



Securities and Exchange Commission of Pakistan  
Company Law Division  
(Enforcement Department)

[Islamabad]

Before Tahir Mahmood, Executive Director (Enforcement)

Order

In the matter of

M/s FATEH TEXTILE MILLS LIMITED

Under Section 208 Read With Section 476 of the Companies Ordinance, 1984

Show Cause Notice No. and Date: EMD/233/250/2002-63-69  
Dated 9.7.2008

Date of final hearing: 9.2.2009

Present: Mr. Muhammad Saleem (Director), on behalf of all the directors and chief executive of M/s. Fateh Textile Mills Limited.

Date of Order: 2.7.2009

This order will dispose of the proceedings initiated against the Chief Executive and Directors of M/s. Fateh Textile Mills Limited (the "Company") for making unauthorized investments in its associated companies in violation of the provisions of Section 208 of the Companies Ordinance, 1984 (the "Ordinance").

2. The brief facts of the case are that while examining the annual audited accounts of the Company for the year ended 30.6.2007, it was observed by the Commission that the Company had trade debts amounting to Rs.81,995,624 which were due from its associated companies in the following manner:

	<i>Rupees</i> 2007	<i>Rupees</i> 2006
<i>Barkat Cotton Mills Limited</i>	29,996,182	32,343,232
<i>Fateh Limited</i>	3,494,801	6,505,801
<i>Fateh Outerwear Limited</i>	11,437,655	11,832,886
<i>Hero Motors Limited</i>	37,066,986	44,986,654
	<b>81,995,624</b>	<b>95,668,573</b>



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3. The aforesaid balances receivable from Company's associated companies were not falling in the nature of normal trade credit which is in violation of Section 208 of the Ordinance. The above revealed that the trade debts amounting Rs.81.995 million were outstanding despite the following facts:

- (a) There had been no sale / purchase from the first three associated companies as stated by the Company in Note 19 to the Accounts which appears to be an abnormal trade credit. In addition to this, the Company was financing these three associated companies through various payments made to it and bearing expenses on behalf of the associated companies as can be seen from their respective ledger accounts.
- (b) The Company was supplying engineering goods to the fourth associated company and the trade credit period allowed to this associated company appeared to be higher than the trade credit period allowed to other trade debtors. At the same time, the Company was also financing this associated company through various payments made to it and bearing expenses on behalf of it as can be seen in the ledger account of Hero Motors Limited and details provided by the Company.

4. The Chief Executive and Directors have breached their fiduciary duty by failing to exercise due diligence while providing open ended trade credits to its associated companies and not recovering long outstanding trade receivables from the said associated companies and advancing loan to its associated companies under the disguise of trade receivables, without authority of the shareholders which is in violation of the provisions of Section 208 of the Ordinance. This clearly establishes the case that the Chief Executive and all the Directors have knowingly and willfully avoided complying with the mandatory provisions of the Ordinance.

5. In this connection, a show cause notice dated 9.7.2008 was issued to the Chief Executive and all the other Directors calling upon them to show cause as to why penal action may not be taken against them under Sub-section (3) of Section 208 read with Section 476 of the Ordinance for violating the statutory requirements of the Ordinance. The reply was received on 16.8.2008 and the submissions made by the Company in their said reply against the SCN are summarized as under:

- (a) Trade debts (Rs.81,995,624) are accumulated from the ordinary sale and purchase transactions between Fateh Textile Mills Limited and its associated undertakings.
- (b) The reasons for long outstanding of the trade receivables (other than from Hero Motors Limited) are summarized as under:-
  - (i) The requirement of export quota (prior to December 2004) for the shipment of export orders necessitates the sale & purchase transactions between Fateh Textile Mills Limited and its associated undertakings.
  - (ii) The Company having the export quota placed the orders for purchase of merchandise on another associated undertaking. In this backdrop, sale & purchase transactions were affected between Fateh Textile Mills Limited and its associated undertakings. The settlement of purchase transaction was effected through realization of export proceeds. Following is present status of trade debts:-



