SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department- I

Adjudication Division

ORDER	
Name of Company:	**M/s. Fecto Cement Limited**
Number and Date of Show Cause Notice (the SCN):	CSD/ARN/54/2024-319 dated June 07, 2024
Name(s) of Respondent(s):	(i) Mr. Amir Ghani, Chairman; (ii) Mr. Mohammad Yasin Fecto, Chief Executive Officer; (iii) Ms. Saira Ibrahim Bawani, Director; (iv) Mr. Khalid Yacoob, Director; (v) Mr. Mohammad Anwar Habib, Director; (vi) Mr. Jamil Ahmed Khan, Director; (vii) Mr. Rohail Ajmal, Director; and (viii) M/s. Fecto Cement Limited
Date(s) of Hearing(s):	(i) September 04, 2024; (ii) October 30, 2024; (iii) November 27, 2024; and (iv) December 16, 2024
Case represented by:	(i) Mr. Muhammad Waseem FCA Partner- M/s. Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants; and (ii) Mr. Muneer A. Malik, Senior Advocate Supreme Court (as the Authorized Representatives.)
Provisions of law involved:	Section 510 of the Companies Act, 2017 read with SRO 633(I)/2014 dated July 10, 2014 and SRO 229(I)/2019 dated February 14, 2019.
Date of the Order:	July 31, 2025

This Order shall dispose of the proceedings initiated by the Securities and Exchange Commission of Pakistan (**the "Commission"**) through Show Cause Notice No. CSD/ARN/54/2024-319 dated June 07, 2024 (**"SCN"**) against M/s. Fecto Cement Limited (**the "Company"**) and its Board of Directors (**"BOD"**) including the Chief Executive Officer (**"CEO"**), hereinafter collectively referred to as the **"Respondents"**, issued under Section 510 of the Companies Act, 2017 **(the "Act")** read with SRO 633(I)/2014 dated July 10, 2014 (**"SRO 633"**) and SRO 229(I)/2019 dated February 14, 2019 (**"SRO 229"**).

2. In terms of SRO 633, the Company, being a publicly listed company, was required to prepare its balance sheet and profit and loss account in compliance with the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), as notified thereunder, including IAS 28 *Investments in Associates and Joint Ventures*. As per IAS 28, an associate is defined as an entity over which the investor has significant influence while significant influence is defined therein as the power to participate in the financial and operating policy decisions of the investee. Similarly, para 5 of IAS 28 provides that if an entity holds, directly or indirectly (e.g. through subsidiaries) 20% or more of the voting power of the investee, it is presumed that the entity has significant influence.

3. In terms of SRO 229, the Company was also required to follow the requirements of IFRS 9 *Financial Instruments* where Para 5.5.3 of IFRS 9 stipulates that at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses (**ECL**) if the credit risk on that financial instrument has increased significantly since initial recognition.

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4. The violations of the aforesaid requirements, as notified through the SROs, attract a penal action in terms of section 510(2) of the Act which provides that <u>any person, who obstructs or contravenes or does not comply with any directive, prudential requirements, codes, circulars or notifications, given under this section shall be liable to a penalty of level 3 on the standard scale</u>.

5. The brief facts of the case are that review of financial statements of the Company for the year ended June 30, 2023 (**the "Accounts"**) revealed that:

(i) Under Note 17.2 to the Accounts, the Company, despite holding 49.21% shares, had not classified M/s. Frontier Paper Products (Private) Limited ("**FPPL**") as an associated company and had not accounted for its investment in FPPL under the equity method, contrary to the requirements prescribed under IAS 28 as notified through SRO 633.

(ii)As per Note 17.3 to the Accounts, the Company had re-classified its investment in Term Finance Certificates ("**TFCs**") issued by M/s. Silk Bank Limited from short term to long-term investment, and no provision for ECL had been made, despite prevailing uncertainty regarding repayment upon maturity, contrary to the requirements of IFRS 9 as notified through SRO 229.

6. In order to probe the matter, the Commission vide letter dated February 06, 2024 sought clarification from the Company to which the Company responded vide letter dated February 20, 2024, *inter alia,* as under:

"The Company holds 49.21% ownership stake in FPPL. However, it is crucial to note that the control over FPPL is exercised by Mr. Mohammad Yasin Fecto, CEO of the Company and FPPL who holds the remaining voting power of 50.79%. In IAS 28, control over an entity is a key determinant in assessing the classification of an investment. The Company despite significant ownership stake is not able to exercise significant influence over FPPL due to control exerted by Mr. Yasin Fecto on both the Company (75% shareholding) and FPPL (51% shareholding);

