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Corporate Governance Codes in Pakistan: A Review

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Abstract

This article examines the current corporate governance laws and rules in Pakistan. Strong corporate governance is crucial for market stability and investor confidence in any nation, developed or underdeveloped. In Pakistan, a Corporate Governance Code was first established in 2002. Later updates occurred in 2012, 2017 and finally in 2019. Although corporate governance practices and concepts are well established across most of the world, Pakistan's corporate governance literature is still limited, and the current rule, as it was enacted in September 2019, hasn't received any commentary or analysis. This research aims to bridge this gap by revealing the evolution of Pakistan's corporate governance and contributing to the continuing discussion on the effect of the fresh legislation using a comparative methodology and a documentary analysis of the changes.

Keywords: Code, Corporate governance, Pakistan, Review

Introduction

Over the past 20 years, the topic of corporate governance and accountability has attracted a lot of attention, in part because it is a global problem. In contrast to South Africa, the United Kingdom, the United States, and the Organization for Economic Co-operation and Development principles of Corporate Governance, this idea is less developed in this region of the world. Pakistan has an economy that is expanding. It is reasonable to say that Pakistan still needs to be more competitive in these demands even if regulators and politicians have made attempts to create a code of corporate governance in order to promote foreign investment and meet international governance standards.

In 2002 the Corporate Governance Code was adopted by Securities and Exchange Commission of Pakistan. It was later updated in 2012 and 2017 as the Corporate Governance Code, and again in 2019 as the Listed Corporations Regulations. The Corporate Governance Codes of the South Africa, the United States, the United Kingdom and OECD served as its main inspiration.

The 2017 Code used a comparison strategy with the country's past corporate governance regulations to explain the reform process in this area. This supports the development of literary explanations for new regulations in conjunction with the passing of the new Act 2017. It also provided a comprehensive view of the code for academics and researchers.

The "comply or explain" approach to governance is the foundation of the 2019 Code, which is based on Pakistan. This new code is more governed by principles than by regulations, which demonstrates the organization's decision-making process. The "comply or explain" approach must be implemented carefully and clearly by boards, and investors must conduct a wise and thorough evaluation of various management arrangements.

Code of Corporate Governance, 2017

All publicly traded companies must abide by the Code of 2017 as well as any firms required to do so by their charters or licensing requirements. Additionally, this code added a few new concepts to the Code of 2012 rather than creating a brand-new regulation. The 2017 Code is divided into fourteen chapters that establish regulations, many of which deal with the board of directors, their functions, and tasks. Along with their tasks and responsibilities, directors' professional development and abilities are also given priority. The Code also defined the standards for key executive positions, such as Company Secretary, Chief Financial Officer and the Chief Executive Officer

Composition of the Board of Directors

The 2017 Code decreased the number of directorships from seven to five, except for those in publicly traded firms (the code 2012). This section of the Companies Act of 2017 states that no one may be a director of more than the specified number of companies at any given time. Additionally, section 155 requires that this requirement be fulfilled within a year after the Companies Act of 2017's effective date by anyone who was a director of more than seven firms at that time. As a result, the independence of directors is given more weight in comparison to the 2012 regulations.

As a result, instead of the statutory minimum of one, corporations must have at least two or one-third of their members serve as independent directors.

In addition, they are required by the Act to present a declaration of their independence at the annual general meeting of each fiscal year. The influence of one director on another's cross-holding relationships is prohibited for directors of charity and not-for-profit organizations.

Another step in the right direction toward reaching gender parity on the board of directors is the appointment of minimum one-woman director. The maximum number of executive directors was also altered by the code, moving from one-third of nominated directors to one-third of the nominated board of directors. The 2017 law keeps the separation of ownership and control in the chairman of the board and the chief executive officer, two separate positions, as it was in 2012. The amendment to the Code is that at the beginning of each director's new term, the chief executive officer must inform each director of their role, authority, responsibilities, remuneration, and rights.

