

CONSULTATION PAPER

Proposed Amendments to the Fourth Schedule of the Companies Act, 2017 – Disclosures by Listed Companies for Shariah Stock Screening

Date of Issue: May 6, 2024

Last date of submission of comments: May 21, 2024



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Islamic Finance Department

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1. Executive Summary:

The proposed amendments to the Fourth Schedule of the Companies Act, 2017 (the “Act”), as contained in the notification and a comparative statement attached as Annexure-I & II, are being published and circulated for the attention of all concerned for feedback and comments, for the consideration of the Commission before promulgations.

The primary aim and objective of the proposed amendments is to enhance transparency in disclosures by the listed companies in their financial statements that enable Shariah stock screening for the benefit of investors and the inclusion or exclusion of shares from the list of Shariah-compliant shares in the Islamic indices maintained by the Pakistan stock exchange.

2. Background:

In line with the constitutional requirement to eradicate Riba from the economy, it is important to promote the development of Islamic finance and provide/implement an enabling legal and regulatory framework that facilitates all stakeholders in achieving the objectives. Through the promulgation of the Act, several provisions have been introduced with respect to Shariah-compliant companies and Shariah compliant securities.

As required under Section 225 of the Act, the financial statements of the companies shall be prepared in accordance with the requirements contained in the Third Schedule (Fourth Schedule for listed companies) to give a true and fair view of the state of affairs of the company. Sub-clause 10 of clause VI of Part I of the Fourth Schedule to the Act obliged every listed company, which is conducting its business according to the principles of Shariah, and the companies listed on the Islamic index to disclose some additional information through the financial statements, including the bifurcation of income, loans and investment into Shariah compliant and non-Shariah compliant. However, to date, only a limited number of companies have disclosed the said information.

According to the said Section 225 of the Act, the financial statements must provide a true and fair picture of the company's financial situation, adhere to the financial reporting standards notified by the SECP, and be prepared in accordance with the guidelines specified in the Third Schedule of

the Act for various classes of companies. Further, the provisions of sub-section (6) of section 220 of the Act shall apply to any person who is a party to the default in complying with any of the provisions of section 225 of the Act, which stipulates that:

“If a company fails to comply with any of the requirements of this section, every director, including chief executive and chief financial officer, of the company who has by his act or omission been the cause of such default shall –

- a) in respect of a listed company, be punishable with imprisonment for a term which may extend to two year and with fine which shall not be less than five hundred thousand rupees nor more than five million rupees, and with a further fine which may extend to ten thousand rupees for every day after the first during which the default continues; and*
- b) in respect of any other company, be punishable with imprisonment for a term which may extend to one year and with fine which may extend to one hundred thousand rupees.”*

3. Shariah stock screening process:

It is important to note that presently the Shariah screening of listed shares is being done in accordance with sub-section (2) of Section 451 of the Companies Act, 2017 read with regulation 9 of the Shariah Governance Regulations, 2023. This process is being conducted from the investor's perspective and not from the issuer's or company's perspective, as is in line with international practices. As such, inclusion or exclusion from indices is not the discretion of a company, nor is it a legal obligation for the index provider to obtain consent from the company. The criteria for index inclusion or exclusion are determined solely by the index provider based on the globally acceptable criteria for creating Shariah compliant investment avenues for the companies.

Furthermore, the disclosures under the Fourth Schedule are applicable to all listed companies having core business activity as permissible from Shariah perspective. The definition of a Shariah-compliant company as per the Act is reproduced below for your reference;

“Shariah compliant company” means a company that conducts its business according to the principles of Shariah.

There are no additional obligations on the company regarding inclusion in the Islamic index. Further, no additional compliance or cost is required, as the required disclosure is not any additional information; rather, it is just a bifurcation of the already available information. For instance, total financing/ investments, and income are already available, and the company is only required to share the composition of Shariah compliant and non-compliant avenues. It is important to emphasize that inclusion in an Islamic index does not entail any additional material cost or effort for the company. The required additional information typically includes financial data breakdowns and ratios, which are readily available to companies.

This categorization of Shariah Compliant company is only to provide an investible universe for Shariah-compliant mutual funds, takafuls, Islamic banks, and other Islamic financial institutions and has no implication on the operations of companies.

The Federal Shariat Court, in its recent judgement, has held that the elimination of Riba is not our religious obligation but a constitutional obligation. Every citizen of Pakistan, including PSX and listed companies, is expected to work together towards achieving the constitutional objective and cannot absolve themselves for any such reasons.

4. Review of state of compliance:

During the review and revamping of Shariah governance regulations, it was noted that an IBA-CEIF study highlighted that only 8% of relevant listed companies are making the full required disclosures, thereby creating serious challenges in Shariah stock screening and the making of Islamic indices at PSX. Non-disclosure of such information is not only a violation of the Act but also jeopardizes the transparency and availability of required information for Shariah-compliant investments in listed companies. Institutional as well as individual investors are required to screen investable universe based on the said disclosures and take investment decisions accordingly.