Paragraph 2 of IAS 28 states that "An associate is an entity over which the investor has significant influence." Further paragraph 13 of IAS 28 also states that "An investor shall discontinue the use of equity method from the date it ceases to have significant influence over an associate." The Company does not have significant influence over FPPL, therefore, it has not applied equity method for accounting its investment in FPPL;

Silk Bank has not met its adequacy ratios as set by State Bank of Pakistan (SBP), however, the Company continued to record mark-up income considering completion of due diligence by a local bank for the acquisition of Silk Bank Limited which is expected to be finalized soon. This acquisition is anticipated to enable Silk bank Limited to meet its prescribed limits of Minimum Capital Ratio and Capital Adequacy Ratio therefore improving its financial position (Note 25.3 to the Accounts). IFRS 9 requires entities to assess the ECL associated with financial instruments, considering all reasonable and supportable information available. The Company after analyzing default probability and ECL calculation method considers that the disclosed information regarding the impending acquisition of Silk Bank Limited and credit enhancement guarantee provided by Soneri Bank Limited, support its decision that no provision is necessary at this time."

7. The aforesaid response of the Company was not found cogent, as the Company, being a

separate legal entity, held 49.21% shareholding; thereby had significant influence over FPPL and by not disclosing the same, the Company, *prima facie,* failed to meet the requirements of IAS 28 as required in the SRO 633. Furthermore, the Company, in Note 25.2.1 to the Accounts, disclosed that M/s. Silk Bank Limited failed to pay profit on TFCs for the financial years 2022 and 2023 and that there was prevailing uncertainty regarding repayment upon maturity. However, it did not measure the loss allowance on TFCs of M/s. Silk Bank Limited as per the ECL, despite an increase in credit risk. The Company, therefore, *prima facie,* contravened with the requirements of IFRS 9 as required in the SRO 229, where such violation of IAS and IFRS attract penal action in terms of Section 510(2) of the Act.

8. For ease of reference, the relevant paragraphs of IAS 28 and Appendix B of IFRS 9 are reproduced hereunder:

> ***"Significant influence***
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> *5. If an entity holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g. through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.*
>
> ***Application of the equity method***
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> *16. An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 17–19."*
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> ***Appendix B of IFRS 9:***
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> *BCE.124 Furthermore, relevant information is provided by updating expected credit loss estimates for changes in expectations, by updating the measurement of the loss allowance at each reporting date, and in particular through the recognition of lifetime expected credit losses when there has been a significant increase in credit risk since initial recognition. In addition, information is provided by requiring the calculation of interest revenue on the amortised cost amount (i.e. net of the loss allowance) of a financial asset when it becomes credit-impaired subsequent to initial recognition."*

9. Taking cognizance of the matter, SCN was issued to the Respondents to show the cause in writing as to why a penal action may not be taken against them for non-compliance of the requirements of the SRO 633 and SRO 229. In response to SCN, the Company Secretary of the Company vide letter dated July 15, 2024, *inter alia,* made the following submissions:

(i) *The Company assessed the credit risk and determined that no loss allowance was required against the investment of Rs. 99.920 million in TFCs maturing in February and August 2025. This conclusion was based on the legal opinion dated June 20, 2022, from the issuer's legal counsel, which confirmed that a Lock-in Event (LIE) had occurred under clause 28 of the Investor Agreement. In light of SBP's Basel III Implementation (BPRD Circular 06 of 2013), the LIE restricted the issuer from redeeming principal or paying interest if doing so would cause or increase a shortfall in the issuer's Minimum Capital Required (MCR) or Capital Adequacy Ratio (CAR) shortfall. Therefore, the non-*

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redemption was not due to financial incapacity but was a regulatory restriction. The Company concluded that redemption would occur once the LIE ceased, and the legal opinion clarified that the LIE did not constitute a breach of the issuer's obligations.

(ii) *While audited financials for the issuer for the year ended December 31, 2021 are pending, the issuer had released its 2020 financials on June 8, 2022, and the 2021 financials are now expected by September 2024 as per permission granted by the Islamabad High Court. Furthermore, multiple financial institutions have expressed acquisition interest and were conducting due diligence to address the MCR and CAR shortfall. The TFCs are unlisted and cannot be measured through a market-based valuation. Despite the LIE, the issuer continues its banking business, has launched REIT projects approved by the Commission, and maintains active dealings with the Company, including a short-term running facility of Rs. 115 million and a Rs. 110 million bank guarantees. The Company has the contractual right to adjust this facility under clause 3.5 of the Investor Agreement. Moreover, clause 29 allows SBP to convert or write off the TFCs upon a Point of Non-Viability (PONV), but such an event has not occurred and is unlikely as the issuer is expected to meet MCR and CAR requirements in due course.*

