SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

SECP

Before Tahir Mahmood Executive Director (Enforcement)

In the matter of

S.G Power Limited

Number and date of notice	EMD/233/410/2002-4018-24 dated May 19, 2008
Date of hearing	June 15, 2009
Present:	Mr. M Javed Panni (Authorized Representative)

ORDER

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

This order will dispose of the proceedings initiated against the directors of M/s S.G Power Limited (the "Company") pertaining to contravention of the provisions of Section 492 of the Companies Ordinance, 1984 (the "Ordinance").

2. The Company is incorporated in Pakistan as public limited company and is listed on Karachi and Islamabad stock exchanges in Pakistan. Issued, Subscribed and Paid up capital of the Company is Rs. 178,332,670 comprising of 17,833,267 ordinary shares of Rs. 10 each as on June 30, 2007. The Company is engaged in the business of generation and distribution of electricity.

3. The facts leading to this case, briefly stated are that the Enforcement department of Securities and Exchange Commission of Pakistan ("Commission") conducted examination of the annual audited accounts of the Company for the period ended June 30, 2007, ("Accounts") revealed that M/s Yousaf Adil Saleem & Company ("Auditors") in their audit report on the Accounts have issued disclaimer of opinion due to pervasive impact of the issues mentioned below:

a) As disclosed in note 1.3 to the financial statements, the Company has discontinued electricity and steam supplies to its only customer, S.G Fibre Limited –an associated Company and have shut down its power generators. Employees have left the Company without handing over their *respective charge to anyone and there is no staff to carryout daily activities. This has also resulted in loss of some accounting records and other financial information. Amounts of Rs. 71,422,097/- Rs. 112,755,729/-and Rs. 8,665,200/- are receivable from its associate as disclosed in note 9, note 10 and note 12 to the financial statements. As the associated Company also shutdown its plant and is running into losses and facing severe financial constrains, these amounts are not confirmed and are doubtful of recovery. Also the Company has incurred gross loss of Rs. 13,737,656/- and net loss of Rs. 14,380,170/- respectively. These raises substantial doubt about the Company's ability to continue as going concern. However these accounts are prepared on going concern basis without any adjustment for realizable value of assets and settlement of liabilities.*

b) *Various payments amounting to Rs. 7,172,987/- identified form bank statements for which no supporting documents were made available to us. We are unable to verify these payments from any alternative audit procedures.*

c) *As disclosed in note 5 to the financial statements, creditors and accrued liabilities amounting to Rs. 4,949,787and Rs. 1,593,470 respectively remained unverified as no supporting documents were made available to us. We were also unable to verify the movement in the individual accounts of creditor and accrued liabilities.*

d) *As disclosed in note 12.1 to the financial statements, the Company was also required by the above said order to accrue markup on long term receivable , based on which Company has accrued markup of Rs. 11,171,550 however, we could not verify the same in the absence of any calculation of this amount.*

e) *As the power plant of the Company was shut down, we could not carry out the physical verification of stores, spares and fixed assets, etc. as at the year end. We were not provided with aging of store and spares items in order to determine provision of slow moving and obsolete stock items. Also we could not verify the movement in stores and spares items during the year and its affects on valuation.*

f) *During the year, the Company has imported spare parts for generators amounting to Rs. 1,603,530 and Rs. 2,843,509. These were recorded at their invoice value. We were not provided with supporting documents such as bill of entry etc. to verify other costs i.e. custom duty and clearing chargers that should have been recorded as part of the cost. Also the cost of imported spare parts amounting to Rs. 1,603,530, that were used to repair generators damaged in previous years, was added to capital work in progress rather than being charged as repair and maintenance as the expenditure is not of a capital nature.*

g) *As disclosed in note 11 to the financial statements, the balance of advance income tax on June 30,006 was Rs 1,605,902 whereas non-refundable balances as per income tax returns from tax years 2003 to 2006 were Rs 1,943,570. We were not provided with reconciliation between these amounts. Also the Company is not claiming, in its income tax returns filed for the tax years 2003 to 2006, the un-refunded amounts of the taxes claimed in previous years. Hence the recoverability of the tax refunds of Rs 1,778,249 representing refunds related to tax years 2003 to 2005, is doubtful of recovery against which no provision has been made. The Company is also claiming in its financial statements, sales tax refunds amounting to Rs 530,511. No break up of this amount was provided except for the sales tax return of November 2006 in which the claimable amount was Rs 329,525. Neither reconciliation for difference in amount is provided nor has the provision for doubtful recovery been made.*

4. The directors of the Company, in the report to members of the Company stated that they are not satisfied with the audit report and submitted Para wise below mentioned denial in respect of Auditors qualifications.

