

Principles of Corporate Governance for Non-Listed Companies

Foreword

Non Listed Companies (NLCs) account for huge percentage of GDP of Pakistan. They are key providers of current and future employment as well as the source of a large proportion of economic growth of Pakistan. It is hoped that this pioneering and practical initiative will have a significant impact on economic development in Pakistan.

Securities and Exchange Commission of Pakistan (SECP) is convinced that Corporate Governance can act as an efficient tool in promoting the growth and sustainability of companies registered in Pakistan. Governance is not only relevant for listed companies but Corporate Governance is important for all kinds of companies.

In this document, thirteen principles of good governance are presented on the basis of a dynamic phased approach, which takes into account the size of individual company. NLCs can extract benefit from these principles to promote their sustainability, to bring external parties to their boards, to attract funds, and to solve issues between shareholders.

Although only applicable on a voluntary basis, the Principles included in this document sets out the best practice governance recommendations of SECP for NLCs in Pakistan.

Executive Summary

Securities and Exchange Commission of Pakistan (SECP) offers a corporate governance agenda for Non-Listed Companies (NLCs) in Pakistan.

NLCs make a major contribution to economic growth and employment in all over Pakistan. However, Code of Corporate Governance (δCCGö) relates to listed rather than NLCs. Many NLCs are owned and controlled by single individuals or families. Good corporate governance in this context is not primarily concerned with the relationship between boards and external shareholders (as in listed companies) nor with a focus on compliance with formal rules and regulations. Rather, **it is about establishing a framework of company processes and attitudes that add value to the business, help build its reputation and ensure its long-term continuity and success.**

Good corporate governance is particularly important to the shareholders of NLCs. In most cases, such shareholders have limited ability to sell their ownership stakes, and are therefore committed to staying with the company for the medium to long term. This increases their dependence on good governance. In an environment of mounting societal scrutiny towards the business world, even NLCs will have to devote attention to fulfilling their corporate responsibilities towards their stakeholders.

An effective governance framework defines roles, responsibilities and an agreed distribution of power amongst shareholders, the board, management and other stakeholders. Especially in medium sized companies, it is important to recognize that the company is not an extension of the personal property of the owner.

This document provides principles for NLCs on the issues involved in designing an appropriate corporate governance framework. **This set of governance principles may be followed or not remains a voluntary decision of each individual company.**

Thirteen principles of good governance are presented on the basis of a dynamic phased approach, which takes into account the size of individual company. A key step in the development of governance of NLCs is the decision to invite external directors onto the board for Public Interest and Large Sized Companies/companies formed for not for profit having gross revenues exceeding Rs. 500 million (excluding companies on which Public Sector Companies (Corporate Governance) Rules, 2013 are applicable) and its effect on behavior of the board of directors.

The principles provide a governance roadmap for NLCs. These principles may be relevant for subsidiary companies, companies formed and licensed for not for profit and joint ventures as well.

The SECP governance principles for NLCs – Preamble:

Reflecting the diversity of non-listed companies, thirteen governance principles are presented on the basis of a dynamic stepwise process. This approach takes into account the specific nature of a company in terms of size, complexity, and maturity. Two categories of corporate governance principles are proposed.

Objectives:

Phase 1 Principles are viewed as broadly universal in their application, and do not necessarily require the creation of bureaucratic or costly governance procedures. These represent a core framework of basic governance principles that can be implemented in some form by aforementioned NLCs.

It may be recognized that the introduction of basic governance Principles, such as external transparency, checks and balances, and external control, is a delicate exercise in an owner managed companies, or in any company with a sole owner or decision maker. Owners need to be convinced that the application of such Principles will bring a substantial return and foster the long term success of their firm.

Phase 2 Principles (8-13) are more sophisticated corporate governance measures that are relevant to Public Interest and Large Sized Companies. These may also be considered by NLCs that are seeking to prepare themselves for future public listings.

The most important of the phase 2 Principles is the decision to invite independent directors onto the board. This is a landmark event in the evolution of an NLC. It normally signals an irreversible step towards good governance and is likely to exert an immediate effect over the culture of boardroom behavior. The implementation of phase 2 Principles is likely to increase the formality of governance arrangements. However, this is invariably a necessary step in Large and more complex companies in order to provide the necessary re-assurance to owners or external creditors regarding the longer term sustainability of the enterprise.

