

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
NIC Building, Jinnah Avenue, Blue Area, Islamabad

No. 2(10)SE/SMD/2002

March 4, 2002

1. The Managing Director
Karachi Stock Exchange (Guarantee) Limited
Karachi.

2. The Managing Director
Lahore Stock Exchange (Guarantee) Limited
Lahore.

3. The Secretary
Islamabad Stock Exchange (Guarantee) Limited
Islamabad.

Subject: Code of Corporate Governance

Dear Sirs,

For establishing a framework of good corporate governance whereby a company is managed in compliance with best practices, the Securities and Exchange Commission of Pakistan considers it expedient and, in exercise of the powers conferred by sub-section (4) of section 34 of the Securities and Exchange Ordinance, 1969 (XVII of 1969), is hereby pleased to direct all stock exchanges to insert the following clauses appropriately in their respective listing regulations within 30 days of issuance of this direction, namely:-

BOARD OF DIRECTORS

- (i) All listed companies shall encourage effective representation of independent non-executive directors, including those representing minority interests, on their Boards of Directors so that the Board as a group includes core competencies considered relevant in the context of each company.

All listed companies shall take necessary steps such that:

- (a) minority shareholders as a class are facilitated to contest election of directors by proxy solicitation, for which purpose the listed companies shall:
- annex to the notice of general meeting at which directors are to be elected, a statement by a candidate from among the minority shareholders who seeks to contest election to the Board of Directors, which statement may include a profile of the candidate;
 - provide information regarding shareholding structure and copies of register of members to the candidate representing minority shareholders; and
 - on a request by the candidate representing minority shareholders and at the cost of the company, annex to the notice of general meeting at which directors are to be elected, an additional copy of proxy form duly filled in by such candidate(s);
- (b) the Board of Directors of each company includes at least one independent director representing institutional equity interest in a banking company, Development Financial Institution, Non-Banking Financial Institution (including a modaraba, leasing company or investment bank), mutual fund or insurance company; and

[Explanation: For the purpose of this clause, the expression "independent director" means a director who is not connected with the company or its promoters or directors on the basis of family relationship and who does not have any other relationship, whether pecuniary or otherwise, with the company, its associated companies, directors, executives or related parties. The test of independence principally emanates from the fact whether such person can be reasonably perceived as being able to exercise independent business judgment without being subservient to any apparent form of interference.

Any person nominated as a director under sections 182 and 183 of the Companies Ordinance, 1984 shall not be taken to be an "independent director" for the above-said purposes.

The independent director representing an institutional investor shall be selected by such investor through a resolution of its Board of Directors and the policy with regard to selection of such person for election on the Board of Directors of the investee company shall be disclosed in the Directors' Report of the investor company.]

- (c) executive directors, i.e. working or whole time directors, are not more than 75% of the elected directors including the Chief Executive:

Provided that in special circumstances, this condition may be relaxed by the Securities and Exchange Commission of Pakistan.

Provided further that nothing contained in this clause shall apply to banking companies, which are required by Prudential Regulation No.9 for Banks to have not more than 25% of the directors as paid executives of the banks.

- (ii) The directors of listed companies shall, at the time of filing their consent to act as such, give a declaration in such consent that they are aware of their duties and powers under the relevant law(s) and the companies' Memorandum and Articles of Association and the listing regulations of stock exchanges in Pakistan.

QUALIFICATION AND ELIGIBILITY TO ACT AS A DIRECTOR

- (iii) No listed company shall have as a director, a person who is serving as a director of ten other listed companies.
- (iv) No person shall be elected or nominated as a director of a listed company if:
 - (a) his name is not borne on the register of National Tax Payers and who, except in the case of a person who was a non-resident for the period, was not an income tax assessee at any time during the three years immediately preceding the year in which the election or nomination took place:

Provided that this condition shall not apply to a person who is 60 years of age or more at the time of election or nomination as a director;

- (b) he has been convicted by a court of competent jurisdiction as a defaulter in payment of any loan to a banking company, a Development Financial Institution or a Non-Banking Financial Institution; and
- (c) he or his spouse is a member of a Stock Exchange and/or is engaged in the business of brokerage (unless specifically exempted by the Securities and Exchange Commission of Pakistan).

