitted for Commission's review.

He requested for time for submission of information in support of aforesaid representations.

5. The verbal submissions during hearing were on some aspects contradictory to that already submitted. In particular, the copy of agreement with KPC already provided alongwith letter dated August 20, 2009 did not include any clause about payment of security deposit. In order to substantiate the verbal submissions, following the hearing a letter was written to the Company requiring the submission of following information before February 05, 2010:



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- a) In respect of transactions with Kohinoor Power Company Limited:
- i) Copy of relevant clause of the agreement under which security deposit of Rs. 10 million was deposited by the Company.
 - ii) Copy of payment instrument through which the payment of Security deposit was made, alongwith copy of ledger account where the amount was booked.
 - iii) Whether or not the amount of security deposit is in accordance with the normal trading practices.
 - iv) Copy of balance confirmation requests received from KPC during audit specifying the amount of security deposit.
 - v) Classification of the amount in KPC's accounts in light of the requirements of Section 226 of the Ordinance.
 - vi) Complete particulars of payments worth Rs. 106.266 million made to KPC during year ended 30.06.2006.
 - vii) Complete particulars of all adjustments made in the current account of KPC for the period 1.07.06-30.06.07 alongwith copies of referred JVs mentioned there against.
- b) In respect of transactions with Kohinoor Industries Limited:
- i) Copies of payment instruments through which payment of advance was made to KIL.
 - ii) Note reference where the assets received from KIL have been incorporated in the Company's respective years' financial statements.
 - iii) Note reference where the assets deletion was recorded in the accounts of KIL.
- c) In respect of transactions with Azam Textile Mills Limited:
- i) Invoice wise detail of transactions alongwith date of recovery of invoiced amount during the period 1.07.05-30.06.08.

6. The information sought through the above referred letter was responded in piece meal on February 16, 2010, February 19, 2010, March 01, 2010, March 25, 2010 and March 31, 2010 after repeated verbal and written reminders from the Commission. The submissions have been compiled as follows:

i. Kohinoor Power Company Limited:

A new version of the agreement already submitted to this office was provided that included a one page insertion about the security deposit. The clause purportedly inserted in the agreement dated 4.09.2000 on



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06.09.2000 is in the form of a letter written to Manager Finance of the Company from a Manager of KPC and reads as follows:

“The purchaser shall, maintain security deposit equivalent to 2 months approximate bill. The purchaser shall made the payment of electricity consumed in a particular month. The payment shall be based on units consumed in a month by the purchaser based on its actual consumption.”

It was submitted that no deposit was maintained in the books of KPC except for a very short period. Due to variable nature of balance it was not possible to classify security deposit and other balances separately and balance confirmation from auditors was also received on aggregate basis. Approximate payments were made in advance on day to day basis on the basis of units consumed in accordance with clause 11 of the agreement. Alternate option at the time of entering the agreement was to go for self generation which required gas connection requiring security deposit equivalent to three months bill. We were purchasing electricity from KPC since long however, in 2007 we transferred entire load to WAPDA during 2007. Meantime advance/security deposit already paid remains unsettled. The amount of advance/ security deposit is being paid back by KPC.

ii. Kohinoor Industries Limited:

Underlying documents comprising payment instruments were not submitted by the Company instead same transaction detail containing Journal entries described as payments was repeatedly submitted.

iii. Azam Textile Mills Limited:

Date wise statement of invoicing and recovery only during the year 2008 was submitted.

7. I have carefully considered the observations as well as the submissions made thereagainst, I would comment on submissions in respect of each associate as follows:

Kohinoor Power Company Limited

As regards transactions with KPC I have noticed that different stances have been taken by the management in response to the queries raised from this office. Even if for the sake of argument I accept the last stance of the management that the overpayments comprise security deposit, instead of advance for purchase of generators, the same is firstly not in accordance with the normal trading practices as connection procedure given at the website of LESCO does not contain any requirement about the security deposit. From the information contained at website of LESCO I have also noticed 7% advance payments incentive available to industries choosing for advance mode. Moreover, had the amount been in the nature



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of security deposit the same was as per the agreement subject to classification in accordance with the requirements of Section 226 in the books of KPC, which was not the case as revealed from the plain reading of balance sheet of KPC. Having said that it also emanates from records that over payments to KPC exceeded two month gas requirement in two out of three years examined. This is evident from the following tabulated facts:

	2008	2007	2006
Description	Amount (Rs.)		
Total invoices raised by KPC for electric supply	2.142	12.177	79.445
Adjustments	-	15.108	-
Total payments made by Saritow Spinning	8.894	2.662	106.266
Opening balance	-0.154	24.468	-2.355
Closing balance/ overpayment (short payment)	6.597	-0.154	24.468
Average one month invoice size	0.178 m	1.01 m	6.6 m

In view of above, it is clear that these overpayments to KPC in year 2006 and 2008 were in the nature of investment as per the definition contained in Section 208 and were subject to shareholders' approval as well as interest, which the Company has failed to comply with and hence attract penal provisions contained in the Ordinance. For the purposes of interest computation, I hereby direct the Company under provisions of Section 473 of the Ordinance to provide interest on all funds that remained outstanding with KPC, and submit to this office detailed working of interest receivable duly certified by its auditors containing following particulars within thirty days of the date of this order.