In short, the SECP Principles offer a phased approach to corporate governance, both in terms of the way in which individual principles are implemented and in the transition from phase 1 to the phase 2 Principles.

After a statement of each of the governance principles, a number of key points are listed. The application of these points is likely to underpin the implementation of each governance principle. It must be stressed that the objective of the SECP Principles is to provide insight for NLCs in the design of a governance framework. They are not intended to be a strait jacket. NLCs may exercise common sense in their implementation, and ensure that their response in both proportionate and tailored to the specific needs to their company.

Applicability of Principles on classes of companies:

Principles are applicable on voluntary basis on Non-Listed Companies.

Phase & Principles	Classes of Companies
Phase 1 Principles 6 (1-7) are applicable.	All Non-Listed Companies except <ul style="list-style-type: none">➤ Small Sized Companies,➤ Not for Profit Companies having annual gross revenue (grants/subsidies/donations) not exceeding Rs. 100 million and➤ Public Sector Companies
Phase 2 Principles (8-13) are applicable	Public Interest Companies, Large Sized Companies and Not for Profit Companies having annual gross revenue (grants/subsidies/donations) exceeding Rs. 500 million except Public Sector Companies

Note: Public Sector Companies that are governed under Public Sector Companies (Corporate Governance) Rules, 2013 are excluded.

Phase-1

Principles

Principle No.	Phase 1 Principles; All Non-Listed Companies except <ul style="list-style-type: none"> ➤ Small Sized Companies, ➤ Not for Profit Companies having annual gross revenue (grants/subsidies/donations) not exceeding Rs. 100 million and ➤ Public Sector Companies 	
Principle No. 1	GENERAL	Shareholders may establish an appropriate governance framework for the company, which may preferably be contained in their constitutive document.
Principle No. 2 and 2.1	BOARD OF DIRECTORS	Every company may strive to establish an effective board, which is collectively responsible for the long-term success of the company. The size and composition of the board may reflect the scale and complexity of the company's activities.
Principle No. 3	MEETING OF BOARD OF DIRECTORS	The board may meet regularly to discharge its duties, and the board may be supplied with appropriate information in a timely manner.
Principle No. 4	REMUNERATION OF BOARD OF DIRECTORS	Structure of remuneration may be sufficient and appropriate to attract, retain, and motivate executives and nonexecutives of the quality required to run the company successfully.
Principle No. 5	INTERNAL CONTROL	The board is responsible for risk oversight and may maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.
Principle No. 6	TRAINING OF BOARD OF DIRECTOR	All directors may receive training on joining the board and may regularly update and refresh their skills and knowledge.
Principle No. 7	GENERAL MEETINGS	There may be a dialogue between the board and the shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board may not forget that all shareholders have to be treated equally.

Phase-2

Principles

Principle No.	Phase 2 Principles: Public Interest Companies, Large Sized Companies and Not for Profit Companies having annual gross revenue (grants/subsidies/donations) exceeding Rs. 500 million except Public Sector Companies.	
Principle No. 8	ROLE OF CHAIRMAN AND CHIEF EXECUTIVE	There may be a clear division of responsibilities at the head of the company between the running of the board and the running of the company's business.
Principle No. 9	INDEPENDENT/ NON EXECUTIVE DIRECTOR	Board structures may contain directors with a sufficient mix of competencies and experiences.
Principle No. 10	BOARD COMMITTEES	The board may establish appropriate board committees in order to allow a more effective discharge of its duties.
Principle No. 11	APPRAISAL OF BOARD OF DIRECTORS	The board may undertake a periodic appraisal of its own performance and that of each individual director.
Principle No. 12	ANNUAL REPORT	The board may present a balanced and understandable assessment of the company's position and prospects for external stakeholders, and establish a suitable program of stakeholder engagement.
Principle No. 13	COMPLIANCE OR DISCLOSURE OF DEVIATION	The non-listed companies falls in this phase-2 shall circulate compliance with principles of good governance along with their annual report as given in Annexure A.

Principles of Corporate Governance for Non-Listed Companies:

Phase 1 Principles - applicable to all NLCs except Small Sized Companies (SSCs), Not for Profit Companies having annual gross revenue (grants/subsidies/donations) not exceeding Rs. 100 million and Public Sector Companies.