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Name of the Undertaking	Amount in Rup	
	2006-2007	2007
Barkat Cotton Mills Limited	29,996,182	3,112,000
Fateh Limited	3,494,801	1,348,587
Fateh Outerwear Limited	11,437,655	4,250,182

- (iii) The Maintenance Division of Fateh Textile Mills Limited having sufficient production facilities to produce sheet metal items such as small housing, covers for housing, shafts and brackets were also required by Hero Motors Limited.
- (iv) Therefore in order to achieve the optimum utilization of the production facilities of Fateh Textile Mills Limited, the sale of engineering goods was / is being made at market price to Hero Motors Limited.
- (v) The recovery against the sale of engineering goods to Hero Motors Limited is more or less within the normal trade credit.
- (c) Fateh Textile Mills Limited has not made any investment in any of its associated undertakings rather the trade debts (Rs 81,995,624) are accumulated from the ordinary sales & purchase transactions between Fateh Textile Mills Limited and its associated undertakings.
- (d) Company requested Commission to withdraw the Show Cause Notice.

6. In order to provide an opportunity of personal hearing, the case was fixed for hearing on 20.1.2009, however, on request of the Company for adjournment, hearing was re-fixed for 9.2.2009 on which date Mr. Muhammad Saleem, Director (the "Representative") on behalf of the Company, appeared and contended vide letter dated 9.2.2009 as under:

**a. Trade Debt Rs.3,494,801 - Fateh Limited:**

- (i) Prior to Dec 2004, only those firms who were holding the export quota could make the export. In this backdrop, the sale and purchase transactions were effected between Fateh Textile Mills Limited and its associated concern i.e. Fateh Limited.
- (ii) On realization of export proceeds, the associated concern settles the purchase transaction.
- (iii) The delay in realization of export proceeds caused the accumulation, however, on 31.12.2008, the balance in the account has been reduced to 'Zero'.

**b. Trade Debt Rs.11,437,655 - Fateh Outerwear Limited:**

- (i) For full utilization of export quota, Fateh Outerwear made the purchases from its Parent Company namely Fateh Textile Mills Limited.
- (ii) The settlement of purchases was being effected from the export proceeds, the delay in realization of export proceeds caused the accumulation, anyhow on 31.12.2008, the balance in the account has been reduced to 'Zero'.

**c. Trade Debt Rs.29,996,182 - Barkat Cotton Mills Limited:**

- (i) For full utilization of export quota, Barkat Cotton Mills made the purchases, from its Parent Company namely Fateh Textile Mills Limited.



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- (ii) The settlement of purchases were effected from the export proceeds, the delay of which caused the accumulation, anyhow as on 31.12.2008, the balance in the account has been reduced to Rs.4,910,052.

**d. Trade Debt Rs.37,066,986 - Hero Motors Limited :**

- (i) Hero Motors Limited, a non listed public limited company is also the associate undertaking of Fateh Textile Mills Limited.
- (ii) The Engineering Development Board, the Ministry of Production & Incentives has awarded the Certificate of authorized assembler cum manufacturers of 'Hero Russi Tractors' to the associated undertaking.
- (iii) The maintenance division of 'Fateh Textile Mills Limited' is having sufficient production facilities to produce sheet metal items such as small housing, covers for housing, shafts and brackets which are also required by the associated concern.
- (iv) In order to achieve the optimum utilization of the production facilities of Fateh Textile Mills Limited, the sale of engineering goods is being made at market price to Hero Motors Limited.
- (v) The recovery against the sale of engineering goods to Hero Motors Limited is more or less within the normal trade credit.
- (vi) The Statement of account on 31.12.2008 is hereunder:

	Rupees
Opening balance on 30.6.2007	37,066,986
Add: Sales of engineering goods	405,854,399
Less: Payment received	407,173,609
Closing balance on 31.12.2008	35,747,776

- (vii) Fateh Textile Mills Limited has not made any investment in any of its associated undertakings rather the trade debts have been accumulated from the ordinary sales & purchase transactions between Fateh Textile Mills Limited and its associated undertakings.
- (viii) Requested this Commission to withdraw the Show Cause Notice.

