

FREQUENTLY ASKED QUESTIONS ON THE CODE OF CORPORATE GOVERNANCE **(REVISED)**

Chairman's Message

The Commission has been actively involved in new initiatives for improving transparency and disclosure in financial reporting of companies and for improving their governance to protect the interests of investors. The Commission played a key role in the introduction of the Code of Corporate Governance (the Code), which is the first ever institutional effort of its kind in Pakistan. The Code is based on internationally recognized principles and emphasizes openness, transparency and accountability in the affairs of listed companies.

The Code was issued by the Commission after an extensive consultative process and is the result of the joint efforts of the Commission and the Institute of Chartered Accountants of Pakistan (ICAP). The initiative to develop a framework of good governance, which addresses the objective circumstances in Pakistan, was taken in December 1998 at the Fifth All Pakistan Chartered Accountants' Conference. The draft Code was developed by a Committee representing ICAP, Institute of Cost and Management Accountants of Pakistan (ICMAP), stock exchanges and the Commission. Seminars were held in Karachi, Lahore and Islamabad to elicit opinion on the provisions of the Code. In addition, the draft Code was placed on the websites of ICAP and the Commission. There has also been extensive media debate on the subject. Based on the recommendations received from various quarters, the Code was finalized and issued in March 2002. It was subsequently incorporated in the listing regulations of the three stock exchanges and is now applicable to all public listed companies.

The Code primarily aims to establish a system whereby a company is directed and controlled by its directors in compliance with the best practices so as to safeguard the interests of diversified stakeholders. It proposes to restructure the composition of the board of directors in order to introduce broad-based representation by minority shareholders and by executive and non-executive directors. The Code emphasizes openness and transparency in corporate affairs and the decision-making process and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner.

The Commission has identified a number of measures to facilitate effective implementation of the Code. The queries of companies regarding the various provisions of the Code are being addressed on a day-to-day basis. In addition, the Commission will arrange workshops for directors/management of listed companies, organize seminars and conferences for various stakeholders, issue publications on corporate governance as well as carry out a feasibility for setting up an institute of corporate governance in Pakistan. In line with its stakeholder awareness programme, the Commission is pleased to present the FAQs - frequently asked questions - on the Code of Corporate Governance, which we hope will further facilitate the smooth implementation of the Code.

Khalid A. Mirza

1. What is the effective date for compliance with the Code of Corporate Governance?

The manner and time of enforcement of each clause of the Code has been specified in the appendix to the Code in the listing regulations.

While the requirement for rotation of external auditors of listed companies after every five years was originally applicable from the forthcoming Annual General Meetings of companies, it has now been phased in by the SEC. As a result, no regulatory action will be taken by stock exchanges until December 31, 2003 against listed companies that fail to rotate their auditors. However, after December 31, 2003, non-compliance with the Code in this regard would render companies liable to action under the listing regulations.

2. Is the Code applicable to modarabas and mutual funds?

The Code, being part of the listing regulations of the stock exchanges, is applicable to all entities listed on the exchanges. The listed entities include not only companies but also funds, such as modarabas and mutual funds. The requirements of the Code are, therefore, applicable to modarabas and mutual funds. Furthermore, the requirements of the Code relevant to the Board of Directors become applicable to management companies of such funds, even if these companies are themselves not listed on the stock exchanges.

3. Does the Code conflict with the Companies Ordinance, 1984?

The SEC considers the Code to be an extension of the requirements of the Companies Ordinance, 1984 rather than in conflict with it. A number of amendments have recently been made in the Companies Ordinance, 1984 for greater harmonization between the provisions of the Code and the Companies Ordinance. Furthermore, the SEC draws support from the decision of the Karachi High Court in the matter of Messrs Data Textiles Limited vs. Karachi Stock Exchange and another, 1999MLD 108. The Honourable High Court held, inter alia, that provisions contained in (Section 249 of) the Companies Ordinance, 1984 do not override and cannot be interpreted to be in derogation with the Listing Regulations framed under the Securities and Exchange Ordinance, 1969, as both the enactments cover separate and distinct spheres.