1. GENERAL:

Principle: Shareholders may establish an appropriate governance framework for the company, which may preferably be contained in the company's constitutive document.

Key points

- *Owners may establish a basic framework of corporate governance* through the company's constitutive documents (e.g. articles of associations).
- *There may be a formal schedule which states which matters are specifically reserved for the owners' decision* and which are to be delegated to the board (see also Principle 2).
- *In the same time, owners may minimize the extent to which the basic framework of corporate governance constrains the ability of the board to shape the detailed governance framework.*

2. BOARD OF DIRECTORS

Principle: Every company may strive to establish an effective board, which is collectively responsible for the long-term success of the company. It shall promote the company's and all its shareholder's interests.

Key points

- The board's role is to provide leadership of the company.
- All directors must take decisions objectively in the interest of the company. As the company develops, inviting an independent director onto the board can help in focusing the board on the corporate interest.
- **The board may elect a chairman.** The chairman is responsible for leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda.
- **The board may appoint a Chief Executive** (or managing director) to lead the management team, and exercise executive authority over the operation of the company.
- **The board may set the company's strategic objectives**, and ensure that the necessary financial and human resources are in place for the company to meet its objectives.
- **The board is responsible for monitoring and evaluating management performance.**
- **The board may set the company's values and standards** and ensure that its obligations to its shareholders and other stakeholders are understood and met. The board may be involved in the strategic development process and as a minimum approve the strategy, and ensure that it lies within the framework of shareholders' expectations.
- It is the responsibility of the board to ensure that the company complies with its articles of association as well as relevant legal, regulatory, and governance requirements.
- **There may be a formal schedule of matters which states which matters are specifically reserved for the board's decision and which are to be delegated to management.**

- Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they may ensure that their concerns are recorded in the board minutes.
- **Written terms of reference may be developed for board members to set out the roles and responsibilities of each director.**

Notes to Principles 2

A schedule of matters reserved for shareholders (at a shareholders' meeting), would typically include the following:

- Approval of appointment of Auditors
- Approval of the annual audited accounts
- Deciding on the dividend
- Approval of changes to the articles of association and memorandum
- Approval of sale and lease of significant portion of assets
- Approval for investment in associated companies/undertaking (except for private companies)
- Approval for reduction in capital structure
- Approval for mergers, amalgamation etc
- Approval for election of directors

A schedule of matters potentially reserved for the board would typically include the following:

- Definition of corporate goals, strategy, and structure
- Responding to shareholders and third parties
- Supervising and controlling company progress
- Supervising the Chief Executive or managing director
- Approval of corporate plans
- Approval of operating and capital budgets including policy related to bad debts
- Approval of major corporate actions (e.g. acquisitions, commencing of business activities)
- Approval of borrowings or creditor guarantees
- Policy on external communications, e.g. with regulators, shareholders, or the media
- Definition of authorities delegated to management
- Nomination and dismissal of the managing director/CEO, and on his/her remuneration as prescribed in law.
- Acting as the custodian of the corporate governance

A schedule of powers delegated to management is likely to cover the following areas:

- Preparing strategic proposals, corporate plans, and budgets
- Executing the strategy agreed upon by the board of directors
- Executing actions in relation to board decisions on investments, mergers, and acquisitions, etc.
- Authorizing financial payments
- Signing of contracts on behalf of the Company
- Signing of regulatory documents
- Powers of attorney
- External communication

- Staff recruitment and remuneration
- Establishing a system of internal control and risk management
- Health and safety operations.

It is best practice to summarize such a schedule of delegation in a delegation policy document or internal governance code, specifying the limits for each of the delegated matters.

The Board may maintain a compliance schedule, which shows when various financial, legal, and regulatory requirements must be completed, and who is responsible for dealing with each item. Such a schedule is likely to include:

- obligations relating to the preparation and filing of financial statements
- tax compliance
- banking facilities and covenants
- health and safety compliance
- insurance

A key responsibility of the board is to promote high standards of professional and ethical conduct amongst employees. As the number of employees expands, the standards expected may be summarized in a code of business conduct. This may be discussed with employees during induction and training periods. It also acts as a benchmark for evaluation during disciplinary proceedings.