7. The written submissions made by the Company's representative were analyzed during the time of hearing and it was brought into the notice of the Company's representative that the submission being made by him were non-cogent due to the facts that the long outstanding trade debts were not in the nature of normal trade credit and that the associated companies were being advanced loans in the form of direct payments and bearing of expenses on behalf of them. The Company's representative was further made aware that these transactions were not brought to the attention of the shareholder for the purpose of obtaining the mandatory approval thereof which resulted in violation of Section 208 of the Ordinance.



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The Company's representative finally admitted to the aforesaid default and undertook to furnish specific information/documents with regard to the said default.

8. As undertaken by the Company's representative in the said hearing further written submissions were made vide letter dated 28.3.2009 stating the following:

- As regards to first three associated undertakings, the companies are cutting and stitching units producing garments, bed sheets, fitted sheets, bedspreads, quilt covers etc. Before the Year 2004 the undertakings holding export quota were eligible to export from Pakistan. In this back drop, the associated concerns were partly engaged in export activities. The purchases (cloth) for export orders were being made from Fateh Textile Mills Limited and the purchase transactions were being settled from the realization of export proceeds. The delay in realization of proceeds was causing the accumulation of trade debts.
- It is evident from the accounts for the period ended on 31.12.2008 that nothing is due from first two associated undertakings, whereas the accounts for the period ended 31.3.2009 confirms that receivables from Barkat Cotton Mills has also become zero.
- The associated undertaking (Hero Motors Limited) is an authorized manufacturers cum assembler of 'Hero Russi Tractor' by the Engineering Development Board, Ministry of Industries, Government of Pakistan.
- As submitted during the hearing that the division of Fateh Textile Mills Limited is having sufficient production facilities to produce sheet metal items such as small housing, covers for housing, shafts and brackets which are required by Hero Motors Limited. The sale of engineering goods was being made at market price to Hero Motors Limited. The recovery against the sale of engineering goods to Hero Motors Limited is more or less within the normal trade credit.
- As regards the payments (Rs.23.758 million as per Annexure A) released by the Fateh Textile Mills Limited to Hero Motors Limited it is submitted that we do accept that the transaction has attracted the violation of Section 208 of the Ordinance.
- However, the company is in the process to get the transaction approved by the shareholders of the companies as required by the Ordinance. Additionally the company will charge the markup at the rate also prescribed by the Ordinance and will claim from its associated concern.
- It is concluded that as for now nothing is receivable from first three associated concerns. Further the payments released by the Company to Hero Motors will be approved by the shareholders of the Company.



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- Additionally the markup will be charged on the payment released by the company and will be claimed from its associated concern (Hero Motors Limited.).
- Requested this Commission to withdraw the SCN.

9. The aforesaid submissions of the Company have been analysed as follows:

- (a) The balances due to the Company in the form of 'trade debts' from the said four associated companies, Barkat Cotton Mills Limited (BCML), Fateh Limited (FL), Fateh Outerwear Limited (FOL) & Hero Motors Limited (HML) have been outstanding since long as also disclosed by the Company in its accounts for the year ended 30.6.2007 and 30.6.2008 and as evident from the Company's letter dated 2.1.2008 as follows:

Name of Company	Rupees 2007	Rupees 2006	Rupees 2005	Rupees 2004	Rupees 2003
Barkat Cotton Mills Limited	29,996,182	32,343,232	34,591,581	52,153,850	52,753,850
Fateh Limited	3,494,801	6,505,801	8,651,591	133,340,785	160,204,565
Fateh Sports Wear Limited	11,437,655	11,832,886	16,779,537	77,505,960	80,877,690
Hero Motors Limited	37,066,986	44,986,654	-	-	-
Total	81,995,624	95,668,573	60,022,709	263,000,595	293,836,105