(iii) *The Company made no investment in FPPL before June 30, 2018. It acquired a 49.21% stake in FPPL in 2019 through right issue. The Company has consistently complied with approved accounting standards and has exercised good faith judgment in applying IAS 28 and IFRS 9 to its investment. The matter is one of interpretation and professional judgment, with no intent to misrepresent. Prior to 2019, FPPL was fully controlled by Mr. Yasin Fecto. When the Company acquired its stake, Mr. Yasin Fecto held 75.11% of the Company, and even after the investment, he maintained significant control over FPPL, both directly (50.78%) and indirectly (36.96% through the Company), totalling 87.74%. This left only 12.26% with the Company. The subordinated loan of Rs. 175.75 million injected by Mr. Yasin Fecto in 2021 into FPPL, classified as equity, further reinforced his dominant position.*

(iv) *Consequently, the Company concluded it does not have significant influence over FPPL, as Mr. Yasin Fecto exercises nearly five times more voting power than the Company, and retains exclusive operational and financial control. He also holds common directorship in both entities. Based on this ownership structure and practical influence, the Company determined that FPPL remained under common control of Mr. Yasin Fecto, not the Company. Therefore, the investment was accounted for in accordance with IFRS 9 at fair value through other comprehensive income, rather than under IAS 28. The Company's position is consistent with the economic substance of the arrangement, and the accounting treatment does not attract provisions of Section 510 of the Act.*

10. In order to provide an opportunity for personal representation, a hearing in the matter was fixed for September 04, 2024; wherein Mr. Muhammad Waseem FCA Partner-M/s. Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants, appeared as the Authorized Representative of the Respondents (**the "Authorized Representative-I"**). During the course of hearing, the Authorized Representative-I reiterated the same stance taken in written response to SCN submitted vide letter dated July 15, 2024.

11. Subsequent to the hearing, the Chief Financial Officer (CFO) of the Company vide letter dated September 12, 2024, made additional submissions which, *inter alia*, included:

(i) Long term investments in unquoted debt securities of TFCs of Silk Bank Limited amounting to PKR 99.920 million and accrued markup thereon were made, wherein Clause 3.5 of the Agreement and Paragraphs 28 ("Lock-in-Clause") and 29 ("Loss Absorbency") of the Terms and Conditions for issuance of TFCs are pertinent. "Loss Absorbency" clause states that subject to decision of SBP and before a PONV is reached, SBP may direct the conversion of said TFCs into ordinary shares or have them written off either partially or in full. The number of shares to be issued on conversion will be up to the value of PKR 1,238,390,093/- (i.e. 62% of the value of TFCs issued). Under clause 3.5, the issuer undertook to pay the redemption amount on the redemption date, which, being an undertaking by a banking institution, confers rights to the Company to enforce remedies including offsetting against amounts owed by the Company on a short-term loan of Rs. 120 million. Enclosed are the confirmation from the issuer on units held as of June 30, 2023, a legal opinion dated June 20, 2022 concluding that a LIE does not breach redemption obligations, and the Company's assessment dated June 30, 2023, whereby it concluded that lifetime ECL, provision is not required.

(ii) Considering the definition under Section 2(4) of the Act and IAS 28, the Company and FPPL were associated entities due to over 75% ownership of the Company and 100% of FPPL by Mr. Yasin Fecto till 2018. In 2019, Mr. Yasin Fecto held 50.79% and the Company held 49.21% in FPPL. This was duly disclosed in Note 17.2 to the Accounts. As per Section 224 of the Act and the Third Schedule, listed entities are required to follow IFRS, and accordingly, IAS 28 was considered. Although the Company held 49.21%, under IAS 28:3 it was presumed that it would not have significant influence unless clearly demonstrated otherwise, especially since Mr. Yasin Fecto had significant influence in both entities through more than 20% shareholding.

(iii) The Company evaluated whether the 2019 investment granted it significant influence over FPPL. It was noted that prior to this investment, there was no Board representation or policy influence. Despite acquiring voting rights, control over FPPL's affairs remained with Mr. Yasin Fecto, who was CEO of both entities. The investment was long-term and for expansion purposes. Even though FPPL had been supplying the Company under related party transactions, the Company had no say in FPPL's decisions. Mr. Yasin Fecto's direct and indirect holding of 87.59% in FPPL enabled him to appoint all FPPL directors and six out of seven directors of the Company. Thus, the remaining 12.41% with the Company had no practical influence. IAS 28's October 2017 amendment requiring IFRS 9 to be applied to such long-term interests was also considered. Therefore, the Company designated the investment at fair value through other comprehensive income as disclosed in Note 17.2.2 to the Accounts.