The internal code could state the company's expectations with respect to:

- compliance with laws and regulations
- standards of customer service
- conflicts of interest
- gifts or preferential treatment in respect of suppliers, customers, etc
- the need for integrity and ethical business practice
- company obligations to the general well-being of the community
- support for employee personal development.

Principle 2.1: The size and composition of the board may reflect the scale and complexity of the company's activities.

Key points

- **The board may not be so large as to be unwieldy.** The balance of skills and experience may be appropriate for the requirements of the business.
- **There may be an explicit procedure for the appointment of new directors to the board.** Appointments to the board may be made after careful examination against objective criteria.
- **The board may satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management.** The aim is to maintain an appropriate balance of skills and experience within the company and on the board.

3. MEETING OF BOARD OF DIRECTORS

Principle: The board may meet regularly to discharge its duties, and the board may be supplied with appropriate information in a timely manner.

Key points

- Regular meetings of the Board of Directors may be considered at least once in every quarter of the financial year.
- **Consideration may be given to the appropriate organization of board meetings.**
- **The chairman is responsible for ensuring that the directors receive accurate, timely, and clear information and board and general meetings are held in time.**
- **Management has an obligation to provide such information.** However, directors may seek clarification or amplification from management where necessary. The board may establish explicit procedures which allow directors to approach management for further information.
- The board may ensure that directors ó especially non-executive directors ó have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors.

Notes to Principle 3

A typical structure for board meetings is as follows:

- An agenda may be prepared by the chairman.
- The agenda and supporting papers (if any) may be circulated in advance of the meeting, allowing directors sufficient time to prepare.
- Written minutes of board meetings may be taken. All decisions may be recorded (including dissenting opinions), along with assigned tasks and timescales. The minutes may also give an overview of the main topics discussed at the meeting.
- Board meetings may monitor progress against approved plans and budgets, and ensure full coverage of matters reserved for the board.

4. REMUNERATION OF BOARD OF DIRECTORS

Principle: Structure of remuneration may be sufficient to attract, retain, and motivate executives and non-executives of the quality required to run the company successfully.

Key points

- **A clear distinction must be made between the remuneration of executives and non-executives.** The former are full-time employees of the company, and are responsible for its operational activities. In contrast, non-executives are óoffice holdersö rather than company employees, and dedicate their time to the company on a part-time basis. Remuneration structure may reflect these differing roles.
- **Members of the board are ultimately accountable to shareholders for their remuneration.**
- **Structure of remuneration for non-executive directors may reflect the time commitment and responsibilities of the role.**
- The board may develop a formal executive remuneration policy and a transparent procedure for implementing the policy, e.g. in terms of fixing the remuneration packages of individual executives and non-executives.
- Boards may compare the remuneration of their executives and non-executives with that of other relevant companies. But they may use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.

- A significant proportion of executive remuneration may be structured so as to link rewards to corporate and individual performance. They may be designed to align their interests with those of shareholders and other key stakeholders, and give these executives incentives to perform at the highest levels.

Notes to Principles 4

- Good practices in executive remuneration is likely to consider the following elements in its design:
- A balance between fixed and variable pay, and the linkage of variable pay to pre-determined performance criteria
- Deferment of some proportion of variable pay
- In cases where share/ownership parts are granted, a minimum vesting period. A requirement to retain some proportion of those shares until the conclusion of employment
- The reclaim of variable pay paid on the basis of data which subsequently proves to be manifestly misstated (clawback)

5. INTERNAL CONTROLS

Principle: **The board is responsible for risk oversight and may maintain a sound system of internal controls to safeguard shareholders' investment and the company's assets and also to facilitate the Board's fulfillment of its supervisory responsibilities.**

Key points

- The board may attempt to identify the main risks facing the company. It may satisfy itself that all material risks are being appropriately managed.
- The board may establish formal and transparent arrangements for applying financial reporting standards e-g Accounting and Financial Reporting Standards and International Financial Reporting Standards as applicable in Pakistan and internal controls principles, and for maintaining an appropriate relationship with the company's auditors.
- The board may periodically assess the need to establish a formal internal controls and risk management function. Moreover, a periodic check on the effectiveness of the company's approach towards internal controls is necessary. Such review may cover all material controls, including financial, operational and compliance controls, and risk-management systems.
- The board may devise mechanism to avoid serious frauds by strict surveillance of its operating and administrative functions.