4. What are the penalties for non-compliance with the Code?

Since the Code has been incorporated in the listing regulations of the stock exchanges, a listed company may be suspended or delisted in case of non-compliance with the various requirements of the Code.

5. What are the implications in case of non-compliance with clause (i) of the Code?

The clause (i) of the Code is voluntary at the moment. This means that listed companies are 'encouraged' to appoint minority shareholders and independent non-executive directors on their Boards of Directors but no regulatory/ punitive action would ensue in case they fail to do so.

6. What are the implications if an investor company fails to nominate an independent director for appointment on the Board of its investee company?

Clause (i) (b) of the Code is not mandatory. Therefore, no punitive action would ensue, for the time being, in case an institutional investor fails to nominate a director on the Board of Directors of its investee company.

7. What is the minimum amount of investment that would qualify a company to nominate a director for appointment on the Board of its investee company?

No minimum amount of investment has been prescribed in the Code.

8. Which companies are referred to by the term "Non-Banking Financial Institutions" in the Code?

For the purpose of the Code, Non-Banking Financial Institutions include DFIs, modarabas, leasing companies, housing finance companies, investment banks, discount houses, venture capital companies, insurance companies and mutual funds.

9. What is the difference between an Executive and a Non-executive director?

Executive directors are the working, whole-time directors of a company. Non-executive directors, on the other hand, are largely independent persons who are expected to lend an outside viewpoint to the Board of Directors of a company and do not undertake to devote their whole working time to the company. The guiding factor in distinguishing between executive and non-executive directors of a company is the extent of their involvement in managing the affairs of the company.

An executive director cannot be categorically defined as a "paid director" and a non-executive director as one who is "not a paid director". While the fact that a company may not pay remuneration to its non-executive directors may facilitate their classification as such, this rule cannot be applied uniformly to all companies since payment of any remuneration to its directors is at the discretion of each company.

10. Can a broker be appointed as a director of a listed company?

The Code restricts election/ nomination of brokers on Boards of directors of listed companies. However, the said clause is voluntary in nature. It is, therefore, at the discretion of listed companies to comply with the relevant clause of the Code.

The SEC issued a directive on July 18, 2002 to brokers, brokerage firms and incorporated brokerage houses registered under the Broker and Agents Registration Rules, 2001. The directive is effective for elections of directors held after August 31, 2002. Under this directive, the following persons, registered with the SEC, have been declared ineligible to become a director or nominee director of a listed company:

- Broker;
- Brokerage firm;
- Director of an incorporated brokerage house;
- Chief Executive Officer, Chief Financial Officer, Head of Internal Audit, research analyst, trader, agent or nominee of a brokerage firm or an incorporated brokerage house; and
- Anyone holding controlling interest in an incorporated brokerage house.

The restriction has been relaxed in case of a listed company in which any of the above stated have a minimum shareholding of 10% or more, provided that a broker/ brokerage firm or an incorporated brokerage house whose directors or nominee directors are so represented on the Board of Directors of a listed company shall not trade in the securities of such company.

11. What should be the format of declaration to be given by directors?

The SEC has recently introduced a standard format of declaration to be filed by directors of listed companies. The format is laid down in Annexure A. The standard format should be followed while filing declaration, along with consent to act as director, on or after November 15, 2002.

12. Who would sign the 'Statement of Ethics and Business Practices' developed by the Board of Directors of a listed company?

The 'Statement of Ethics and Business Practices' should be signed by all directors and employees of listed companies. Employees, here, include managerial (top, middle and lower management), clerical and secretarial staff. The requirement for signing the Statement of Ethics and Business Practices is not applicable to such employees of a listed company as are involved in support services, like peons, drivers, etc.