TENURE OF OFFICE OF DIRECTORS

- (v) The tenure of office of Directors shall be three years. Any casual vacancy in the Board of Directors of a listed company shall be filled up by the directors within 30 days thereof.

RESPONSIBILITIES, POWERS AND FUNCTIONS OF BOARD OF DIRECTORS

- (vi) The directors of listed companies shall exercise their powers and carry out their fiduciary duties with a sense of objective judgement and independence in the best interests of the company.
- (vii) Every listed company shall ensure that:
 - (a) a 'Statement of Ethics and Business Practices' is prepared and circulated annually by its Board of Directors to establish a standard of conduct for directors and employees;
 - (b) the Board of Directors adopt a vision/ mission statement and overall corporate strategy for the company and also formulate significant policies, having regard to the level of materiality, as may be determined it;

Explanation:

Significant policies for this purpose may include:

- risk management;
- human resource management including preparation of a succession plan;
- procurement of goods and services;
- marketing;
- determination of terms of credit and discount to customers;
- write-off of bad/ doubtful debts, advances and receivables;
- acquisition/ disposal of fixed assets;
- investments;
- borrowing of moneys and the amount in excess of which borrowings shall be sanctioned/ ratified by a general meeting of shareholders;
- donations, charities, contributions and other payments of a similar nature;
- determination and delegation of financial powers;
- transactions or contracts with associated companies and related parties; and
- health, safety and environment

A complete record of particulars of the above-mentioned policies along with the dates on which they were approved or amended by the Board of Directors shall be maintained.

The Board of Directors shall define the level of materiality, keeping in view the specific circumstances of the company and the recommendations of any technical or executive sub-committee of the Board that may be set up for the purpose;

- (c) the Board of Directors establish a system of sound internal control, which is effectively implemented at all levels within the company;
- (d) the following powers are exercised by the Board of Directors on behalf of the company and decisions on material transactions or significant matters are documented by a resolution passed at a meeting of the Board:

- investment and disinvestment of funds where the maturity period of such investments is six months or more, except in the case of banking companies, trusts, mutual funds and insurance companies;
 - determination of the nature of loans and advances made by the company and fixing a monetary limit thereof;
 - write-off of bad debts, advances and receivables and determination of a reasonable provision for doubtful debts;
 - write-off of inventories and other assets; and
 - determination of the terms of and the circumstances in which a law suit may be compromised and a claim/ right in favour of the company may be waived, released, extinguished or relinquished;
- (e) appointment, remuneration and terms and conditions of employment of the Chief Executive Officer (CEO) and other executive directors of the company are determined and approved by the Board of Directors; and
- (f) in the case of a mutual fund or a modaraba, whose main business is investment in listed securities, the Board of Directors approve and adopt an investment policy, which is stated in each annual report of the mutual fund/ modaraba.

Explanation:

The investment policy shall inter alia state:

- that the mutual fund/ modaraba shall not invest in a connected person, as defined in the Asset Management Companies Rules, 1995, and shall provide a list of all such connected persons;
- that the mutual fund/ modaraba shall not invest in shares of unlisted companies; and
- the criteria for investment in listed securities.

The Net Asset Value of each mutual fund/ modaraba shall be provided for publication on a monthly basis to the stock exchange on which its shares/ certificates are listed

- (vii) The Chairman of a listed company shall preferably be elected from among the non-executive directors of the company. The Board of Directors shall clearly define the respective roles and responsibilities of the Chairman and Chief Executive, whether or not these offices are held by separate individuals or the same individual.

MEETINGS OF THE BOARD

- (viii) The Chairman of a listed company shall preside over meetings of the Board of Directors.
- (ix) The Boards of Directors of listed companies shall meet at least once in every quarter of the financial year. Written notices (including agenda) of meetings shall be circulated not less than seven days before the meetings, except in the case of emergency meetings, where the notice period may be reduced or waived.
- (x) The Chairman of a listed company shall ensure that minutes of meetings of the Board of Directors are appropriately recorded. The minutes of meetings shall be circulated to directors and officers entitled to attend Board meetings not later than 30 days thereof, unless a shorter period is provided in the company's Articles of Association.