Notes to Principle 5

It is useful for companies to develop a basic risk register, which is reviewed by the board on regular basis. This register may contain the following categories of information:

- A description of the main risks facing the company
- The impact should this event actually occur
- The probability of its occurrence
- A summary of the planned response should the event occur
- A summary of risk mitigation (the actions that can be taken in advance to reduce the probability and/or impact of the event).

A company manual should be available to all employees, and should outline policies and procedures relating to specific risks, to which company is exposed. For example, policies should be developed with regard to:

- Anti-corruption
- Anti money-laundering
- Key Operational Risks and Whistle Blowing
- Cash management
- Monitoring of banking covenants
- Business continuity
- Data security and reliability
- Records managements
- Regulatory and standards compliance
- Health and safety compliance

Procedures which are likely to support an effective internal control environment are likely to include:

- authorization limits
- segregation of duties
- accounting reconciliations and monitoring of cash flow
- suitable qualifications and training
- budgetary controls
- controls over funds, expenditure, and access to bank accounts
- security of premises and control over assets.

In fulfilling its control and oversight responsibilities, it is important for the board to encourage the reporting of unethical/unlawful behavior by employees. The existence of a company code of ethics may aid this process and may be underpinned by legal protection for the individuals concerned.

6. TRAINING OF BOARD OF DIRECTOR

Principle: All directors may receive training on joining the board and may regularly update and refresh their skills and knowledge.

Key points

- The rigor and formality of the induction may reflect the size and complexity of the enterprise.
- The chairman may ensure that the directors continually update their skills, and obtain the knowledge and familiarity with the company required to fulfill their role on the board.
- The chairman may encourage board members to engage in professional training that specifically enhances their functioning as company directors.
- Directors be encouraged to participate in trainings about applicable legal regime.

7. GENERAL MEETINGS

Principle There may be a dialogue between the board and the shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board may not forget that all shareholders have to be treated equally.

Key points

- The board may keep in touch with shareholder opinion in whatever ways are most practical and efficient.
- The chairman has particular responsibility for the effectiveness of communication between shareholders and the board, and may discuss corporate governance and strategy with shareholders.
- The chairman is the primary means of ensuring that the views of shareholders are communicated to the board as a whole. However, other directors may also be offered the opportunity of attending meetings with shareholders.
- A key role of the chairman is to set the agenda of the Annual (and Extra-ordinary) General Meetings.
- The relationship with the shareholders may be viewed as a continuous process and not limited to an annual formal meeting.

Notes to Principle 7

SHAREHOLDERS' MEETING

- The Annual General Meeting will be the main forum for shareholders to obtain information relative to the Company and in which to hold discussions and adopt decisions, participating actively in the main aspects of Corporate Governance. At the same time, the Annual General Meeting will ensure that the interests and expectations of shareholders, albeit minority, will be satisfied and that full exercise of their rights will be guaranteed.

SHAREHOLDERS' RIGHT OF INFORMATION

- The shareholders' right of information is an essential principle underlying the philosophy of corporate governance, and the board as a whole is responsible for ensuring its adequate operation and the establishment of a successful dialogue with shareholders. Stable, adequate and regular information channels between the company and investors must be in place. The board is responsible for submitting complete and comprehensive financial and management information in order to facilitate a balanced valuation of the current situation and the company's foreseeable future.
- The Board must ensure that a dialogue with institutional investors exists so that these may become familiar with and participate in corporate plans, objectives and achievements. The Board will supervise the training plans necessary to ensure an adequate and sufficient understanding of the items and matters included in the agenda.

GENERAL MEETING PROCEDURES

The board will ensure that the Annual General Meeting is properly used as an adequate channel to communicate with shareholders and foster their participation. Therefore, with regard to the Annual General Meeting, the following minimum standards are recommended:

- The Annual General Meeting will approve its own regulation, which will allow management and maintenance of control there over.
- To call the Annual General Meeting with sufficient notice as provided in the law to ensure that shareholders may benefit from information in time to exercise their rights prior to the Meeting and to decide whether to take part and how they are going to vote.