12. Hearings in the matter were subsequently fixed for October 30, 2024 and November 27, 2024. However, the Company vide letters dated October 29, 2024 and November 21, 2024 sought adjournments which were acceded to. Later, the Company vide letter dated November 20, 2024 made additional submissions, *inter alia,* as under:

"1. SRO 633 requires that investment in FPPL should have been reported in the financial statements in accordance with IAS 28. It may be noticed that IAS 28 was itself amended in October 2017 whereby entities are required to apply IFRS 9 Financial Instruments to Long Term Interests in Associates and Joint Ventures to which the equity method is not applied. As will be seen from Note 10.1 to the financial statements for the year ending June 30, 2019, the Company irrevocably elected reporting under IFRS 9. It is submitted that IAS 28 itself states that "this Standard shall be applied by all entities that are investors with

joint control of, or significant influence over, an investee." The Company owns 49.21% shares in FPPL thus attracting the presumption of significant influence, but the said presumption is not conclusive and is rebuttable. In rebuttal of this presumption, it has been submitted that in fact, the Company is not represented on the Board of Directors of FPPL. Under paragraph 6 of IAS 28 none of the ways specified in clauses (a), (b) and (d) to (e) of IAS 28 subsist. The only material transactions between the Company and the investee are that the latter has been meeting the entire requirement of the Company of paper sack for packing cement, but this supply is not influenced by any policy decision in relation to FPPL. So, in fact the Company has first applied IAS 28 and then determined that it does not have any significant influence over FPPL and then accordingly applied IFRS 9 in terms of paragraph 14A of IAS 28.

2. In fact, the Pakistan Stock Exchange Limited (PSX) in its financial statements also shows its investment in Pakistan Mercantile Exchange Limited (PMEX) in accordance with IFRS 9.

3. In response to the allegation that the Company prima facie failed to comply with the requirements of IFRS 9 "by not measuring the loss allowance on TFCs of Silk Bank Limited" it is submitted that the decision of the management was that if the TFCs are classified as long terms instruments, there would be no life-time risk at all. The calculation of zero life-time risk is based on information in the public domain to the effect that (i) Silk Bank was not in breach of the TFC Redemption Agreement, (ii) that the Company would have an equitable offset against loans and guarantees taken from Silk Bank against the TFCs, (iii) the Board of Directors of Silk Bank Limited was sanguine of merger options with United Bank Limited ("UBL"). The decision as to zero risk was validated by subsequent events in that the Board of Silk Bank in its meeting dated November 6, 2024 accorded in principle its approval for a potential merger with UBL (iv) UBL has proposed to issue and allot new ordinary shares of UBL to Silk Bank shareholders in the ratio of one ordinary share of UBL for every 325 shares of Silk Bank Limited, and (v) the investment in TFCs has been re-classified as a long-term investment instead of short-term, with full disclosure in the form of Notes 17.3 and 23 in the Accounts.

4. It may be noted that full disclosure has been made and there is no possibility of misleading the general public, shareholders or the creditors. The accounting treatment being a bona fide exercise, it is submitted that there is no occasion for the imposition of a penalty."

13. In order to conclude the matter and to meet the ends of justice, final hearing in the matter was fixed for December 16, 2024; wherein the Authorized Representative-I along with Mr. Muneer A. Malik, Senior Advocate Supreme Court, appeared as the Authorized Representatives of the Respondents (**the "Authorized Representatives**"). During the course of hearing, the Authorized Representatives reiterated the written stance taken earlier vide letters dated July 15, 2024 and November 20, 2024 and, *inter alia,* further stated that holding of 20% or more, only creates a presumption for IAS 28 not conclusion, as it is based on the redundant factors that who has an influence or control on the associate. Moreover, the Company in fact measure the loss, as M/s. Soneri Bank had provided guarantee to provide the first two installments. Furthermore, the Authorized Representatives also submitted the following, *inter alia,* written submissions during the hearing:

"1. The scheme of Sections 510 read with 478 and 479 of the Act contemplates a two-step process; first, a show cause notice has to be issued to determine whether any violation of

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sub-section (1) of Section 510 of the Act has taken place; and second, if a violation has taken place, then a show cause is to be issued under Section 478 of the Act as to why a 'penalty' should not be imposed. No penalty can be imposed, unless it has been first adjudged under section 479(3) of the Act. Adjudge means to decide on judicially-meaning thereby decide fairly and reasonably.

2. The offence under Section 510(2) of the Act is NOT a strict liability or 'civil liability offence'. Mens rea is an essential ingredient of the offence. Reliance is placed on the Judgment of the Supreme Court in the case of Deputy Collector, Central Excise and Sales Tax vs. ICI Pakistan Limited 2006 PTD 1132 and Commissioner in land Revenue vs BYCO Petroleum Pakistan Limited 2023 PTD 1498 [Sindh High Court]. In these cases, the provisions of section 33 and 34 of the Sales Tax Act were interpreted and the argument that these sections created a 'civil liability' was firmly rejected and it was held that in the absence of mens rea, penalty could not be imposed.

