Salient Features of Draft Changes in Code of Corporate Governance

MOORE STEPHENS

Shekha & Mufti
Chartered Accountants

INTRODUCTION

The Securities and Exchange Commission of Pakistan (SECP) has released a draft Listed Companies (Code of Corporate Governance) Regulations 2017 through SRO 880(I) 2017 dated August 31, 2017. When finalized and implemented this may be termed as third edition of the Code, which was first implemented in the year 2002. A major round of amendments followed in the year 2012.

This document contains salient features of the changes proposed in the code of corporate governance for listed companies.

The document can also be accessed on our website www.shekhamufti.com

1. BOARD OF DIRECTORS

A. Composition

i) Limit on directorship; number reduced

The limit on holding directorship in listed companies, excluding the directorships in their listed subsidiaries, has been reduced from the existing seven to five. .

ii) Independent director; now more than one

The existing code mandates at least one director to be independent and prefers that one third of the board comprise of independents. In the draft code, independent directors' representation on the Board has been increased to include at least two independent directors or one third of the total Board members whichever is higher. This requirement shall be effective on reconstitution of the board upon expiry of its term.

Under the proposed regulations every independent director is required to give a Declaration of Independence to the Chairman of the Board, annually, in the first meeting of the Board and in the event of any change affecting his independence.

The criteria of independence is provided under section 166(2) of the Companies Act, 2017.

iii) Gender Diversity to be ensured

While the existing code encourages gender diversity in the Board, representation of at least one (1) female director on the Board is made mandatory under the draft regulations. The compliance is to be ensured within one year, from effective date of the regulations or reconstitution of the board whichever is later. The said mandatory requirement come in vide section 154(1) of the Companies Act, 2017.

B. Conflict of Interest

Presence of at least two independent directors shall be mandatory in meetings, where an agenda item, involving conflict of interest on a director, is under consideration. This provision has an overriding effect on the articles of association of the Company.

C. Responsibilities

i) Business Risk Review

Besides overall responsibility for governance of risk, the Board shall be responsible to undertake at least annually, an overall review of business risks faced by the Company. .

ii) Prevention of Conflict through Code of Conduct

It is already the Board's responsibility to put in place a formal Code of Conduct. The proposed regulation has stressed on promotion of ethical culture and prevention of conflict of interest at all levels i.e. board members, senior management and other employees.

iii) Evaluation of Board Committees

The mechanism for annual evaluation that was required for the Boards' own performance is also proposed to be put in place for the evaluation of committees.

iv) *Whistleblowing Mechanism*

A whistle blowing policy is to be introduced and mechanism to be established thereunder, to receive and handle complaints, while providing protection to the complainant against victimization.

A draft Whistleblowing Regulations 2017, issued under the Securities and Exchange Commission of Pakistan Act, 1997, are also awaiting approval of the Commission. These regulations, once approved, shall be applicable on listed companies as well.

D. Chairman's Responsibility

The Chairman of the Board has been made responsible to issue letters to the appointed directors, at the beginning of term of each director, setting out his role, responsibilities, obligations, powers, remuneration and entitlements.

E. Placement of Issues for Board Decision

The Chief Executive Officer (CEO) has now been made explicitly responsible to place before the Board all significant issues. Following items have been added in the list of significant issues:

- Quarterly details of foreign exchange exposures and the safeguards taken by management against material adverse exchange rate movement;
- Sale of assets, investments and interest in subsidiaries and undertakings, of material amount or significant nature, which is not in the ordinary course of business;
- Report on corporate social responsibility activities and status of adoption / compliance of corporate social responsibility (Voluntary) Guidelines 2013.

F. Training Program

The existing Code requires that after June 30, 2018, any newly appointed director on the board shall acquire the certification within a period of six months from the date of his/her appointment. While retaining the period of six months, proposed regulation has withdrawn the relaxation provided till June 30, 2018 as aforesaid.

Besides the above, the proposed code requires completion of director training program by 50% and 75% of total members of the Board till June 30, 2018 and 2019 respectively. All directors are required to be certified by June 30, 2020.

The provision of experience based exemption, as available under existing Code, has been retained.

G. Committees

i) Audit Committee

- The regulations provide that the Board of Directors shall ensure that at least one member of the audit committee qualifies as "financially literate".

  The said expression has been defined in the regulations which means *"a person who is a member of a recognized body of professional accountants or has a post graduate degree in finance from a university or equivalent institution, either in Pakistan or abroad recognized by the Higher Education Commission".*
- Chief Executive Officer (CEO) and Chief Financial Officer (CFO) shall not attend any meeting of audit committee except by invitation only.
- The regulations require the Board of Directors to provide resources and authority to enable the audit committee to carry out its responsibilities effectively.