- To advise the date, place and agenda and to ensure that the complete text of the resolutions to be approved is made available.
- To contact all shareholders individually through delivery of the notice at their registered address before the meeting or through email where consented by shareholders to ensure that they are informed and are aware of the items to be discussed.
- To furnish shareholders all reports that justify each resolution proposed, at the time notice of the meeting is sent, at the Meetings called, or at the start of the meeting.
- To ensure availability, while Meetings are being held, of those professionals in the company, as well as external professionals, given their association or knowledge of the items to be discussed, who may be considered useful for shareholders to receive complete information, ask for clarification and thus form a better opinion.
- To ensure the right of shareholders present at the Meeting to have their interventions and votes set forth in the minutes.
- Secret balloting procedure may contain modus operandi for balloting in given circumstances as prescribed in law.

Phase 2 Principles – applicable to Public Interest and Large sized Non-Listed Companies, and Not for Profit Companies having annual gross revenue (grants/subsidies/donations) exceeding Rs. 500 million.

These are however not applicable on companies which are governed under Public Sector Companies (Corporate Governance) Rules, 2013.

8. ROLE OF CHAIRMAN AND CHIEF EXECUTIVE

Principle: There may be a clear division of responsibilities at the head of the company between the running of the board and the running of the company's business.

Key points

- In larger companies, the roles of chairman of Board of Directors and chief executive (or managing director) may be segregated.
- The division of responsibilities between the chairman and chief executive may be clearly established, set out in writing, and agreed by the board.

Notes to Principle 8

- The chairman sets the agenda for and chairs board meetings, and most importantly facilitates constructive deliberations at the board.
- The chairman's role is of a facilitator of board discussions.
- He or she must be sufficiently informed, engaged, and able to intervene when required, but must avoid becoming too involved with the day-to-day business of the company.
- Board dysfunction is likely to result when the distinct roles of the chief executive and chairman are not properly understood or respected.

9. INDEPENDENT/ NON EXECUTIVE DIRECTOR

Principle: Board structures may contain directors with a sufficient mix of competencies and experiences in order to act objectively in their opinion and judgment. No single person (or small group of individuals) should dominate the board's decision making.

Key points

- The board of larger companies may include a sufficient number of non-executive and independent directors.
- The largest NLCs or NLCs working towards a public listing on a regulated market may aim to add non-executive directors and preferably independent directors to boards until they represent a significant proportion of board seats (although the exact proportion will be a matter for the judgment of individual boards).
- Care may be taken to ensure that non-executive or independent appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships. The letter of appointment may set out the expected time commitment. Non-executive or independent directors may undertake that they will have sufficient time

to meet what is expected of them. Their other significant commitments may be disclosed to the board before appointment and the board may be informed of subsequent changes.

- The chairman may facilitate the effective contribution of non-executive and independent directors and ensure constructive relations between all directors.
- Non-executive directors and independent directors may scrutinize the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.
- Non-executive directors and independent directors may satisfy themselves on the integrity of financial information and make sure that financial controls and systems of risk management are robust and defensible (although their approval remains a collective responsibility).
- Non-executive directors and independent directors may assume primary responsibility for determining appropriate levels of remuneration of management, including executive directors. They may also play a leading role in appointing, and where necessary removing, executives, and in succession planning.
- The chairman may decide to hold meetings with the non-executive directors without the executive directors present.
- On resignation, a non-executive director may provide a written statement to the chairman, for circulation to the board, if they have significant concerns about the running of the company.

Notes to Principle 9

The key benefits of including independent non-executive directors on the board include the following:

- Bringing an outside perspective on strategy and control
- Adding new skills and knowledge that may not be available within the company
- Bringing an independent and objective view from that of the owner
- Making hiring and promotion decisions independent of family ties
- Bringing an independent view whenever there may be conflicts of interest within the board
- Acting as a balancing element between the different shareholders
- Benefiting from their business connections and other contacts.

Director independence is not a concept that can be precisely defined. However, factors which may be of relevance in establishing the perceived independence of a non-executive director include the following:

- Has not in recent years been an employee of the company
- Has no material business relationship with the company
- Does not receive (additional) remuneration from the company during the period of appointment/election as a director (apart from the director's fee)
- Does not have close family ties with any of the company's advisers, directors, or senior employees
- Does not hold cross-directorships or have significant links with other directors through involvement in other companies or bodies
- Does not represent a significant shareholder
- Has not served on the board for an extended period.