13. Does the Board of Directors of a listed company need to specify by a resolution the limits of materiality for the policies to be presented to the Board?

The level of materiality should be determined by a resolution in the Board meeting.

14. Do the matters required to be decided by the Board through a resolution under the Code have to be decided by the Board in a Board meeting as under Section 196 (2) of the Companies Ordinance, 1984?

Only such matters as are considered to be material/ significant to a listed company should be decided by its Board of Directors in a meeting in a manner similar to Section 196 of the Companies Ordinance, 1984.

15. Can a committee of the Board of Directors decide the terms of employment of the CEO and executive directors of a listed company?

A committee of the Board of Directors can only 'recommend' the terms and conditions of employment of the CEO and executive directors to the Board. The appointment, remuneration and terms of employment must, however, be approved by the Board of Directors in a meeting.

16. What information should be circulated among directors of a listed company along with the notice of a Board Meeting?

The agenda of the Board meeting and complete details of agenda items, including working papers, should be circulated among the directors of a listed company along with the notice of the Board meeting. These documents should be circulated at least seven days before the meeting of the Board of Directors.

17. Do the qualifications prescribed for CFO and Company Secretary apply to employees who are already in service of a listed company?

The qualification criteria for CFO and Company Secretary of a listed company are applicable to new appointments only. The relevant clauses do not apply to appointments made prior to the issuance of the Code.

18. Would the terms of employment of existing employees of a listed company, working in the positions of CFO, Company Secretary and Head of Internal Audit, need to be ratified in the manner laid down in clause (xv) of the Code?

The relevant clause of the Code is applicable to new appointments made by a listed company on or after July 1, 2002. The terms and conditions of existing employees need not be ratified in terms of the Code.

19. Can the same person be appointed as CFO and Company Secretary of a listed company?

The terms of reference of the two positions are distinct. It is, therefore, preferred that separate persons handle the functions of CFO and Company Secretary within a listed company. However, due to resource constraints, small listed companies may decide to appoint one person as CFO as well as Company Secretary, provided such person possesses requisite qualifications for both positions. Companies, by virtue of their size, would not be entitled to this relaxation. If the particular circumstances of a company justify this relaxation, it may assign both functions to one person.

20. Can the positions of Company Secretary and Internal Auditor be given to one person within a listed company?

No. The two positions carry minimal synergy and, therefore, should be performed by separate persons.

21. Can a full time employee (including CFO and Company Secretary) of a listed company hold a similar position in a group company?

The Code does not restrict any full time employee in a listed company from working in a similar position in a group company. However, appropriate steps should be taken by the Board of Directors of the companies concerned to ensure that additional workload would not affect the quality of work performed by such employee and no conflict of interest would arise as a result of holding similar positions in two group companies. Separate persons must be appointed if the volume of work is extensive or a conflict of interest exists.

22. Does the directors' report, containing the information specified in clause (xix) of the Code, have to be published along with quarterly accounts?

The clause (xix) of the Code deals with directors' report to be attached to the annual accounts of a listed company. Quarterly accounts should be circulated along with directors' review on the affairs of the company which need not include the information required by clause (xix) of the Code.

23. Should the disclosure in the directors' report regarding the number of Board meetings held during a year include the number of resolutions passed by the Board by circulation?

The number of resolutions passed by the Board of Directors of a listed company through circulation should not be considered in determining the number of Board meetings held during a year for the purpose of the Code.

24. Does the Code require quarterly accounts to be filed by listed companies for each quarter?

The listed companies are required to comply with the earlier circulars of the SEC in determining the period for and the manner in which quarterly accounts should be published. The only requirement imposed by the Code is that these quarterly accounts should be published and circulated along with directors' review on the affairs of the company for the relevant quarter.

25. Who can perform limited scope review of half-yearly accounts of listed companies?

Only statutory auditors appointed to conduct the annual audit of a listed company can carry out a limited scope review of the company's half-yearly accounts.