  Mechanism has to be in place where staff and management can report to audit committee, in confidence, of any actual or potential improprieties. This is besides having a whistle blowing mechanism.

ii) Human Resource and Remuneration Committee

- Composition of the Committee has been changed to have at least one independent director. Further it requires that the Chairman of the Committee shall be an independent director.

- The regulations want this committee to meet at least in a financial year; once in every six months. The secretary can be Head of Human Resource or any other person, to be appointed by the Board.

- The draft regulations include the following new items in the terms of reference of the committee:

  - Recommend to the Board a policy framework on remuneration for executive and non-executive directors and members of senior management. Senior management is said to include first layer of management below CEO.
  - Lead the process for Board appointments by identifying and assessing candidates for election.
  - Undertake the process of annual evaluation of performance of the Board and its committees. The Committee can appoint independent consultant for the purpose.

iii) Nomination Committee

The Board of directors may constitute this committee for considering and making recommendations to the Board in respect of appointments to the Board, Committees of the Board and the Chairmanship of the Committees.

In case of formation of this Committee, Terms of Reference (TORs) of Human Resource and Remuneration Committee (HR&RC) concerning recommendations for appointments to the Board shall be deemed to be excluded from TORs of HR&RC.

iv) Risk Management Committee

The Board may constitute the risk management committee to carry out a review of effectiveness of risk management procedures and present a report to the Board. The terms of reference have been defined in the regulations.

H. Director' Remuneration

Mandatory requirement is being introduced to put in place a formal policy and transparent procedure for fixing the remuneration packages of individual directors for attending meetings of the Board and its committees.

The regulations provide an option to engage an independent consultant to recommend an appropriate level of remuneration for consideration of the board in case the Articles of Association of the Company authorizes the board to determine directors' remuneration.

The Directors, in their report to the members, shall state the 'remuneration policy' of non-executive directors including independent directors. This includes disclosing the significant features and elements thereof.

2. DIRECOTRS' REPORT

Besides contents of the report governed by section 227 of the Companies Act, 2017, draft regulations require the Directors' Report to contain following information:

- Statement to the fact and disclosure of name, qualification and major terms of appointment where HR&R Committee appoints an independent consultant for the performance evaluation process of the Board.
- Disclosure, to an appropriate extent, of the company's risk framework and internal control system.
- Directors' review on the affairs of company in accordance with requirements of section 227 of the Companies Act, 2017 is to be circulated with the quarterly unaudited financial statements.
- Significant features and elements of directors' remuneration policy.

3. QUALIFICATION OF CFO

The requirement of experience to become a CFO of a listed company is proposed to be changed from three (3) years to five (5) years. Further, the regulations propose the said experience of five (5) years to be managerial experience in field of audit or accounting or in managing financial or corporate affairs function of a company. The term 'managerial experience' is not defined in the regulations.

4. INTERNAL AUDIT

Performance appraisal of the Chief Internal Auditor is required to be done jointly by the Chairman of the audit committee and the CEO. The existing Code does not provide requirement of performance appraisal.

Removal of Head of Internal Audit has been proposed to be effected on the recommendation of Audit Committee as against the existing requirement of recommendation coming from Chairman of the Audit Committee.

5. EXTERNAL AUDIT

Besides other disqualifications under existing code, now a person being close relative of Company Secretary is also ineligible to be appointed as external auditor of the listed company.

6. SECRETARIAL COMPLIANCE CERTIFICATE

The draft regulations has no provision regarding secretarial compliance certificate as it is required under the existing code.

7. PENALTY

In case of non-compliance with any provisions of the regulations there is a one-time maximum penalty of Rs. 5 million (five million rupees) and a per day penalty of Rs. 100,000 (hundred thousand rupees) in case of continuing default. The amounts of penalty are coming from section 512(2) of the Companies Act, 2017.

Contact Us

PRINCIPAL OFFICE

C-253, P.E.C.H.S., Block 6,
Off Shahrah-e-Faisal,
Karachi, Pakistan.

P: + 92 21 34374811-15
F: + 92 21 34544766

Jawwad.Shekha@shekhamufti.com

Nusrat.latif@shekhamufti.com

info@shekhamufti.com

BRANCH OFFICE

Office No.4, 3rd Floor,
Rehman Plaza,
Queens Road,
Off: The Mall,
Lahore – Pakistan.

P: + 92 42 36298231-33
F: + 92 21 36298234

info.lhr@shekhamufti.com

www.shekhamufti.com