However, these are only guidelines. Ultimately, it is a matter for the board to determine if the director is independent in character and judgment, and whether there are relationships or circumstances

(including the level of remuneration as board member) which are likely to affect, or could appear to affect, the director's judgment.

10. BOARD COMMITTEES

Principle: The board may establish appropriate board committees with appropriate terms of reference in order to allow a more effective discharge of its duties.

Key points

- A company's committee structure may be proportionate to the needs of the company. However, most large NLCs are likely to require investment committee and audit committee. Other committees may be established if required in particular circumstances.
- The board may define in writing the terms of reference of the various committees, explaining their role and the advisory authority delegated to them by the board. These terms of reference may be reviewed by the board on a periodic basis.
- Committees may be provided with sufficient resources to undertake their duties.
- Independent non-executive directors may play a significant role in such committees.

Notes to Principle 10.

The audit committee plays a particularly important role in the monitoring and oversight of larger companies. The main responsibilities of the audit committee include the following:

- To monitor the integrity of the financial statements of the company
- To review the company's internal controls and risk management systems
- To monitor and review the effectiveness of the company's internal audit function
- To make recommendations to the board in relation to the appointment or removal of the external auditor
- To approve the remuneration and terms of engagement of the external auditor
- To review and monitor the external auditor's independence and effectiveness
- To develop and implement policy on the engagement of the external auditor to supply non-audit services
- To review the risk situation, and to monitor risk-management processes.

Given the relatively technical nature of the audit committee's activities, the board may satisfy itself that at least one member of the audit committee has recent and relevant financial experience. In practice, this is likely to mean that this individual has an accountancy qualification, and has gained relevant financial experience while working as an auditor or financial manager. The majority of the members of the audit committee may be non-executives, and preferably independent directors.

Where there is no internal audit function, the audit committee may consider whether there is a need for an internal audit function and make recommendations to the board. The head of internal audit should report to the audit committee and his appointment and removal should be subject to the recommendation by the audit committee and the formal approval by the board.

The audit committee may also review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters (i.e., whistle-blowing).

No one other than the committee chairman and members may be entitled to be present at a meeting of the committees. However, others may attend at the invitation of the committees. The audit committee should be meeting external auditors when necessary to discuss audit findings as part of the management letter.

11. APPRAISAL OF BOARD OF DIRECTORS.

Principle: **The board may undertake a periodic appraisal of its own performance and that of each individual director.**

Key points

- The rigor and formality of the appraisal techniques utilized by the board may reflect the size and complexity of the company. Once again, a stepwise or phased approach is the best route ahead for smaller companies.
- The chairman may use the appraisal process to obtain feedback on the effectiveness of his or her management of the board.
- Group appraisal may examine how the board operates as a collective decision-making body.
- Individual appraisal may aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time).
- The chairman may act on the results of the appraisal by recognizing the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.
- Special attention may also be paid to the assessment of the collaboration with the (executive) management.

Notes to Principle 11:

Some of the key questions that an appraisal should address include the following:

- Is there sufficient challenge of executive management in board meetings?
- Does the board have the right balance between expertise and independence?
- Does the board correctly perform its duties? Are directors setting direction (guidance and advice on strategy) and monitoring the company (control and risk management) and its management?
- Do board members devote sufficient time and effort to the company and their boardroom role?
- Do board members have adequate access to information and advice?
- Does the board engage sufficiently with shareholders and key stakeholders?
- Are there personal factors that might inhibit individual board members from fulfilling their duties in an independent and objective manner?
- Does board have effective practices and procedures for running board meetings?

Evaluating individual directors is a very sensitive issue, given the fact that the board is a collegial body, composed of peers. Therefore caution will be necessary in order to avoid possible conflicts and frustrations. The chairman can be instrumental in bridging the gap between individual and confidential evaluations.

12. ANNUAL REPORT.

Principle: The board may present a balanced and understandable assessment of the company's position and prospects of compliance with these principles for external stakeholders, and also establish a suitable program of stakeholder engagement.