Date of payment of advance	Cheque no.	Amount (Rs.)	Date of recovery/ electricity bill	Period outstanding	Interest rate	Interest amount
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Kohinoor Industries Limited

Management has failed to give any evidence about exact dates when the funds were transferred to KIL. The ledger print outs submitted before me show that the payments to KIL were booked in the year 2007 by journal entries, the underlying documents were never submitted by the Company despite ample opportunity. This suggested that either the Company's finance personnel lack the desired level of competence for responsibly responding to the queries raised by the regulator or they deliberately attempted to delay the proceedings unnecessarily. I am convinced about the later and hence proceed to decide this case on the basis of following established facts:

- KIL had been in financial difficulties, its BOD in their meeting held on April 30, 2008 decided that Company's business be closed down and machines...



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an argument, that advance for acquisition of machinery was paid by the Company to KIL in June 2007 and immediately afterwards the machinery was received.

- Neither the Company nor KIL in their respective financial statements for the year ended June 30, 2007 classified the amount as advance for purchase/sale of machinery. KIL narrated the amount as "Advance for supply of cotton" and the Company classified the same amount as trade debt.
- None of the other non-associated buyers of KIL's machinery had deposited any advance in the year 2007.
- KIL classified its assets as "held for sale" in its accounts for the year ended June 30, 2008 and the disposal was recorded in the year 2009.

Hence the amount comprised an advance within the meaning of Section 208 and required authorization of shareholders as well as provision of interest. The directors have failed to comply with the legal provisions and hence their action attracts penal provisions contained in the Ordinance. As far as the calculation of interest is concerned, I hereby direct the Company under provisions of Section 473 of the Ordinance to submit interest receivable's working duly certified by its auditors within thirty days of the date of this order. It is further clarified that the working should include the following information:

Date of payment of advance	cheque no.	Amount (Rs.)	Date of receipt of machinery	Period outstanding	Interest rate	Interest amount
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Azam Textile Mills Limited

For the purposes of concluding the matter I deem it necessary to reproduce the working of credit period allowed in the case of associates and non-associates as follows:

	2008		2007		2006	
	Associates	Others	Associates	Others	Associates	Others
Sales	83.142	367.413	127.36	337.162	145.337	258.664
Debtors	7.526	0.449	73.894	3.708	55.843	6.588
Collection period	33	1	212	4	140	9

The argument presented during hearing could not be established from the additional information submitted by the Company rather it confirmed the stance that trading terms during the period reviewed have not been normal. Date wise statement of invoicing and recovery only during the year 2008 submitted by the Company showed that out of net sales made on 30.06.2007, amounting to Rs. 36.842 million, 30.812 million was recovered after four months on 31.10.2007 and balance Rs. 6.9 million on 31.12.2007. This compared with the Company's sales to non-associates is considerably lenient and hence falls within



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the definition of investments, legally requiring approval from shareholders as well as recovery of interest thereon. As far as the calculation of interest is concerned, I hereby direct the Company under provisions of Section 473 of the Ordinance to submit working of interest receivable duly certified by its auditors.

8. In view of the above, I am of the opinion that Company has been violating the mandatory provisions of law by leniently accommodating its associates under the garb of trading transactions. In view of above in exercise of the powers conferred on me I, hereby impose a fine of Rs. 150,000 on each one of the following directors of the Company:

Mr. M. Naseem Saigol, Chairman

Mr. M. Azam Saigol, Director

Mr. Shahid Sethi, Director

Mr. Muhammad Ather Rafiq, Director

Mr. Muhammad Asif Bajwa, Director

Mr. Saeed Mian Ansari, Director

In addition, I also advise the Company to prepare and submit working of interest due from associates on the above balances duly certified by its auditors as already advised above.

9. The directors are hereby directed to deposit the aforesaid fine 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 date of this order and furnish receipted challan to the Commission, failing which proceedings for recovery of the fines as arrears of land revenue will be initiated.

Tahir Mahmood
Executive Director (Enforcement)

Announced:

05.05.2010