



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. IV

In the matter of

Appeal No. 05 of 2014

Mr. Imran Zahid, Chief Executive, J.A. Textile Mills Limited

.... Appellant

Versus

Head of Department (Enforcement)

.... Respondent

Date of hearings:

06/04/15

### Present:

#### For Appellant:

1. Mr. Ajmal Shahab, Company Secretary
2. Mr. Muhammad Yousaf, Director

#### For the Respondent

1. Mr. Ali Azeem Akram, Director (Enforcement)
2. Ms. Ayesha Riaz, Joint Director (Enforcement)

### ORDER

1. This order shall dispose of Appeal No. 05 of 2014 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 16/01/14 ("the Impugned Order") passed by the Respondent.
2. The facts leading to this case are that the examination of the financial statements of J.A. Textile Mills Limited (the Company) for the year ended June 30, 2012 (financial



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statements) filed with the Securities & Exchange Commission of Pakistan (the Commission) pursuant to the provision of Section 233(5) of the Ordinance revealed that Company had revalued its fixed assets by Rs. 119 million (excluding land) during the year and reported an amount of Rs. 336 million on account of Surplus on Revaluation of Property Plant & Equipment (revaluation surplus). Further, the Company had not accounted the deferred tax impact of the revaluation in accordance with requirements of International Accounting Standard (IAS) 12 - Income Taxes. The above stated Accounts position was based on the following observations:

- a) The reported amount of Revaluation Surplus was not net of deferred tax.
  - b) The reported increase in Deferred Tax Liability (DTL) was not in proportion to the revaluation of Property Plant & Equipment at the applicable tax rate.
  - c) The Company had recognized the deferred tax on account of revaluation in the profit or loss in contravention to the requirements of IAS 12 - Income Taxes which require deferred tax to be recognized outside profit or loss if it relates to items that are recognized outside profit or loss.
  - d) The difference between the carrying amount of fixed assets with and without revaluation did not match with the balance of Revaluation Surplus.
3. In the light of the facts narrated above, matter was taken up with the Appellant, rest of the directors and the statutory auditor (auditor) of the Company. The Appellant informed the Respondent, vide letter dated July 20, 2013, that the difference was due to the deferred tax impact on account of incremental depreciation. However, the Auditor submitted, vide his letter dated October 5, 2013, that deferred tax impact on Surplus of Property Plant & Equipment was not transferred to retained earnings.
4. The response of the Appellant was not found satisfactory. Therefore, Show Cause Notice (SCN) was issued on October 11, 2013 for contravention of Section 492 of the Companies Ordinance 1984 (Ordinance).



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5. The Appellant responded to the SCN vide letter dated December 13, 2013 and stated that DTL arising on account of revaluation of Property Plant & Equipment during the year amounted to Rs. 37.617 million but erroneously reduced by Rs. 12.756 million by reversing the deferred tax impact on incremental depreciation. The net deferred tax impact of Rs. 24.861 million was charged to profit and loss account. It was further submitted that there was no effect on the operational results, overall equity and financial state of affairs of the Company due to above stated transaction.
6. The Appellant failed to satisfy the Respondent regarding compliance of the requirements of IASs and Section 492 of the Ordinance through written reply, therefore opportunity of personal hearing was provided to the Appellant. Mr. Ajmal Shahab (Company Secretary) and Mr. Allah Dittah (Accountant) appeared in person as the authorized representatives (Representatives) on January 15, 2014. In addition to reiterating previous arguments, it was argued by them that there would have been no material impact on the Earnings per Share (EPS). Moreover, it was also submitted that the default had not occurred knowingly, willful, intentionally or with malafide intention and the management had not derived any benefit or gain. The Representatives once again strongly contended that deferred taxes were merely entries and had no actual impact on the financial performance of the Company. After arguments on the merits of the case, the Representatives requested to take a lenient view in the case.
7. The Respondent being dissatisfied with the written submissions and verbal arguments put forth by the Appellant, held that the Company having its securities listed on Stock Exchanges was deemed to comply with the requirements of IAS – 12 Income Taxes which prescribes the accounting treatment of deferred taxes on equity and the income statement. Further, section 492 of the Ordinance was also violated by submitting False Statement before the Commission, however, keeping in view the fact that the financial statements for the year ended 30/06/13 had been rectified by the Company in accordance with the requirements of IASs and assurance provided by the Representatives to remain careful in future, a fine of Rs. 30,000 was imposed on the Chief Executive with a stern

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warning to remaining directors of meticulous compliance with ISAs and provisions of the Ordinance in the future.