Key points

- The board may publish an annual report that is tailored to the needs of its shareholders and its other stakeholders.

Notes to Principle 12

A strong disclosure regime that promotes transparency will be a pivotal feature of a company's relationship with stakeholders. Disclosure improves public understanding of the structure and activities of the company, its policies with respect to environmental and ethical standards, and its relationship with the communities in which it operates.

The annual report is an important means of communicating with stakeholders (as well as shareholders). Apart from the traditional financial reporting, which is mandatory for most companies in Pakistan, annual reports can include more information on the following corporate issues:

- A statement of the company's vision, mission, and values.
- An outline of the company's business strategy and the likely risks associated with that strategy.
- A review of the company's activities and performance, and a forward-looking assessment of the business environment.
- A statement of its corporate governance principles and the extent to which it has complied with a specific corporate governance code, with additional governance information, such as:
 - a statement of how the board operates, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management;
 - the names of all the directors, including the chairman, the chief executive, and the chairmen and members of the nomination, audit and remuneration committees (if relevant);
 - the names of the non-executive directors whom the board determines to be independent, with reasons for that assessment where necessary;
 - details of the appraisal of the board, its committees, and its directors that has been conducted.
- A summary of activities and projects of special relevance to stakeholders.

The content of the annual report will become more important as the company evolves.

Social responsibility projects can act as a major point of engagement with stakeholders. They may be integrated into the company's activities and included in management's list of strategic goals.

The board can facilitate communications by providing a contact person with whom stakeholders may discuss any issues. During times of change, it may be useful for the board to communicate regularly with stakeholders to explain what is happening at the company. For example, stakeholders of a

company contemplating a major expansion or retrenchment ó or merger with another company ó may wish to meet with the board to discuss the proposed strategy for the new organization.

Stakeholders ó including individual employees and their representative bodies ó may be able to freely communicate their concerns about illegal or unethical practices to the board. Their rights may not be compromised for doing this. Unethical and illegal practices by corporate officers may not only violate the rights of stakeholders but also be to the detriment of the company in terms of reputation effects with an increasing risk of future financial liabilities. It is therefore to the advantage of the company to establish procedures and safe harbors for complaints by stakeholders.

13. COMPLIANCE OR DISCLOSURE OF DEVIATION

Principle: **The non-listed companies falling in this phase-2 may circulate a statement of compliance with the principles of good governance along with their annual report**

Key point

- All non-listed which falls in the category of Phase 2 may circulate a statement along with their annual reports to set out the status of their compliance with the principles set out above.

Conclusion

The above Principles address the following three subjects which are at the heart of good corporate governance:

É The board of directors ó high performing, effective board is needed to challenge executive management. This means that boards need non-executive members with diverse views, skills and appropriate professional experience. Such members must also be willing to invest sufficient time in the work of the board. The role of chairman of the board is particularly important, as are the board's responsibilities for risk management.

É Shareholders ó the corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance. However, there is evidence that the majority of shareholders is passive and is often only focused on short-term profits. It therefore seems useful to consider whether more shareholders can be encouraged to take an interest in sustainable returns and longer term performance, and how to encourage them to be more active on corporate governance issues. Moreover, in different shareholding structures there are other issues, such as minority protection.

É How to apply the 'comply or explain' approach which underpins the corporate governance framework. It may also be considered that if the entities do not adopt good governance principles they may only explain the deviation.

Statement of Compliance with Principles of Corporate Governance for Non-Listed Companies

No.	Principle	Complied	Not Complied	Reason for non-compliance
1	GENERAL			
2	BOARD OF DIRECTORS			
3	MEETING OF BOARD OF DIRECTORS			
4	REMUNERATION OF BOARD OF DIRECTORS			
5	INTERNAL CONTROL			
6	TRAINING OF BOARD OF DIRECTOR			
7	GENERAL MEETINGS			
8	ROLE OF CHAIRMAN AND CHIEF EXECUTIVE			
9	INDEPENDENT/ NON EXECUTIVE DIRECTOR			
10	BOARD COMMITTEES			
11	APPRAISAL OF BOARD OF DIRECTORS			
12	ANNUAL REPORT			
13	COMPLIANCE OR DISCLOSURE OF DEVIATION			