3. Whether an investor has 'significant influence' over an investee to be considered an 'associate' is a question of fact and the holding of 20 percent or more of the voting power of the investee creates only a presumption of 'control within the meaning of IAS 28. This presumption is rebuttable. The conclusion in the SCN to the effect "the response of the Company is not cogent as it is a separate legal entity and distinguish from its shareholders and by holding 49.21% shareholding has significant influence over FPPL" has been arrived at after ignoring that the Company has no representation of the Board of Directors of FPPL.

4. The charge that the Company "did not measure the loss allowance on TFCs of Silk Bank Limited at an amount equal to the lifetime ECL despite increase in credit risk" is not well founded. The Company did in fact measure the loss on account of the 'prevailing uncertainty in relation to the affairs of Silk Bank and found it to be zero. Risk evaluation in the final analysis is judgmental. The Company arrived at a "Judgment' and as long as the judgment arrived at is not irrational or unreasonable, the Commission cannot substitute its own judgment of the risk. In fact, the Guidelines issued by the International Accounting Standards Board (IASB) - albeit during the uncertain situation of COVID-states that IFRS 9 'requires the application of judgment and both requires and allows entities to adjust their approach to determining ECLs in different circumstances". In the instant case, a detailed credit risk evaluation was done and a copy has been placed on record. Reasonable persons can arrive at different opinions on "control" and "risk assessment". The Commission cannot substitute its own assessment of the risk of loss with that made by management.

5. Assuming, but not admitting, that there has been a contravention of the SROs 633 and 229, under section 479(3) of the Act, the penalty shall be adjudged. While adjudging a penalty, the proportionality principle must be kept in mind. Section 479 of the Act provides the 'maximum limit' of penalty. The imposition has to be "judicial". The guidelines issued by the Competition Commission of Pakistan may be found useful as these are based on settled law. The following factors are to be taken in to consideration while imposing a penalty which has a maximum limit: (i) the seriousness of the infringement, (ii) the duration of the infringement, (iii) mitigating factors, (iv) mens rea, (v) absence of bad intention, (vi) extent of injury caused, (vii) the financial circumstances of the offender, (viii) maximum fine is meant only for extreme cases

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6. That there is no mens rea on the part of the Company and/or any of its directors. This is evident from the following:

(i) Full disclosure of FPPL holdings and Silk Bank TFCs has been made in the financial statements. Nothing has been suppressed or concealed or mis-stated so as to mislead any investor, shareholder or the general public,
(ii) The financial statements have been audited by independent accountants who are experts in the field of accounting- which respectfully the Adjudication Division of the Commission is not.
(iii)Even the stock exchange on which the Company is listed has not applied IAS 28 to its investment in an 'associate'.
(iv) The independent auditors have certified that the financials give a 'true and fair view of the state of the Company's affairs'.
(v) The rationale for not applying the equity method to its investment in FPPL has been fully explained in Note 17.2.
(vi) Note 25.2.1 discloses as to why there is no loss provision. The cited reasons are the guarantee extended by Soneri Bank, the expectation of Silk Bank being acquired (which expectation has been validated by subsequent events), evidence of which has been placed on record.

7. Relevant case law and guidelines issued by IASB are attached for ease of reference."

14. Subsequent to the hearing, the Company Secretary vide letter dated January 13, 2025 made further submissions, *inter alia,* as under:

"We are availing this opportunity to update your office on the progress in the merger of Silk Bank Limited with UBL which is now at final stage. In this respect, we as one of TFC holders has issued NOC to the merger upon receipt of confirmation to our joint query from the Secretary, Board of Silk Bank Ltd that the principal amount of TFCs holders and profits payable thereon shall be paid by UBL as per the terms of the TFC agreement after the merger transaction is concluded.

For your kind consideration, we are sharing below email exchanged with the TFC holders.

Quote

Point-wise responses to the queries are as follows:

1. Post amalgamation resolution is passed by the TFC holders of Silk Bank, what will happen with the TFC structure? Will it remain the same as it is now, like the coupon rate, principal repayment, maturity date etc?

Response: Post sanction and effective of the scheme, all terms of the TFC will remain as is and will be binding in UBL as the surviving entity, as if UBL itself had issued the instrument.

2. Will all the previous overdue coupon payments be made to the investors?
Response: Post amalgamation, if the lock-in is lifted (assuming UBL will be MCR and CAR compliant post amalgamation), UBL would be required to settle the suspended payments.

3. Please confirm that at any point in time after this resolution is passed, the TFC principal amount is not going to be settled by giving UBL shares or any other equity instrument to the TFC investors.