Roles of the Board of Directors

The board of directors is obligated by the 2017 Code to act in a fiduciary role for stakeholders in addition to the company and its shareholders. These responsibilities include:

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- Identifying, managing, developing, and implementing effective internal controls for risk governance.
- The establishment of a reliable annual performance review process for the board of directors as well as individual directors.
- Establishing a formal code of conduct to promote moral behaviour at work and guard against any potential conflicts of interest with the corporation.
- To sustain an accurate record of significant strategies, including those that deal with risk management, human resources, whistleblowing, and executive or independent director compensation.

A special resolution must be passed in accordance with the Act in order to submit the related party transactions to the audit committee and board of directors for evaluation or approval. Directors' training programmes approved by the Securities and Exchange Commission of Pakistan will continue through 2021 with the addition of 100% directors' training. In addition, beginning in June 2019, every year a minimum of one female executive and one female department head must attend a directors' training programme. At least two independent directors must be present when a meeting is planned to discuss about a director's potential conflict of interest, and every director must be present at the annual general meeting.

Committees of the Board of Directors

For the benefit of and efficient use of the board of directors' time, the Code of 2017 specifies two mandatory committees, the audit and human resource committees, as well as two optional committees, the nominating and the committees for risk management. There must be at least three independent, non-executive directors on the audit committee, and it needs to be run by a director who is independent. "Financial Literacy" is a company's need for at least one board member's eligibility. According to the Code of 2017, the chairman and chief financial officer are not obligated to attend audit committee meetings unless specifically asked. The new rule requires that meeting minutes be given to the chief financial officer only when necessary, as opposed to the 2012 code's requirement that it be done automatically.

In the 2017 revision, the human resources and remuneration committee, which the 2012 law encouraged, is now mandated. It must be overseen by an independent director and hold meetings at least once a year. Like the chief executive officer, audit committee and the chairman are not notified in advance of meetings regarding compensation and human resources. The terms of reference will be decided by the board of directors.

The 2017 Code now specifies that risk management and nomination committees are not required to exist. With a few exceptions, such include monitoring internal controls, risk reduction, and disclosure of the firm's risk strategies, the board of directors has final say over the makeup of these committees and their decision-making processes.

The Chief Offices of a Company

The roles and responsibilities of the key executive positions inside an organization, such as the head of internal audit, the corporate secretary, and the chief financial officer, were also made clearer in the law's 2017 revision. The board of directors has authority over the hiring and firing of these top employees. Only on the suggestion of the audit committee may the director of the internal audit department be terminated. The new law has altered the qualifications for appointment to the positions of head of internal audit and chief financial officer, which now range between three and seven years of experience depending on whether a person is a member of any established

professional accounting organization, maintained, or recognized by Pakistan. The Securities and Exchange Commission of Pakistan's applicable regulations must be followed for someone to be appointed as the company secretary. Since this code is founded on the "comply or explain" principle, corporations have the option to request a relaxation of the requirements from Pakistan's Securities and Exchange Commission if the regulations are not followed, provided that they pay a fee and provide justification for their failure to do so. If necessary, the Securities and Exchange Commission of Pakistan has the power to alter the rules. A violation of any law, according to the 2017 Code, is subject to a fine that may reach rupees five million and, where the violation is ongoing, by an additional fine that may reach Rs one lakh for each day that it continues after the first. The Code of 2017 specifies that penalties for non-compliance with this code will be determined as defined by this Code.

Code of Corporate Governance, 2019

The terms "mandatory" and "comply or explain" are new to the 2019 Code of Corporate Governance. There are some rules that must be obeyed or there will be consequences. Companies may request a case-by-case exemption from the application of required regulations. The appointment of independent directors, consistent directorship of no more than seven firms; the existence of a woman director; the maximization of executive directors; the appointment of registered auditors; the formation of an audit committee; the rotation of auditors to financial sector companies; and the publication and review of the declaration of compliance with the Code by external auditors are all mandatory provisions.

Except for a few essential elements, this Code establishes the 'comply or explain' idea. The phrase "Comply or Explain method" refers to a company's option to either comply with non-mandatory requirements of these regulations or to adequately explain any obstacles to obedience for compliance report. The interpretation of the code indicates that each regulation is either mandatory or not. If mandatory regulations are not followed, penalties apply. while non-binding regulations must also be followed. These must be used to justify non-compliance in the event of non-compliance.