In the event that a director of a listed company is of the view that his dissenting note has not been satisfactorily recorded in the minutes of a meeting of the Board of Directors, he may refer the matter to the Company Secretary. The director may require the note to be appended to the minutes, failing which he may file an objection with the Securities and Exchange Commission of Pakistan in the form of a statement to that effect.

KEY INFORMATION TO BE PLACED FOR DECISION BY BOARD OF DIRECTORS

- (xi) In order to strengthen and formalize corporate decision-making process, significant issues shall be placed for the information, consideration and decision of the Boards of Directors of listed companies.

Key information for this purpose may include:

- annual business plans, cash flow projections, forecasts and long term plans;
- budgets including capital, manpower and overhead budgets, along with variance analyses;
- quarterly operating results of the company as a whole and in terms of its operating divisions or business segments;
- internal audit reports, including cases of fraud or irregularities of a material nature;
- management letter issued by the external auditors;
- details of joint venture or collaboration agreements or agreements with distributors, agents, etc;
- promulgation or amendment of a law, rule or regulation, enforcement of an accounting standard and such other matters as may affect the company;
- status and implications of any law suit or proceedings of material nature, filed by or against the company;
- any show cause, demand or prosecution notice received from revenue or regulatory authorities, which may be material;
- default in payment of principal and/or interest, including penalties on late payments and other dues, to a creditor, bank or financial institution or default in payment of public deposit;
- failure to recover material amounts of loans, advances, and deposits made by the company, including trade debts and inter-corporate finances;
- any accidents, dangerous occurrences and instances of pollution and environmental problems involving the company;
- significant public or product liability claims likely to be made against the company, including any adverse judgement or order made on the conduct of the company or of another company that may bear negatively on the company;
- disputes with labour and their proposed solutions, any agreement with the labour union or Collective Bargaining Agent and any charter of demands on the company; and
- payment for goodwill, brand equity or intellectual property.

- (xii) All listed companies shall make appropriate arrangements to carry out orientation courses for their directors to acquaint them with their duties and responsibilities and enable them to manage the affairs of the companies on behalf of shareholders.

CHIEF FINANCIAL OFFICER (CFO) AND COMPANY SECRETARY

APPOINTMENT AND APPROVAL

- (xiii) The appointment, remuneration and terms and conditions of employment of the Chief Financial Officer (CFO), the Company Secretary and the head of internal audit of listed companies shall be determined by the CEO with the approval of the Board of Directors.

The CFO or the Company Secretary of listed companies shall not be removed except by the CEO with the approval of the Board of Directors.

QUALIFICATION OF CFO AND COMPANY SECRETARY

- (xiv) No person shall be appointed as the CFO of a listed company unless:
- (a) he is a member of a recognized body of professional accountants; or
 - (b) he is a graduate from a recognized university, having at least five years experience in handling financial or corporate affairs of a listed public company or a bank or a financial institution.
- (xv) No person shall be appointed as the Company Secretary of a listed company unless he is:
- (a) a member of a recognized body of professional accountants; or
 - (b) a member of a recognized body of corporate/ chartered secretaries; or
 - (c) a lawyer; or

- (d) a graduate from a recognized university having at least five years experience of handling corporate affairs of a public company or corporation.

REQUIREMENT TO ATTEND BOARD MEETINGS

- (xvi) The CFO and the Company Secretary of a listed company shall attend meetings of the Board of Directors.

Provided that unless elected as a director, the CFO or the Company Secretary shall not be deemed to be a director or entitled to cast a vote at meetings of the Board of Directors for the purpose of this clause. Provided further that the CFO or the Company Secretary shall not attend such part of a meeting of the Board of Directors, which involves consideration of an agenda item relating to the CFO/ Company Secretary.

CORPORATE AND FINANCIAL REPORTING FRAMEWORK

THE DIRECTORS' REPORT TO SHAREHOLDERS

- (xvi) The directors of listed companies shall include statements to the following effect in the Directors' Report, prepared under section 236 of the Companies Ordinance, 1984:

- (a) The financial statements, prepared by the management of the company, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- (b) Proper books of account of the company have been maintained.
- (c) Appropriate accounting policies have been consistently applied in preparation of financial statements and accounting estimates are based on reasonable and prudent judgment.