26. Is there a standard format for Secretarial Compliance Certificate?

The SEC has recently introduced a standard format for Secretarial Compliance Certificate to be filed by Company Secretaries. The format is laid down in Annexure B and should be followed in respect of all accounting periods ending on or after December 31, 2002.

27. What is meant by closed period?

The closed period, referred to in the Code, restricts the directors, CEO and executives of every listed company from dealing in its shares, whether directly or indirectly. The closed period should start from the day when any document/statement, which forms the basis of price sensitive information, is sent to the Board of Directors and terminate after the information is made public. It is expected that such a restriction would help minimize the risk of insider trading by key management/directors of the company.

28. Does regulation 14(1) of the Listing Regulations of the Karachi Stock Exchange apply to closed period?

The clause (xxvi) of the Code does not require closure of share transfer books of listed companies for all shareholders in terms of regulation 14 (1) of the Listing Regulations. While clause (xxvi) seeks to reduce insider trading, regulation 14 (1) provides that listed companies should give sufficient notice of closure of share transfer books to the stock exchanges so that the same can be notified to shareholders in advance.

29. Should the closed period be intimated to directors and stock exchanges?

Every listed company should advise its directors about the closed period at the time of circulating agenda and working papers for Board meetings. Furthermore, the closed period should be intimated to the stock exchanges to enable them to effectively regulate the enforcement of the Code.

30. Who can be members of an Audit Committee?

The Audit Committee should be constituted from amongst the directors of a listed company. The Code requires that the majority of members of the Audit Committee should be from among the non-executive directors of the company. The remaining members should be appointed from amongst the executive directors. The employees of the company (including CFO and Head of Internal Audit) as well as its CEO should not be represented on the Audit Committee.

31. If the existing Board of Directors of a listed company does not have sufficient number of non-executive directors, how can the Audit Committee be constituted in compliance with the Code?

Listed companies which do not have sufficient numbers of non-executive directors on their existing Boards may encounter practical difficulties in appointing majority of members of Audit Committees from among non-executive directors, in accordance with the Code. In this regard, listed companies may request the SEC to relax the relevant requirement of the Code. The SEC may, after considering the specific circumstances of each company, relax the same, subject to such conditions as it may deem necessary. It is expected, however, that new Boards of Directors

would be constituted at the time of next election so as to seek compliance with all the provisions of the Code.

32. The Code requires that an Audit Committee should be constituted within a listed company by July 1, 2002. Should it review accounts for the period ended June 30, 2002?

The audit committees are encouraged but not mandatorily required to review quarterly/annual accounts for the period ended June 30, 2002. However, they should be fully involved in review of all accounts for periods ending after July 1, 2002.

33. Who can be appointed as the secretary of the Audit Committee?

The secretary of the Audit Committee may be appointed from among the employees of the company. However, adequate assurance should be obtained that there would be no conflicts of interest for the person so appointed. On this basis, it is preferred that the Company Secretary be appointed as the secretary of the Audit Committee. In case the positions of Company Secretary and CFO are held by the same person within a company, the secretary of the Audit Committee should be appointed from among the employees of the company who are not involved in the preparation and maintenance of accounts of the company and the audit thereof.

34. Can a director of a listed company be appointed as the Head of Internal Audit of the company?

The internal audit function of a listed company must be independent from the management/directors of a listed company. Therefore, a director cannot be appointed, in any capacity, in the internal audit function.

35. Can the internal audit function be outsourced to a professional firm?

The Code does not restrict outsourcing of internal audit function by a listed company. However, it is essential that suitably qualified and experienced persons, who are conversant with the company's policies and procedures, are engaged in internal audit. In addition, these persons must be involved in the internal audit function on a full time basis so as to achieve the objectives of the Code. While outsourcing the function, the company must not, however, appoint its statutory auditors as internal auditors.