The annual examination of the board, committees and its members, the division of office of the chief executive officer and the chairman, training of directors, qualifications of the chief financial officer, the placement of related party transactions with a board of auditors, internal audits and internal auditing boards, the internal auditor and corporate secretary, and the comply or explain principle is the foundation for other optional provisions in this Code.

The establishment of an audit committee is also required under this code. However, a separate audit committee, internal control committee, and business and strategy analysis committee may be established to provide focused functional attention to each issue in the practical parts of the listed company's activities.

Comply or Explain Approach

The assumption that the 2019 Code isn't a collection of rigid standards is largely based on the "compliance or explain" method. It contains such non-obligatory clauses, and listed firms must report whether the non-obligatory conditions have been met in a statement of compliance, and if not, an acceptable description of any hindrance. The non-mandatory articles, in our opinion, are at the basis of the Code of 2019 and should be the primary concern of the board of directors when implementing it. If good governance is to be achieved, this "comply or explain" technique recognizes an alternate means of compliance with a non-obligatory rule. It is required that this be

mentioned explicitly and carefully in the declaration of conformance. Listed businesses should be informed about how actual operations relate to good governance. Its background should ideally be spelled out, and all subsequent actions should be transparent. When deviating from a non-obligatory provision has a time limit, the justification can state when the listed firm intends to complete the non-obligatory provision.

Composition of Board of Directors

No person shall be elected, nominated or serve as a director of more than seven listed firms, including as an independent director. Any listed company, whichever is higher, must have independent directors make up a minimum of two or one-third of the board. The Board must be reorganised before the end of its present term to elect an independent Chairman. It is required that the independent director give his approval to serve as a director and announce that he meets the independence requirements set forth in the Companies Act of 2017, and that such a declaration be submitted at the first Board of Directors meeting following the election of the directors, as well as any changes to the independent director. A minimum of one-woman director is required on the board, and more than one-third of the board cannot be made up of executive directors, including the CEO. This is necessary for compliance purposes.

Audit Committee

An audit committee must be established by the board and include a minimum of three non-executive directors and one independent director. A non-board chairman independent director must serve as the audit committee's chairperson, and the board of directors shall be comfortable that the board of auditors shall constitute minimum one audit committee member. A corporate audit committee must appoint a secretary, who can be either the company secretary or the internal audit director. During the fiscal year, meetings must be conducted at least once every three months. Meetings are frequently held until their board accepts interim reports, and after external audits have been completed, a meeting of the audit board is held where the external auditors, internal audit heads, or a member of the member's involvement represents the audit board chairman, the chief of audit committees, and the external auditors, or in his absence, any other member of the board. The audit committee's terms and conditions must be decided by the corporate board of each organization. Before the Audit Committee's next meeting, the secretary is compulsory to distribute the minutes to the members, directors, head of internal audit, and, if necessary, head of finance.

Rotation of auditors

Every five years, publicly traded companies must replace out their external auditors. All registered firms, except for those who work in finance, must rotate their engagement partner at least every five years.

Auditor Review and Compliance Statement

To ascertain whether it has complied with the requirements of these regulations, the company must publish and distribute a declaration in accordance with the provisions of Annex A to those legislation, along with its annual reports. The declaration must be detailed and include all necessary justifications.

Code of Corporate Governance Regulations 2019, as compared with 2017

1. An individual cannot serve on the boards of directors of more than seven publicly listed businesses (including as an alternate director) (previously it had been 5). Previously, directorships in a listed company's listed subsidiaries were barred. However, because this provision has been removed from the new legislation, we anticipate that directorships in listed subsidiaries of a listed parent will now be included in the calculation of the aforesaid limit.

2. Executive directors must not account for more than 1/3 of the board, with explanations rounded up to one, and independent directors should account for at least two thirds of the board, with explanations not rounded up to one. A corporation is expected to give an explanation, stating that when computing a one-third number, if there is any fraction available that has not been rounded up altogether, a corporation is expected to give the explanation in its compliance report. There was no such obligation under the previous regulations.

3. Regulation 10(3)(vi)(vii) of the previous regulations exempted the provisions addressing fund investment and divestment, character of loans, and level of materiality determination from the governing body's responsibilities.