a) *The payments receivable from S.G Fibre is correct which is to be paid by the associated Co. S.G Fibre which for the time being has stopped their production because of overall crisis in Fibre industries and interruption in regular supplies of Gas from time to time. But Inshaallah hopeful that production would start very soon. There are no outstanding liabilities in M/s. S.G Fibre in any bank or financial institutions. Receivable from S.G Fibre is well secured because there are Rs. 873 Million fixed assets stands with S.G Fibre. There is therefore no question of Company's ability to pay these outstanding liabilities. Besides S.G Power has obtain conformation from S.G Fibres the amounts of Rs. 71,422,097 , Rs. 112,755,729 and Rs. 8,665,200 are due from them and the associated company will be able to dispose off their liabilities on priority basis.*

b) *This is not correct at all. We strongly disclaim this and state that these payments are made for and accounted for in accordance with the Company's policies and set procedures of accounting after proper entries and classification in respective ledger accounts for each and every transaction. This statement is as such strongly denied. Further these accounts are always available for review 24 hours a day and 7 days a week.*

c) *This is not correct. We again disown this observation and put on record that all the relevant records, ledgers and accounts are available for checking and verification as mention in para b above 24 hours a day 7 days a week. There is no liability outstanding in S.G Power name in* *any bank or financial institutions and the Company's assets are crystal clear and solely owned by the directors and shareholders with no sort of mortgage whatsoever. All the requirements of the auditors were met to their entire satisfaction and set procedure of accounting, but the closure of the power plant may be the reason of this note.*

d) *As per SECP Order dated April 06,2006, we were suppose to charge markup on outstanding balance of receivables that should not be less than the borrowing cost of the Company. Since we have not borrowed any funds from any bank or financial institution, the interest accrued is adequate.*

e) *This is not correct at all. The store spares and fixed assets are available for inspection and verification as mention in Para" b" and" c" above, 24 hours a day 7 days a week. The relevant staff is partly available and partly can be called for carrying out any inspection at any time if need be raised. It was the auditor's requirement and willingness for this inspection as this was their mandatory responsibility. This is not all acceptable as all the arrangements to fulfill this inspection were and are still ready for the Auditors if they so desire. It may also be noted that the Company has not sold any assets, stores, and spares in the market till the date the audit was conducted.*

f) *Because of the fact that the capitalization always has positive effects on the working life of assets and increase in capital means the life extension of the Company. We have the evidence of the cost of imported spare parts amounting to Rs. 1,603,530 and Rs. 2,843,509 respectively. We believe that the capitalized amount of Rs. 1,603,530 will increase the working life of the generators, hence it was capitalized.*

g) *We are consulting our tax lawyers on these matters. Last Assessment received is up to the year 2004. Soon assessment for the other years will be received and relevant entries will be finalized accordingly.*

5. The Commission vides its letter dated February 27, 2008 requested the Auditors to explain in detail qualification wise justification for these disagreements of the Directors. The reply of the Auditors is summarized as follows:

a) <u>Doubtfulness of Company's ability to continue as a Going concern</u>

The auditors reiterated their Audit report view point and as a support to their contention also quoted the qualification by the Auditors of S.G Fibre Ltd in their Audit report on its accounts for the year ended June 30, 2007, which states *"As disclosed note 1.3 to the financial statement, the operations of the company have been shut* *down temporarily due to adverse fiscal measures and unfavorable market conditions. The Company owes Rs 184.177 million as at June 30, 2007 as mentioned in note 18 and 19 to the financial statements to the associated company, S. G Power Limited. Due to the closure of operations it is unlikely that the Company will pay the principal and mark up thereon on regular basis, as per directions of SECP in this regard. Moreover, markup of Rs 8.655 million provided by the management on the above amount as per direction of the SECP could not be verified due to non availability of the proper working of the same".*

b) <u>Other payments</u>

The Second qualification is about the non availability of supporting documents in respect of Payments amounting to Rs 7,172,987. Auditors again confirmed that the same were not made available to them in spite of repeated demands till our signing of report on January 07, 2008.

c) <u>Creditors and accrued liabilities</u>

The third qualification explains the non availability of supporting documents in respect of creditors and accrued liabilities amounting to Rs. 4,949,787 and Rs. 1,593,470 respectively. Auditors again confirmed that the same were not made available to them, in spite of repeated demands, till our signing of report on January 7, 2008.

d) <u>Accrued markup</u>

The fourth qualification refers to the non availability of markup calculation amounting to Rs 11,171,550 on outstanding balance of long term receivable from S.G Fibers Limited. The same has also been reported by the Auditors of the said associated undertaking in Para (a) of their audit report dated January 17, 2008.

e) <u>Verification of store, spares and fixed assets</u>

Auditors again confirmed that they were not invited to perform the physical verification of the company's assets as at the year end in spite of their reminder. No arrangements were made for them even after June 30, 2007, to carryout these procedures. They again confirm that they were not provided any information to verify aging of stores and spares as at the year end to determine slow moving and obsolete items and movement in stores and spares items and its affect on valuation.

f) <u>Capitalization of store and spares</u>

During the year, the Company had imported spare parts amounting to Rs. 1,603,530/- and Rs. 2,843,509/- These were recorded at their invoice value. Company has not provided supporting documents such as bill of entry, etc. to verify other costs i.e. custom duty, clearing charges that should have been recorded as part of the cost. Also the cost of imported spare parts amounting to Rs. 1,603,530/- that were used to repair generators damaged in previous years, was added to capital work in progress rather than repairs and maintenance as the expenditure was not of a capital nature.

g) <u>Tax Refunds</u>

The last qualification refers to

i. Reconciliation of advance income tax as on June 30, 2006, as per books of accounts and as per tax returns field with tax authorities, amounting to Rs 1,605,902 and Rs 1,943,570, respectively.

ii. Not claiming Rs 1,778,249 as un-refunded amounts of tax in the tax returns of tax years 2003 to 2005.

iii. Reconciliation of sales tax refundable as per books of accounts and as per sales tax returns amounting to Rs 530,511 and Rs 329,525 respectively.