- (b) The Company has stated in its letter dated 2.1.2008 that the average collection period of the Company is four months. Therefore, the same are 'amounts not in the nature of normal trade credit' as per Section 208 which required approval of the shareholders of the company, however, have not been approved.
- (c) The contention of the Company with regard to export quota is no excuse of violating the provisions of Section 208 of the Ordinance.
- (d) **Subsequent Position as of 30.6.2008:**

	Recovery Rupees	Recovery %
Barkat Cotton Mills Limited	26,883,527	89.6
Fateh Limited	2,146,214	61.4
Fateh Outer wear Limited	7,187,473	62.8

The aforesaid analysis shows that the Company has made significant recoveries from its associated companies after initiating our show cause proceedings under Section 208. However, the recovery of the balances as reported by the Company is not the appropriate way to make the default good. Moreover, the aforesaid abrupt trend of recovery raises a question as to how come the associated companies suddenly became capable of paying



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significant amounts suddenly just after the initiation of show cause proceedings which shows that the problem may have been fabricated by the Company.

- (e) The Company has advanced loans to all its associated companies as evident from the ledger accounts. Furthermore, the Company itself also submitted vide letter dated 28.3.2009 in case of Hero Motors an 'Annexure A' showing an amount of Rs.23.758 million being advanced through various payment being made from 2.7.2007 to 27.3.2008 that were disguised under the account head of trade debts and admitted that such transactions attract the punitive provisions of Section 208 of the Ordinance.
- (f) Using Maintenance Division of the Company to produce sheet metal items for its associated company, HML or selling thereto at market rates as stated by the Company are not cogent contentions for justifying the default of the provisions of Section 208.
- (g) Attention is drawn to the decision of this Commission in the Order under Section 208 of the Ordinance dated August 12, 2002 of M/s Dadabhoy Cement Industries Limited which states:

*"In the circumstances, the payments made by the Dadabhoy Cement to Dadabhoy Sack Limited on day-to-day basis including payments for expenses apparently were intended to provide financial benefit to the associated company and cannot be treated as normal trade credit."*

In the above matter the aim of the Company was to provide financial benefit to its associated companies and therefore it is clear that if trade credit facilities are provided with intention to give financial benefit, then it will not be termed as normal trade credit.

- (h) It has been observed that the Chief Executive and Directors of the Company instead of recovering the trade debts which were not in the nature of normal trade credit, extended further credit. In this connection, attention is drawn to the decision of this Commission in the Order of the Appellate Bench dated April 12, 2002 of M/s Gharibwal Cement Limited which states:

*"An open ended credit without specific purpose cannot be termed as normal trade credit. Therefore, the mere fact that the parties have covered these financial facilities by subsequently entering into a Commercial Trade Agreement would not make the financial facilities extended fall within the ambit of "normal trade credit". In our view the Appellants have failed to prove that the objective was for normal trade practice."*

In view of the above, the ever increasing receivables were open ended credit and cannot be termed as normal trade credit.



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- (i) The said trade debts have been disclosed in the balance sheet of the Company under the account head of current assets. However, Para 57 of IAS-1 (Presentation of Financial Statements) states and requires the following:

*"An asset should be classified as a current asset when it:*

*(a) is expected to be realized in, or is held for sale or consumption in, normal course of the enterprise's operating cycle; or*

*(b) is held primarily for trading purposes or for short-term and expected to be realized within twelve months of the balance sheet date; or*

*(c) is cash or a cash equivalent asset which is not restricted in its use.*

*All other assets should be classified as non-current assets."*

The trade debts collection/settlement period with regard to the balances outstanding from the associated companies which is more than 12 months period reveals misclassification of trade debts by the Company which is in violation of the requirements of IAS-1.

10. From the above, it appears that the Company has violated the provisions of Section 208 of the Ordinance by providing loan in the form of trade debts to its associated companies without the approval of shareholders and without charging interest on such loan.