Response: As per the proposed amalgamation, all obligations of Silk Bank Limited in respect of the TFC Issue will be transferred /vested with UBL as is. The amalgamation scheme does not involve issuance of shares against the TFC liability."

15. I have gone through the requirements of IAS 28 and IFRS 9 as prescribed in the SRO 633 and SRO 229, the provisions of Section 225 of the Act, and considered the facts of the case along with the available record of the Company as well as written and verbal submissions of the Respondents and their Authorized Representatives made at different stages of the proceedings. I have also perused Section 510(2) of the Act, which stipulates penal action for contravention of the afore-referred requirements. It is pertinent to observe that IAS 28 is a critical accounting standard that ensures companies properly account for investments in entities over which they have significant influence. Significant influence is defined under IAS 28 as the power to participate in the financial and operating policy decisions of the investee. Under IAS 28, such investments must be accounted for using the equity method, which requires the investor to recognize its share of the profit or loss of the investee in its own financial statements. This standard ensures that the investor's financial statements accurately reflect its economic exposure to the performance of the associate.

16. The foremost contention put forward by the Respondents through their Authorized Representatives is that the Company despite having significant ownership stake is not able to exercise significant influence over FPPL due to 'control' exerted by Mr. Yasin Fecto on FPPL by virtue of his 51% shareholding. However, it is imperative to observe here that para 5 of IAS 28 clearly stipulates that *a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence*. Furthermore, IAS 28 defines significant influence as "the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies." Importantly, paragraph 7 of IAS 28 stipulates that if an investor holds 20% or more of the voting power of the investee, there is a presumption that the investor has significant influence, <u>unless it can be clearly demonstrated otherwise</u>. This is a stringent evidentiary standard that clearly affixes the onus on the investor (i.e., the Company) to substantiate the absence of significant influence through clear and persuasive evidence, in case its shareholding in an investee exceeds 20%.

17. Moreover, paragraph 6 of IAS 28 sets out that significant influence is usually evidenced in <u>**one or more**</u> of the following ways:

a) Representation on the board of directors or equivalent governing body;
b) Participation in policy-making processes, including decisions about dividends or other distributions;
c) Material transactions between the investor and the investee;
d) Interchange of managerial personnel; and
e) Provision of essential technical information.

At this juncture, it is considered necessary to analyze as to how one or more of the aforementioned 'indicators' apply to the instant matter and determine the existence of significant influence of the Company over FPPL:

(i) **Participation in policy-making processes, including decisions about dividends or other distributions:**
Paragraph 6(b) of IAS 28 identifies "participation in policy-making processes" as one of the primary indicators of significant influence. This includes, but is not limited to, involvement in decisions related to corporate strategy, approval of financial statements, and most notably, the declaration of dividends or other financial distributions.

Under Section 240 of the Act, the shareholders of a company are empowered to declare dividends in a general meeting. In the instant case, the Company unarguably holds 49.21% of the shareholding in FPPL. This means that nearly half of the voting rights in general meetings lie with the Company. As per the above provisions, this level of voting power clearly enables the Company to participate in material and policy-level decisions including with respect to dividend distribution; thereby fulfilling the condition of policy-making influence under IAS 28.6(b). This 'shareholder-level power' particularly in companies where shareholding is not widely dispersed amongst numerous shareholders including public (as in the case of FPPL) can effectively be translated into participation in policy decisions and in most of the instances may actually result in leading the policy decisions. Hence, mere absence of board representation cannot altogether absolve the shareholder having around half of the ownership of an unlisted company from participating in policy-making processes. Moreso, the law envisages multiple strategic approvals and powers that are conferred in and exercised by the shareholders in a general meeting, which the Company being a shareholder of 49.21% shares undeniably is fully entitled to.

Moreover, the Respondents through their Authorized Representatives have argued that Mr. Yasin Fecto possesses sole authority of participating in the financial and operational policy decisions of FPPL; however, in terms of section 240 of the Act, all the shareholders possess the right to participate or otherwise contest against such decisions. Thus, in terms of para 6(b) of IAS 28, existence of significant influence is evidenced by power of the Company to participate in policy-making processes including participation in decisions about dividends. Be that as it may, the Respondents have not demonstrated by way of any documentary evidence including contractual arrangements that this is not the case and such statutory powers are not in fact conferred (or restrictively conferred) upon the Company being a shareholder of FPPL.

Furthermore, the Respondents have contended that the impact of subordinated loan provided by Mr. Yasin Fecto to FPPL in the year 2021 grants him an additional right or power to exercise significant influence over FPPL. However, the instant proceedings essentially relate to non-compliance with the recognition requirements of IAS 28, and a subordinated loan for all such purposes cannot be accounted for as an 'equity stake' of the Company in FPPL. Thus, this contention does not any grounds in the instant matter.