The Auditors stated that the explanation of directors in Para g of their report is not correct as the finalization of the assessment by the tax department will have no bearing on the reconciliation as mentioned in Para (i) and (iii) above. Further our contention is that the refund of Rs 1,778,249 has not even been claimed in the tax return.

6 In view of information furnished by the Auditors as summarized above, it was observed that the Directors of the Company have misrepresented the facts in their report to the members, Consequently a Show Cause Notice dated May 19, 2008 under Section 492 reads with Section 476 of the Ordinance ("SCN") was issued to directors and chief executive, calling upon them to show cause in writing as to why the penalty as provided under Section 492 of the Ordinance may not be imposed on them for making false statements in the director's report.

7. The reply of SCN was submitted by all the directors vide their letter dated June 16, 2008, in which it was narrated that the auditor issued disclaimer of opinion that is his own privilege and directors of the Company furnished explanation for the objections highlighted by the auditors as per director's report printed in Annual Report 2007. In half year report for December 31st 2006, auditor had not highlighted such point while the operations of both the

companies were shut down in December 2006, and after that point no movement in stock, accounts, purchase, sale and production done by the Company. However, auditor made such big ground to justify his disclaimer report, however I understand that he can issue disclaimer report on one point the Company is not in operation. On other hand after issuing disclaimer report by Auditors of the Company the auditors of S.G Fiber Limited was not in position to issue favorable report because it would be against the code of ethic of professionalism. In director report, it was clearly mentioned that operations were shut down temporarily and we would like to restart the operation after some updating. As electricity is very scare now a day and it having very high demand, we are trying our best to start our production soon. Some objections have been resolved, stock taking has been taken place with auditor on March 28, 2008, income tax and sale tax observation settled down.

8. In order to give an opportunity to the management of the Company to clarify their position, a hearing was fixed on July 25, 2008, which was adjourned at the request of the Company and after adjournment of different hearing dates by the Company the case was re-fixed for hearing on June 15, 2009. On the date of hearing, Mr M. Javed Panni ("Authorized Representative") appeared on behalf of all the directors of the Company. During the course of hearing, submissions made in the written reply were reiterated, and Mr Panni contended that the Company had suffered heavy cash losses which have forced the management to suspend its operations. He requested for a lenient view.

9. I have analyzed the written representation made by the Company, verbal submissions of the representative and relevant provisions of the law and as per Section 255 of the Ordinance which require the auditors to conduct the audit of a company's books of accounts and express their opinion in their report to the members of the Company. The directors of the Company communicate with the members of a company through their report to members which generally includes an operating and financial review of a Company and tells the shareholder about the director's perspective of Company's state of affairs. In addition the Ordinance also requires the directors to disclose certain information in the directors' report regarding the state of affairs of the Company. Section 236 of the Ordinance specifically requires the directors to provide fullest information and explanation in regard to auditors reservations, observations, qualification or adverse remarks contained in the auditor's report. The aforesaid provisions of the Ordinance aim to present a true state of affairs of a company

to its shareholders. In the instant case, however, the directors of the Company in their written representation and through their authorized representatives have failed to justify most of the statements made in the director's report. For the forgoing, I conclude that the directors of the Company have misrepresented facts to the shareholders in the Directors Report and have hence contravened the provisions of Section 492 of the Ordinance.

10. In view of the above discussion the default is established. However, I am inclined to take a lenient view in the matter and instead of imposing maximum fine of Rs. 500,000 on every Director. I hereby impose a fine of Rs. 300,000 (Rupees three hundred thousand only) on Mr. S. M Ahmed the Chief Executive of the Company only under Section 492 of the Ordinance , other directors are strictly warned to be careful in future. I hope that directors of the Company will react positively to this lenient view and ensure compliance with mandatory provisions of the Ordinance in future.

The Chief Executive of the Company is hereby directed to deposit the aforesaid fine of Rs.300,000/- (Rupees three hundred thousand only) 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 receipt of this Order and furnish receipted vouchers or pay by a DD/pay order issued in the name of Commission for information and record, failing which proceedings under the Land Revenue Act,1967 will be initiated which may result in the attachment and sale of movable and immovable property. It may also be noted that the said penalties are imposed on the Chief Executive in his personal capacity and are required to pay the said amount from his personal resources.

Tahir Mahmood
Executive Director (Enforcement)

Announced
July 03, 2009
Islamabad