11. After having considered the admitted default of the Chief Executive and Directors of the Company and the perusal of the documents and information placed on record, it is evident that the said credit facility extended to the associated companies, cannot be termed as a normal trade credit and therefore falls under the ambit of Section 208 of the Ordinance and was extended without seeking prior approval of the shareholders through a special resolution, in violation of the requirements of Section 208 of the Ordinance and without charging any return on such credit given. Had there been any return on such credit it would have been higher than the borrowing cost under the Law. It is important to mention that the Company's paid up capital is just Rs.12.5 million as at 30.6.2007 and 30.6.2008 whereas the closing balance of trade debts due from the associated companies as at 30.6.2007 was Rs.81.995 million. The said trade debts are far exceeding the paid up capital of the Company.

12. For the foregoing reasons, it is established that the Chief Executive and the Directors have violated the provisions of Section 208 of the Ordinance and have not exercised due care while extending the said credit to the associated companies. I have, however, noted that the Directors of the Company have admitted the default and are in a process of rectifying the default by recovering the balance of trade debts due from its associated companies along with interest and obtaining the shareholders' approval in this regard. The Representative of the Company has also assured that Company would ensure strict compliance of the provisions of the Ordinance in future.





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13. In view of the above, I, instead of imposing maximum penalty of ten million rupees as prescribed by Sub-section (3) of Section 208 of the Ordinance, take a lenient view of the default and impose a fine of Rs.500,000 (Rupees five hundred thousand) on the following directors:

Sr. #	Name of director	Total (Rs)
1	Mr. Gohar Ullah, Chairman	500,000
2	Mr. Asad Ullah Barkat, Chief Executive	500,000
3	Mr. Humayun Barkat, Director	500,000
4	Mr. Maqsood Ahmed Khan, Director	500,000
5	Mr. Muhammad Saleem, Director	500,000
6	Mr. Abdul Razzak Memon, Director	500,000
	<b>Grand Total</b>	<b>3,000,000</b>

14. The afore-named directors are directed to deposit the aforesaid fine in the designated bank account maintained in the name of Securities & Exchange Commission of Pakistan maintained with MCB Bank Limited within 30 days of the date of this Order and furnish a receipted challan to the Securities and Exchange Commission of Pakistan in this regard failing which proceedings for recovery of the fines as an arrear of land revenue will be initiated. It should also be noted that the said penalty is imposed on the Chief Executive and Directors in their personal capacity and they are required to pay the said amount from their personal resources. In addition to the above, the Company and its Directors are hereby warned to be careful in future while complying with the requirements of law.

**Direction under Section 473 of the Ordinance**

15. Before parting with this Order, it is necessary for me to issue directions regarding the aforesaid outstanding receivables from the said associated company. I deem it appropriate in the said circumstances, to invoke powers contained in Section 473 of the Ordinance and direct the Company to:

- (i) Recover the abnormal trade debt balances from its associated companies, BCML, FL, FOL and HML up till 31.7.2009. Upon full recovery, the Company shall submit an auditors' certificate certifying the full recovery.
- (ii) Recover all the un-approved loans advanced to its associated companies.
- (iii) The Company shall enter into a written agreement with the said associated companies specifying the collection period in relation to the trade debts. The said agreement shall be submitted to the Commission thereafter.



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- (iv) The Company shall calculate and recover the interest as return on its previous years' credits which were not in the nature of normal trade credit. The return to be calculated on such credits shall not be less than the borrowing cost of the Company. In this connection, the chief executive and directors of the Company are called upon to submit a certificate from statutory auditors of the Company within 30 days indicating that interest is calculated in accordance with the provisions of proviso (b) of Sub-section (1) of Section 208 of the Ordinance. The Chief Executive and Directors are further called upon to recover the interest from the said associated companies up till 31.7.2009.

**Tahir Mahmood**  
Executive Director (Enforcement)

**Announced**  
2.7.2009  
**Islamabad**