(ii) **Material transactions between the investor and the investee:**
Paragraph 6(c) of IAS 28 recognizes "material transactions between the investor and the investee" as a strong indicator of significant influence. In the instant case, a review of the Company's financial statements for the last four years (2021-2024) reveals recurring related party transactions with FPPL, which are as under:

Financial Statements for the year	Loan Transactions with FPPL	Related Party Transactions with FPPL
2024	51 Million (Note 23)	1.62 Million (Note 40)

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2023	103.5 Million (Note 24)	1.22 Million (Note 40)
2022	134 Million (Note 23)	0.96 Million (Note 39)
2021	105.4 Million (Note 22)	0.96 Million (Note 37)

The analysis of the aforementioned transactions reveals a consistent and significant volume of loan exposure to FPPL over multiple years, accompanied by operational-level transactions that reflect continuing engagement. These include procurement arrangements, services rendered, and credit-based dealings. The pattern and magnitude of these transactions demonstrate a sustained operational linkage between the Company and FPPL and are indicative of the Company's ability to influence the terms, continuity, or execution of such dealings. This operational proximity and financial interdependence provide clear evidence of material transactions as envisaged under paragraph 6(c) of IAS 28; thereby reinforcing the presence of significant influence of the Company over FPPL.

(iii)Interchange of managerial personnel:

According to Paragraph 6(d) of IAS 28, the "interchange of managerial personnel" is another indicator of significant influence. This indicator recognizes that shared leadership or executive overlap often effectively translates into significant influence over an entity's operational and financial policies. In the instant case, Mr. Yasin Fecto serves as the CEO of the Company and simultaneously holds the position of CEO of FPPL as well. Thus, having a common key managerial personnel i.e., CEO, undoubtedly enables the transfer or alignment of strategy, decision-making preferences, and executive influence between the two entities (the Company and FPPL). This situation is further contextualized for clarification in light of the fact that FPPL has only two significant/major shareholders i.e., Mr. Yasin Fecto (50.77%) and the Company (49.21%).

Based on the above detailed analysis, it is clearly evident that the Company, in fact, holds significant influence over FPPL. IAS 28 does not solely require board representation to establish existence of significant influence of an investor over an investee; instead, it looks at the 'totality' of the influence and structure of the relationship between the two entities, including shareholding, existence of common management, occurrence of material transactions, and the ability to participate in policy-making. In the instant case, it is evident that the Company holds a substantial ownership interest in FPPL; its key managerial personnel i.e. CEO represents as CEO on the board of FPPL; there have been frequent, material transactions between the two entities; and that the Company enjoys statutory shareholder rights regarding participation in policy-making including declaration of dividends. These facts, taken together, clearly demonstrate that the Company had both the ability and avenue to exercise significant influence; thereby meeting the definition of significant influence stipulated under IAS 28 and mandating the application of the equity accounting method for its investment in FPPL. It is thus established that the Respondents had failed to comply with the mandatory requirements of the said accounting standard in recognition of its investment and preparation of its financial statements.

18. It is also pertinent to observe that IFRS 9 is a fundamental accounting standard that governs the recognition and measurement of financial instruments, including loans, bonds, and other credit-exposed assets. One of the core features of IFRS 9 is the ECL model, which requires entities to recognize credit losses not just on the occurrence of default, but proactively, using historical data or past events, current conditions, and forward-looking information. In terms of para 5.5.4 of IFRS 9, the objective of the impairment requirements is to recognize lifetime ECL for all financial instruments for which there have been significant increases in credit risk since initial recognition, whether assessed on an individual or collective basis, considering all reasonable and supportable

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information, including that which is forwarding-looking. In the instant case, the Company invested in TFCs issued by M/s. Silk Bank Limited. These TFCs were initially classified as short-term investments. However, due to a LIE triggered by the issuer, early redemption of the instruments became restricted. A LIE is a contractual clause that restricts the issuer from repaying or redeeming the financial instrument prior to maturity or unless certain regulatory conditions are met. The activation of this clause substantially changed the liquidity and risk profile of the TFCs, transforming them from short-term to non-current investments. Under IFRS 9, such a material change in credit terms and redemption risk warranted a thorough reassessment of the instrument's impairment status.