8. The Appellant preferred the instant appeal on the following grounds:

- i) The order is against the law and facts of the case and is only an exercise in discussion of technicalities.
  - ii) Though errors were pointed out which are inadvertent but the same as contended by the Appellant had no adverse effect in the shape of materiality to any party concerned for whose protection the law, body of rules, regulations and international standards are framed. The impugned order does not state detail of any loss which may have occurred to anyone concerned. Without doing so the order could not have been passed.
  - iii) There was absolutely no advantage / benefit which accrued to anybody including the sponsoring directors / management or any other officers / related parties of the company for such an inadvertent mistake that too in case of a fictitious assets / liability i.e. profit after deferred taxation.
  - iv) Additionally, the anomaly in the computation of deferred tax has been duly rectified by the company with retrospective effect under the guidance and advice of the auditors in the financial statements for the year ended June 30, 2013.
9. On the basis of above mentioned grounds and verbal submissions made by the Appellant, it was requested to set aside the Impugned Order being unlawful.
10. The Respondent vehemently denied and rebutted the grounds of the Appeal taken by the Appellant through written and verbal arguments. They stated:

- i. The Impugned Order is lawful and factually correct.



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- ii. The amount of misstatement in the financial statements for the year ended June 30, 2013 is as under:
- The Revaluation surplus was overstated by Rs. 37 million.
  - Net loss for the year under reference and accumulated loss thereon was overstated by Rs. 24.861 million.
  - Deferred tax liability was understated by Rs. 12.756 million.

In terms of percentage, the revaluation surplus would have been lower by 11%, and Non-current liabilities would have been higher by 17%. The Company would have reported a net profit of Rs. 1.397 million instead of a loss of Rs. 23.464 million. Consequently, EPS would have been +0.11 instead of - 1.86 i.e. different by 106%.

The above depicts that the reported performance would have been materially different, had the company accounted for the transaction in accordance with the requirements of IAS 12 – Income Taxes. The intended users of the financial statements have suffered loss as they have been presented untrue state of affairs of the Company. EPS is a significant indicator of an entity's performance. The significance of EPS as benchmark of performance of an entity can be analyzed from the fact that it is released four times a year and monitored very closely by investors/stakeholders across the globe such as Karachi Stock Exchange, London Stock Exchange and Wall Street. Following is the extract from the order under reference refers to the loss caused to the shareholders:

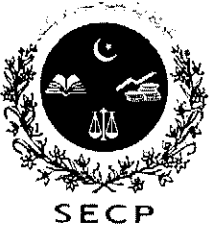
“The Company would have reported a Profit after Tax of nearly Rs. 1.4 million, instead of significant loss of Rs.23.464 million, had it accounted in accordance with requirements of IAS 12-Income Taxes with a likewise effect on reported EPS which would have been adjusted from the reported Rs.1.87 per share in negative to Rs. 0.11 in positive representing a change of 105%. EPS is one of the most commonly used performance measures worldwide by the stakeholders.



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Moreover, it is also an important component in the price earnings ratio which is a key summary statistic in business valuations.”

- iii. The argument that no benefit accrued to anybody does not justify the misstatement in the financial statements. The loss, however, has been caused to the intended users of the financial statements who have been given incorrect information regarding the financial position of the Company which was required to be prepared in accordance with the requirements of IASs.
  - iv. Financial statements of the Company for the year ended June 30, 2007 (earlier year) were materially misstated on exactly similar grounds. The correction was not made until in the financial statements for the year ended June 30, 2013. Therefore, it is apprehended that the error had been removed only after the SCN was issued by the Commission. The existence of material misstatement in the financial statements since June 30, 2007 constitutes continuous negligent conduct.
11. We have heard the parties at length and perused the relevant record with the assistance of the parties. After careful examination of the record, facts of the case and the submissions made before the Bench by the parties, we state that:
- i. The Company failed to prepare their financial statements in accordance with the Ordinance. Revaluation surplus was overstated by Rs. 37 million, net loss for the year and accumulated loss was overstated by Rs. 24.861 million. Further, DTL was understated by Rs. 12.756 million and EPS was understated.
  - ii. The argument of the Appellants that there would have been no material impact on the presentation of financial position and performance of the Company does not hold ground. The Company has violated the express provisions of law, which cannot be tolerated to ensure justice and rule of law. As matter of fact the amounts



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of misstatements referred above are material. Jurisprudence has envisaged a principle for administration of justice which requires that "If law requires that an act must be done in a particular way, it should be done in that manner as prescribed by law."

- iii. The plea of the Representatives that the default was not willful or intentional has not been supported by any evidence and submission was a mere plea without any appropriate justification.

12. In view of the aforesaid, we find no reason to interfere with the Impugned Order. Therefore, appeal is dismissed with no order as to cost.

**(Fida Hussain Samoo)**  
Commissioner (Insurance)

**(Zafar Abdullah)**  
Commissioner (SCD)

Announced on: **15 MAY 2015**