- (d) International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and any departure therefrom has been adequately disclosed.
- (e) The system of internal control is sound in design and has been effectively implemented and monitored.
- (f) There are no significant doubts upon the company's ability to continue as a going concern.
- (g) There has been no material departure from the best practices of corporate governance, as detailed in the listing regulations.

The Directors' Reports of listed companies shall also include the following, where necessary:

- (a) If the company is not considered to be a going concern, the fact along with reasons shall be disclosed.
- (b) Significant deviations in operating results of the company shall be highlighted and reasons thereof shall be explained.
- (c) Key operating and financial data of last six years shall be summarised.
- (d) If the company has not declared dividend or issued bonus shares for any year, the reasons thereof shall be given.
- (e) Where any statutory payment on account of taxes, duties, levies and charges is outstanding, the amount together with a brief description and reasons for the same shall be disclosed.

- (f) Significant plans and decisions, such as corporate restructuring, business expansion and discontinuance of operations, shall be outlined along with future prospects, risks and uncertainties surrounding the company.
- (g) A statement as to the value of investments of provident, gratuity and pension funds, based on their respective audited accounts, shall be included.
- (h) The number of Board meetings held during the year and attendance by each director shall be disclosed.
- (i) The pattern of shareholding shall be reported to disclose the aggregate number of shares (along with name wise details where stated below) held by:
- associated companies, undertakings and related parties (name wise details);
 - NIT and ICP (name wise details);
 - directors, CEO and their spouse and minor children (name wise details);
 - executives;
 - public sector companies and corporations;
 - banks, Development Finance Institutions, Non-Banking Finance Institutions, insurance companies, modarabas and mutual funds; and
 - shareholders holding ten percent or more voting interest in the company (name wise details).

Explanation: For the purpose of this clause, clause (b) of direction (i) and direction (xxiii), the expression “executive” means an employee of a listed company other than the CEO and directors whose basic salary exceeds five hundred thousand rupees in a financial year.

- (j) The pattern of trading in the shares of the company by its directors, CEO and their spouses and minor children shall also be disclosed.

FREQUENCY OF FINANCIAL REPORTING

- (xvii) The quarterly unaudited financial statements of listed companies shall be published and circulated along with directors' review on the affairs of the company for the quarter.
- (xviii) All listed companies shall ensure that half-yearly financial statements are subjected to a limited scope review by the statutory auditors in such manner and according to such terms and conditions as may be determined by the Institute of Chartered Accountants of Pakistan and approved by the Securities and Exchange Commission of Pakistan.
- (xix) All listed companies shall ensure that the annual audited financial statements are circulated not later than four months from the close of the financial year.
- (xx) Every listed company shall immediately disseminate to the Securities and Exchange Commission of Pakistan, the stock exchange on which its shares are listed and the shareholders all material information relating to the business and other affairs of the company that will affect the market price of its shares.

This information may include but shall not be restricted to information regarding a joint venture, merger or acquisition or loss of any material contract; purchase or sale of significant assets; any unforeseen or undisclosed impairment of assets due to technological obsolescence, etc.; delay/ loss of production due to strike, fire, natural calamities, major breakdown, etc.; issue or redemption of any securities; a major change in borrowings including any default in repayment or rescheduling of loans; and change in management, Chairman or CEO of the company.

RESPONSIBILITY FOR FINANCIAL REPORTING AND CORPORATE COMPLIANCE

- (xxi) No listed company shall circulate its financial statements unless the CEO and the CFO present the financial statements, duly endorsed under their respective signatures, for consideration and approval of the Board of Directors and the Board, after consideration and approval, authorize the signing of financial statements for issuance and circulation.

- (xxii) The Company Secretary of a listed company shall furnish a Secretarial Compliance Certificate, in the prescribed form, as part of the annual return filed with the Registrar of Companies to certify that the secretarial and corporate requirements of the Companies Ordinance, 1984 have been duly complied with.