36. Do the provisions of Section 205 of the Companies Ordinance, 1984 apply to internal auditor and members of Audit Committee?

The provisions of Section 205 of the Companies Ordinance, 1984 are applicable to directors and officers of every company. An internal auditor falls within the definition of "officer" provided in Section 2 (24) of the Ordinance. Hence, the particulars of internal auditor should be maintained in the register of directors and officers and also filed with the Registrar in Form 29 under Section 205. In case of members of audit committee, their particulars should be maintained and filed in their capacity as directors of the company while duplication of particulars is not desirable.

37. With regard to rotation of auditors, would the five-year period commence from the issuance of the Code?

The period of engagement of an auditor before the issuance of the Code would be considered in complying with the relevant clause of the Code. Thus, an auditor who has been engaged by a listed company since the last five years or more, as on December 31, 2003, must be changed not later than the AGM immediately following December 31, 2003.

38. Is there a standard format for statement of compliance with best practices that has to be published in annual reports of listed companies?

The SEC has recently introduced a standard format for compliance statement to be published in annual reports of listed companies. The format is laid down in Annexure C and should be followed in respect of accounting periods ending on or after December 31, 2002.

39. Does a statement of compliance have to be issued with annual accounts for the year ended June 30, 2002 since some of the provisions of the Code are applicable from July 1, 2002?

The statement of compliance should be published in annual reports of listed companies for the year ended June 30, 2002. This statement should set out the extent of compliance by a company with the provisions of the Code that became effective before June 30, 2002.

40. How can I resolve my queries pertinent to the Code?

Any queries on the Code should be referred to the Specialized Companies Division of the SEC on the following address:

Director
Specialized Companies Division
Securities and Exchange Commission of Pakistan
NIC Building, 63-Jinnah Avenue
Blue Area Islamabad, Pakistan
Fax: (92 51) 9218590

[Annexure](#)

Annexure A

To be attached with the consent to act as directors/ chief executive under section 184 of the Companies Ordinance, 1984

DECLARATION WITH CONSENT TO ACT AS DIRECTORS

[See clause (ii)]

Name of Company

To

Enforcement and Monitoring Division,
Securities and Exchange Commission of Pakistan

Along with the consent to act as director(s) of^[1], I/ we
..... of do solemnly and sincerely
declare that I/ we are aware of the duties and powers of directors under the Companies
Ordinance, 1984 and^[2], memorandum and articles of association
of^[1] and the listing regulations of^[3] and have
read the relevant provisions contained therein.

Verified that the above is true to the best of my/ our knowledge and belief and that
nothing has been concealed.

Date:
Place:

Signature (s)
(Name (s) in block letters)
NIC number

^[1] Insert name of the company

^[2] Insert name of any other relevant law or strike out if not applicable

^[3] Insert names of the stock exchanges on which shares of the company are listed

Note:- The declaration need not be –

(a) signed before a Magistrate or an officer competent to administer oaths; or

(b) stamped as an affidavit

Annexure B

SECRETARIAL COMPLIANCE CERTIFICATE

[See clause (xxv)]

Name of Company

To

Enforcement and Monitoring Division,
Securities and Exchange Commission of Pakistan

I of being the Secretary of^[1]
..... certify, to the best of my knowledge and belief, that I am qualified to be
appointed as the Company Secretary of a listed company and that the secretarial and corporate
requirements of the Companies Ordinance, 1984, memorandum and articles of association of^[1]
..... and the listing regulations of^[2] have been duly
complied with for the year ended * and that nothing has been concealed
or withheld in this regard.

Date:

Place:

Signature (s)
(Name (s) in block letters)
NIC number

* State exceptions in case of non-compliance.

^[1] Insert name of the company

^[2] Insert names of the stock exchanges on which shares of the company are listed

Note:- The declaration need not be –

(c) signed before a Magistrate or an officer competent to administer oaths; or

(d) stamped as an affidavit

**STATEMENT OF COMPLIANCE WITH THE
CODE OF CORPORATE GOVERNANCE**

[See clause (xlv)]

Name of Company

Year Ended.....