19. It is also pertinent to observe that the Company failed to recognize the lifetime ECL associated with the TFCs. At the relevant time, M/s. Silk Bank was undergoing financial stress and there were widespread market discussions of its potential merger with a local financial institution. This merger created significant uncertainty around M/s. Silk Bank's future structure, operations, and ability to honour its obligations. Under IFRS 9, such forward-looking indicators especially relating to credit risk and issuer stability are precisely the kinds of inputs that require an entity to evaluate impairment proactively. However, instead of applying the ECL model, the Company simply reclassified the investment from short-term to long-term, without recognizing any impairment or disclosing the underlying credit risk. Since a LIE restricts liquidity and limits access to principal repayment, it is a clear indicator of increased credit risk under the standard. Additionally, the merger raises the probability of restructuring or default, which again calls for impairment testing. Under IFRS 9, an entity need not to wait for an actual default or breach to occur; rather, it is required to recognize ECL as soon as there is a significant increase in credit risk. More specifically, under IFRS 9, evidence that a financial asset is credit-impaired include observable data about significant financial difficulty of the issuer, and/or probability of its bankruptcy or other financial reorganization. However, in the instant case, it is clearly evident that the Company failed to meet the impairment requirements prescribed under the standard, despite existence of observable data and indicators evidencing significant increase in credit risk.

20. The Authorized Representatives assertion that LIE did not constitute a breach and that the TFCs remained secured due to internal guarantees is misplaced. IFRS 9 requires recognition of ECL not only in cases of default, but also when there is a significant increase in credit risk which includes events such as delay in recoverability, regulatory restrictions and deterioration in the issuer's financial position. The presence of a LIE, delayed payments, and merger-related uncertainty support a finding that there was a material increase in credit risk.

21. The Authorized Representatives further argued that there was no *mens rea* or intentional concealment and that penalties should not be imposed for mere technical non-compliance. However, it is important to note that the regulatory framework under Section 510 of the Act read with the notified SROs, imposes an obligation on companies and their officers to comply with prescribed accounting standards which form the basis of disclosures especially in case of the listed company. The failure to do so whether deliberate or negligent constitutes a contravention under the law. Even otherwise, the premise of establishing a 'guilty intent' is necessitated only in adjudicatory cases of criminal nature. Reliance is placed on the case cited as 2014 CLD 299. Reliance is also placed on the Order passed by the Appellate Bench of the Commission in Appeal No. 8 of 2012 i.e. Zephyr Textiles Mills Limited vs Head of Department (Enforcement), wherein it was *inter alia* held that:

"We place our reliance on Principle of Statutory Interpretation, by Justice G.P. Singh (7th

edition, Chapter 11, page 653 & 659, published by Wadhwa & Company Nagpur) to expound on the issue of mens rea that; ....existence of a guilty intent is an essential ingredient of a crime at common law and the principle is expressed in the maxim- Actus non facit reum nisi mens sit rea...penalty imposable under an Act for breach of civil obligation by an adjudicatory proceeding which is not criminal in nature does not attract the rule that mens rea is essential before a penalty could be imposed".

22. In view of the foregoing, I am of a well-considered view that failing to adopt and implement the clear provisions of the relevant accounting and financial reporting standards, the contravention of the requirements of IAS 28 and IFRS 9 as prescribed in SRO 633 and SRO 229, has been established beyond doubt, which attracts penal action in terms of Section 510(2) of the Act. I have given due attention to the arguments presented by the Authorized Representatives to the said non-compliance, however, none of the argument justifies the non-compliance with the provisions of the SROs and Act. I, therefore, hereby, in terms of powers conferred under Section 510(2) of the Act read with S.R.O. 1545(I)/2019 dated December 06, 2019, impose an aggregate penalty of **Rs.75,000/- (Rupees Seventy-Five Thousand only)** on the Respondents on account of established default in the following manner:

Sr. #	Name of Respondent	Amount in Rupees
1	Mr. Amir Ghani, Chairman	5,000
2	Mr. Mohammad Yasin Fecto, CEO	20,000
3	Ms. Saira Ibrahim Bawani, Director	5,000
4	Mr. Khalid Yacoob, Director	5,000
5	Mr. Mohammad Anwar Habib, Director	5,000
6	Mr. Jamil Ahmed Khan, Director	5,000
7	Mr. Rohail Ajmal, Director	5,000
8	M/s. Fecto Cement Limited	25,000
Total		**75,000**

The Respondents are also advised to meticulously ensure the compliance to the applicable and legal framework in the future.

23. The Respondents are, hereby, directed to deposit the aforesaid amount of penalty in the designated bank account maintained in the name of the Commission with MCB Bank Limited or United Bank Limited within thirty (30) days from the date of this Order and to furnish a receipted bank challan to the Commission forthwith. In case of failure to deposit the penalty, the proceedings under Section 485 of the Act will be initiated for recovery of the penalty/fines as arrears of land revenue pursuant to provision of Section 42B of the Securities and Exchange Commission of Pakistan Act, 1997.

31-07-2025

Sohail Qadri
Director/Head of Department
Adjudication Department – I

Announced:
July 31, 2025
Islamabad.