DISCLOSURE OF INTEREST BY A DIRECTOR HOLDING COMPANY'S SHARES

- (xxiii) Where any director, CEO or executive of a listed company or their spouses sell, buy or take any position, whether directly or indirectly, in shares of the company of which he is a director, CEO or executive, as the case may be, he shall immediately notify in writing the Company Secretary of his intentions and deliver a written record of the price, number of shares and nature of transaction to the Company Secretary within four days of effecting the transaction. The notice of the director, CEO or executive, as the case may be, shall be presented by the Company Secretary at the meeting of the Board of Directors immediately subsequent to such transaction. In the event of default by a director, CEO or executive to give a written notice or deliver a written record, the Company Secretary shall place the matter before the Board of Directors in its immediate next meeting:

Provided that each listed company shall determine a closed period prior to the announcement of interim/ final results and any business decision, which may materially affect the market price of its shares. No director, CEO or executive shall, directly or indirectly, deal in the shares of the company in any manner during the closed period.

AUDITORS NOT TO HOLD SHARES

- (xxiv) All listed companies shall ensure that their external auditors or any partner in the firm of external auditors and his spouse and minor children do not at any time hold, purchase, sell or take any position in shares of the company or any of its associated companies or undertakings:

Provided that where a firm or a partner or his spouse or minor child owns shares in a listed company, being the audit client, prior to the appointment as auditors, such listed

company shall take measures to ensure that the auditors disclose the interest to the company within 14 days of appointment and divest themselves of such interest not later than 90 days thereof.

CORPORATE OWNERSHIP STRUCTURE

(xxv) Every company which is listed or proposed to be listed shall, at the time of issue of share capital, offer not less than 20% of the issued capital to the general public, unless the limit is relaxed by the stock exchange, and shall ensure that the issue is underwritten. In case 50% shares offered to the general public remain unsubscribed by the due date, such shares shall be taken up by the underwriters.

DIVESTURE OF SHARES BY SPONSORS/CONTROLLING INTEREST

(i) In the event of divestiture of not less than 75% of the total shareholding of a listed company, other than a divestiture by non-resident shareholder(s) in favour of other non-resident shareholder(s) or a disinvestment through the process of privatization by the Federal or Provincial Government, at a price higher than the market value ruling at the time of divestiture, it shall be desirable and expected of the directors of the company to allow the transfer of shares after it has been ascertained that an offer in writing has been made to the minority shareholders for acquisition of their shares at the same price at which the divestiture of majority shares was contemplated. Where the offer price to minority shareholders is lower than the price offered for acquisition of controlling interest, such offer price shall be subject to the approval of the Securities and Exchange Commission of Pakistan.

AUDIT COMMITTEE

COMPOSITION

(xxvii) The Board of Directors of every listed company shall establish an Audit Committee, which shall comprise not less than three members, including the chairman. Majority of

the members of the Committee shall be from among the non-executive directors of the company and the chairman of the Audit Committee shall preferably be a non-executive director. The names of members of the Audit Committee shall be disclosed in each annual report of the company.

FREQUENCY OF MEETINGS

(xxviii) The Audit Committee of a listed company shall meet at least once every quarter of the financial year. These meetings shall be held prior to the approval of interim results of the company by its Board of Directors and before and after completion of external audit. A meeting of the Audit Committee shall also be held, if requested by the external auditors or the head of internal audit.

ATTENDANCE AT MEETINGS

(xxix) The CFO, the head of internal audit and a representative of the external auditors shall attend meetings of the Audit Committee at which issues relating to accounts and audit are discussed. Directors of the company shall also have a right of attendance at the meetings of the Audit Committee:

Provided that at least once a year, the Audit Committee shall meet the external auditors without the CFO, the head of internal audit or other directors being present.

Provided further that at least once a year, the Audit Committee shall meet the head of internal audit and other members of the internal audit function without the CFO, the external auditors or other directors being present.

TERMS OF REFERENCE

(xxx) The Board of Directors of every listed company shall determine the terms of reference of the Audit Committee. The Audit Committee shall, among other things, be responsible for recommending to the Board of Directors the appointment of external auditors by the company's shareholders and shall consider any questions of resignation or removal of external auditors, audit fees and provision by external auditors of any service to the

company in addition to audit of its financial statements. In the absence of strong grounds to proceed otherwise, the Board of Directors shall act in accordance with the recommendations of the Audit Committee in all these matters.