4. The directors of the corporation will define the scope of materiality while considering the unique characteristics of the corporation. The board will make decisions on material transactions or important matters relating to financing and underinvestment of finances with a six-month or longer maturity time; determination of the character of advances and loans made by the company.

5. The previous regulations stipulated that if a director has a conflict of interest in any transaction, in addition to the requirements of section 207 and the corporate articles of association, the administrators must ensure that the quorum consists of at least two independent directors; otherwise, the meeting's quorum will not be considered present. As a result of the difficulties that businesses have encountered, this clause has now been removed.

6. The prior regulations governing transactions not conducted on an arm's length basis have likewise been repealed. It turns out that section 166(1)(f) is exhaustive because it states that any transaction in which a director or a group of directors has an interest must be approved by the general meeting.

7. The prior legislation allowed for the hiring of a consultant to recommend an appropriate level of remuneration to the board for approval. This clause has now been removed.

8. Directors' training was previously required under the Regulations. However, directors are advised to complete the training in these Regulations. It does, however, mandate that fifty percent of the administrators complete the training by June 30, 2020; 75 percent by June 30, 2021; and one hundred percent by June 30, 2022.

9. The following is added to the "financial literate" explanation: c) has at least 20 years of senior management expertise in handling monetary, audit-related matters; or d) has at least 10 years of experience as an audit committee member.

10. Outsourcing of internal audit functions to any affiliated firm or associated undertaking of external auditors is prohibited under these regulations. This is a positive change because it will increase external auditor independence, which is needed under auditing standards.

11. According to these Regulations, a sole proprietorship audit firm that has served as the external auditors of a publicly listed business for five years shall be replaced.

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12. The category of "female director" has been added to the list of directors in the Directors' Report. In addition, corporations are encouraged to provide information on individual director remuneration in their annual report under sub-regulation 3 of the aforesaid law. There was no such obligation in the earlier regulations.

13. Any violation of the necessary requirements of those Rules, including regulations 3, 6, 7, 8, 27, 32, 33, and 36, is punishable by a penalty of Rs.5 million, plus Rs.100,000 per day if the violation is ongoing (section 512(2) of the Act). Previously, a fine was imposed for failure to comply with all the Listed Corporations (Corporate Governance Code) Regulations, 2017 provisions.

King Report on Corporate Governance and Pakistan Code of Corporate Governance Comparison

The Corporate Governance King Report

A document called The Corporate Governance King Report contains recommendations for the management and governance practices of South African corporations. The King's Council on Corporate Governance released it. The Corporate Governance King Code and the Corporate Governance King Report are protected by the copyright of the Institute of Directors in Southern Africa. The King Reports must be followed by companies with stock listed on the Johannesburg Stock Exchange. As "the most successful synthesis of the best international standards in corporate governance," the Corporate Governance King Report has received high praise.

The King I report, the first of its kind for South Africa, was released in 1994. For boards of directors of publicly traded firms, banks, and specific state-owned businesses, it established suggested norms of conduct. It proposed an integrated strategy that covered all stakeholders in addition to financial and regulatory considerations.

When the Earth Summit was convened in Johannesburg later that year, King pushed for a revision of the report (King II), which added additional sections on sustainability, the role of the corporate board, and risk management.

Companies now report on sustainability separately from other aspects because Mervyn King believed the King II report erred in including it as a distinct chapter. Governance, strategy, and sustainability were all included in the next study, King III, which was released in 2009. The paper suggests that businesses prepare one integrated report rather than a financial statement and a separate sustainability report, and that they do it in compliance with the Global Reporting Initiative's guidelines for sustainability reporting.

A new study, King IV, was released in 2016. King IV will likely go into effect in the middle of 2017. It will provide organizations with a two-year drafting period and an additional year of grace to implement it. The philosophy, principles, methods, and results that serve as the standard for corporate governance in South Africa are outlined in this study. The King III Code was replaced by the King IV Code, which superseded earlier King Reports.

Since King III was published in 2009, there have been substantial changes to corporate governance and regulations both domestically and abroad, including the adoption of Companies Act 71 of 2008. The interpretation and application of King III to non-profit organizations, commercial businesses, and government agencies has proven difficult. The goal is to increase accessibility for King IV across all business sectors. For simpler interpretation and application, King IV contains fewer and

more condensed principles. To help organizations in various industries interpret King IV, sector supplements will also be issued with the book.