This statement is being presented to comply with the Code of Corporate Governance contained in Regulation No. of listing regulations of for the purpose of establishing a framework of good governance, whereby a listed company is managed in compliance with the best practices of corporate governance.

The Company has applied the principles contained in the Code in the following manner:

1. The Company encourages representation of independent non-executive directors and directors representing minority interests on its Board of Directors. At present the Board includes at least independent non-executive directors and directors representing minority shareholders.
2. The directors have confirmed that none of them is serving as a director in more than ten listed companies, including this Company.
3. All the resident directors of the Company are registered as taxpayers and none of them has defaulted in payment of any loan to a banking company, a DFI or an NBFII or, being a member of a stock exchange, has been declared as a defaulter by that stock exchange.
4. A casual vacancy occurring in the Board on was filled up by the directors within days thereof.
5. The Company has prepared a 'Statement of Ethics and Business Practices', which has been signed by all the directors and employees of the Company.
6. The Board has developed a vision/mission statement, overall corporate strategy and significant policies of the Company. A complete record of particulars of significant policies along with the dates on which they were approved or amended has been maintained.
7. All the powers of the Board have been duly exercised and decisions on material transactions, including appointment and determination of remuneration and terms and conditions of employment of the CEO and other executive directors, have been taken by the Board.
8. The meetings of the Board were presided over by the Chairman and, in his absence, by a director elected by the Board for this purpose and the Board met at least once in every quarter. Written notices of the Board meetings, along with agenda and working papers, were circulated at least seven days before the meetings. The minutes of the meetings were appropriately recorded and circulated.

9. The Board arranged orientation courses for its directors during the year to apprise them of their duties and responsibilities.

10. The Board has approved^[1] appointment of CFO, Company Secretary and Head of Internal Audit, including their remuneration and terms and conditions of employment, as determined by the CEO.

11. The directors' report for this year has been prepared in compliance with the requirements of the Code and fully describes the salient matters required to be disclosed.

12. The financial statements of the Company were duly endorsed by CEO and CFO before approval of the Board.

13. The directors, CEO and executives do not hold any interest in the shares of the Company other than that disclosed in the pattern of shareholding.

14. The Company has complied with all the corporate and financial reporting requirements of the Code.

15. The Board has formed an audit committee. It comprises members, of whom are non-executive directors including the chairman of the committee.

16. The meetings of the audit committee were held at least once every quarter prior to approval of interim and final results of the Company and as required by the Code. The terms of reference of the committee have been formed and advised to the committee for compliance.

17. The Board has set-up an effective internal audit function/ or has outsourced the internal audit function to who are considered suitably qualified and experienced for the purpose and are conversant with the policies and procedures of the Company and they (or their representatives) are involved in the internal audit function on a full time basis.

18. The statutory auditors of the Company have confirmed that they have been given a satisfactory rating under the quality control review programme of the Institute of Chartered Accountants of Pakistan, that they or any of the partners of the firm, their spouses and minor children do not hold shares of the Company and that the firm and all its partners are in compliance with International Federation of Accountants (IFAC) guidelines on code of ethics as adopted by Institute of Chartered Accountants of Pakistan.

19. The statutory auditors or the persons associated with them have not been appointed to provide other services except in accordance with the listing regulations and the auditors have confirmed that they have observed IFAC guidelines in this regard.

20. We confirm that all other material principles contained in the Code have been complied with^[1] except for the following, towards which reasonable progress is being made by the Company to seek compliance by the end of next accounting year.

Signature (s)
(Name (s) in block letters)
Chairman / CEO

Note: Any exception to the above should be adequately noted with reasons.

[\[1\]](#) in case of new appointments made after the application of the Code of Corporate Governance

[\[1\]](#) Delete if not applicable