The terms of reference of the Audit Committee shall also include the following:

- (a) determination of appropriate measures to safeguard the company's assets;
- (b) review of quarterly, half-yearly and annual financial statements of the company, focusing on:
 - major judgmental areas;
 - significant adjustments resulting from the audit;
 - the going-concern assumption;
 - any changes in accounting policies and practices;
 - compliance with applicable accounting standards; and
 - compliance with listing regulations and other statutory and regulatory requirements.
- (c) facilitating the external audit and discussion with external auditors of major observations arising from interim and final audits and any matter that the auditors may wish to highlight (in the absence of management, where necessary);
- (d) review of management letter issued by external auditors and management's response thereto;
- (e) ensuring coordination between the internal and external auditors of the company;
- (f) review of internal audit programme and ensuring that the internal audit function has adequate resources and is appropriately placed within the company;
- (g) consideration of major findings of internal investigations and management's response thereto;

- (h) ascertaining that the internal control system including financial and operational controls, accounting system and reporting structure are adequate and effective;
- (i) review of the company's statement on internal control systems prior to endorsement by the Board of Directors;
- (j) determination of compliance with relevant statutory requirements;
- (k) monitoring compliance with the best practices of corporate governance and identification of significant violations thereof; and
- (l) consideration of any other issue or matter as may be assigned by the Board of Directors.

REPORTING PROCEDURE

(xxxix) The Audit Committee of a listed company shall appoint a secretary of the Committee. The secretary shall circulate minutes of meetings of the Audit Committee to all members, directors and the CFO within a fortnight.

INTERNAL AUDIT

(xxxix) There shall be an internal audit function in every listed company. The head of internal audit shall have access to the chair of the Audit Committee.

(xxxix) All listed companies shall ensure that internal audit reports are provided for the review of external auditors. The auditors shall discuss any major findings in relation to the reports with the Audit Committee, which shall report matters of significance to the Board of Directors.

EXTERNAL AUDITORS

(xxxix) No listed company shall appoint as external auditors a firm of auditors which has not been given a satisfactory rating under the Quality Control Review programme of the Institute of Chartered Accountants of Pakistan.

- (xxxv) No listed company shall appoint as external auditors a firm of auditors which firm or a partner of which firm is or appears to be non-compliant with the International Federation of Accountants' (IFAC) Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan.
- (xxxvi) The Board of Directors of a listed company shall recommend appointment of external auditors for a year, as suggested by the Audit Committee. The recommendations of the Audit Committee for appointment of retiring auditors or otherwise shall be included in the Directors' Report. In case of a recommendation for change of external auditors before the elapse of three consecutive financial years, the reasons for the same shall be included in the Directors' Report.
- (xxxvii) No listed company shall appoint its auditors to provide services in addition to audit except in accordance with the regulations and shall require the auditors to observe applicable IFAC guidelines in this regard and shall ensure that the auditors do not perform management functions or make management decisions, responsibility for which remains with the Board of Directors and management of the company.
- (xxxviii) All listed companies are required to change their external auditors every three years. If for any reason this is impractical, a listed company may at a minimum, rotate the partner in charge of its audit engagement after obtaining the consent of the Securities and Exchange Commission of Pakistan.
- (xxxix) No listed company shall appoint a person as the CEO, the CFO, an internal auditor or a director of the company who was a partner of the firm of its external auditors (or an employee involved in the audit of the company) at any time during the two years preceding such appointment or is a close relative, i.e. spouse, parents, dependents and non-dependent children, of such partner (or employee).
- (xl) Every listed company shall require external auditors to furnish a Management Letter to its Board of Directors not later than 30 days from the date of audit report.

- (xli) Every listed company shall require a partner of the firm of its external auditors to attend the Annual General Meeting at which audited accounts are placed for consideration and approval of shareholders.
- (xlii) All listed companies shall publish and circulate a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance set out above.
- (xliii) All listed companies shall ensure that the statement of compliance with the best practices of corporate governance is reviewed by auditors, where such compliance can be objectively verified, before publication by companies.

Yours truly,

(Shahid Ghaffar)
Commissioner (SM)