This paper offers substantial information on how to put the principles into reality by outlining suggested actions for each of the principles. These suggested practices provide guidance in this area by outlining how each principle ought to be put into practice. That is, the way these techniques are applied should be modified as needed to achieve the desired governance result. To increase the adoption of corporate governance and to make this report accessible and appropriate for use across sectors, organizations, and entities of all sizes, resources, and complexity, sector supplements for certain categories of organizations have been added. Each sector supplement explains how to interpret, modify, and customize the King IV Code's vocabulary, concepts, and recommended procedures to match the needs and expectations of organizations sectors.

Pakistan Code of Corporate Governance

Corporate governance is a useful instrument for expanding a business earlier a certain point and maintaining that expansion. It gives stakeholders and investors assurance about how the organization is run. The Pakistan Institute of Chartered Accountants has long advocated for corporate governance, and in 1998 it held the "All Pakistan Chartered Accountants Conference" with the topic of corporate governance as its focus. The release of the Code of Corporate Governance has been debated by the Securities and Exchange Commission of Pakistan and the Institute of Chartered Accountants of Pakistan.

Corporate governance in Pakistan has advanced over time to the point where businesses, whether publicly traded or not, now place a strong emphasis on it. It has been observed that even privately held family businesses are thinking about adding outside family directors to the board to provide a diverse perspective.

The Pakistan's first Corporate Governance Code was published by the Securities and Exchange Commission of Pakistan in 2002. It had more recommendations than mandatory rules.

A new Corporate Governance Code for listed businesses was published by Pakistan's Securities and Exchange Commission later in 2012, deleting the previous one. This Code was essentially a set of principles. Additionally, this legislation established the requirement for every director to undergo a directors' training programme, unless they meet specified requirements.

The Securities and Exchange Commission of Pakistan adopted a new Code in 2017 to replace the one from 2012. With a few exceptions, such as the formation of a Nomination Committee, This Code was more governed by rules, and all rules had to be followed.

A new Corporate Governance Code that marks a fundamental paradigm shift was published in 2019. This code successfully combines techniques based on rules and principles. This document details the significant modifications to corporate governance made by the 2017 Code. It is agreed that the complete regulations regulating the 2019 Code and the 2017 Code shall be referred to where a thorough understanding of the changes is required. As this paper is not intended to address any potential legal difficulties, a formal legal opinion may be requested as needed, or the Securities and Exchange Commission of Pakistan may be contacted to obtain the required clarification.

This Code is based on the new governing system in Pakistan known as "comply or explain." The precise provisions have been compelled to be followed since the introduction of corporate governance in Pakistan for listed businesses in 2002 and later changes in 2012 and 2017. Any

deviation from the requirements is considered a "non-compliance" and must be reported. As a result, the "mandatory" approach has been the foundation for monitoring the implementation of corporate governance. The decision-making processes of listed businesses would be scrutinized because it is anticipated that under this new regime, corporate governance will be more governed by principles than by rules. We think that this new system would give businesses the chance to learn about and enhance their governance practices while also outlining their progress toward complying with a requirement.

Additionally, the flexibility encourages firms to think creatively because a different course of action could be taken while maintaining transparency. With this approach, it is acknowledged that what is successful for one company, one investor, or one stakeholder may not always be broadly applicable to other companies, stakeholders or investors working in a different environment or with different requirements. The "comply or explain" principle must be applied carefully by the board members of listed firms, and investors must carefully consider the various company strategies.

Conclusion

Finally, it should be noted that Pakistan's corporate governance legislation is still in the formative and incomplete stages of development. The reforms implemented over the past sixteen years make this clear. There's no denying that initiatives have been taken to strengthen board independence, with a focus on board diversity and director expertise. However, the advancement of regulations and legislation will be less helpful if firms do not show a commitment to their execution by rejecting a simple "box-ticking" approach. In addition, if successfully implemented in the social and economic environment of Pakistan, the convergence of corporate governance standards will raise Pakistan's competitiveness on a global scale.

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