To address this issue, the following actions have so far been taken:

- a) Shariah Governance Regulations, 2023 (the “Regulations”), have been promulgated, providing a detailed mechanism for the stock screening process for listed companies for the purposes of the construction of Islamic indices;

- b) Shariah stock screening criteria have also been revamped and notified under the Regulations.
- c) PSX, vide notice dated January 21, 2021; ICAP, through a technical brief; and SECP, vide general letter dated February 25, 2022, urged the listed companies to make the required disclosures;
- d) A series of seminars have been conducted for CFOs of listed companies to enhance the said disclosures in the financial statements.
- e) Listed companies are included in KMI All Shares Islamic Index have been approached through individual letters, drawing their attention to the said disclosure requirements; and
- f) PSX has also been amending PSX Rulebook to require listed companies to directly report to PSX the information required under the said disclosures.

5. Proposal under consideration:

In addition to the foregoing, it was highlighted during public consultation that the language of the Fourth Schedule is ambiguous and may not be applicable to listed companies that are not included in the Islamic index for Shariah or technical reasons at any given point in time. Apart from updating the list of disclosures, information on subsidiary companies of listed companies is vital for Shariah stock screening.

Accordingly, the SECP has prepared the proposed amendments to the Fourth schedule, which are attached herewith in a comparative format.

6. Format for sharing feedback/comments:

Any feedback should be sent via email to islamic.finance@secp.gov.pk or by post to the Head of Islamic Finance Department, SECP Head Office, NICL Building, Jinnah Avenue, Islamabad, in the following format.

Name of the Commenter	
Name of the related Entity	

Sr. No.	Existing provisions in the Regulation	Proposed Changes in track-change format	Rationale for the change
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Confidentiality

If you wish to keep all or any parts of your submission and your identity confidential, please indicate the same. In all other cases, your provided comments may be made public, except your contact information.

7. Indicative Timeline

Stage	Date/Timeline	Detail
1	May 06, 2024	SECP releases Consultation Paper
2	Within 15 days of issuance of Consultation Paper	Comments due on consultation paper
4	Within 15 days of conclusion of stakeholder consultation /roundtables	Issuance of final notification

8. Disclaimer

- *The objective of the issuance of the consultation paper is to seek stakeholders' feedback but SECP is fully empowered, at its discretion, to accept or not to accept a recommendation in accordance with its mandate and policy objectives.*
- *SECP reserves the right not to publish any submission received where SECP considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.*

PART II
Statutory Notifications (S. R. O.)
GOVERNMENT OF PAKISTAN
SECURITIES AND EXCHANGE COMMISSION OF
PAKISTAN

Islamabad, the 6th May, 2024

NOTIFICATION

S.R.O.....- In exercise of the powers conferred under sub-section (2) of section 507 of the Companies Act, 2017 (XIX of 2017), the Securities and Exchange Commission Pakistan is pleased to make the following alterations in the Fourth Schedule to the Companies Act, 2017 (XIX of 2017), namely:-

DRAFT AMENDMENTS

In the aforesaid Fourth Schedule, in PART I, in clause No VI, for sub-clauses (10), the following shall be substituted, namely: -

“VII. Every listed company and its subsidiary, which is not engaged in *Shariah* non-permissible business activities as their core business activities, shall disclose the following in their standalone and consolidated financial statements in accordance with section 228 of the Act, as separate disclosures by way of a note that is cross-referenced with relevant notes:

Disclosures Required in relations to the Statement of Financial Position—

Liability Side:-

- (i) Financing (long-term, short-term, or lease financing) obtained as per Islamic mode;
- (ii) Interest or mark-up accrued on any conventional loan or advance;

Disclosures Required in the Statement of Financial Position – Asset Side:-

- (iii) Long-term and short-term *Shariah* compliant Investments;

- (iv) *Shariah*-compliant bank deposits, bank balances, and TDRs;

Disclosures Required in relation to the Statement of Comprehensive Income:-

- (v) Revenue earned from a *Shariah*-compliant business segment;
- (vi) Break-up of late payments or liquidated damages;
- (vii) Gain or loss or dividend earned on *Shariah* compliant investments or share of profit from *Shariah*-compliant associates;
- (viii) Profit earned from *Shariah*-compliant bank deposits, bank balances, or TDRs;
- (ix) Exchange gain earned from actual currency;
- (x) Exchange gains earned using conventional derivative financial instruments;
- (xi) Profit paid on Islamic mode of financing;
- (xii) Total Interest earned on any conventional loan or advance;
- (xiii) Source and detailed breakup of other income, including breakup of other or miscellaneous portions of other income into *Shariah*-compliant and non-compliant income; and

Other Disclosure Requirements:-

- (xii) Relationship with *Shariah*-compliant financial institutions, including banks, takaful operators and their windows, etc.

Explanation:- For the purposes of this provision, *Shariah* non-permissible business activities shall include but not be limited to business of conventional financial institutions, including conventional banks, insurance, interest-based lending, gambling and betting, liquor and liquor-related activities, pork and pork-related activities, non-halal food and beverages, *Shariah* non-compliant entertainment, tobacco and tobacco-related activities, and other activities that are deemed *Shariah* non-permissible. ”.

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(Bilal Rasul)

Secretary to the Commission

**Proposed Amendments to the Fourth Schedule of the Companies Act, 2017 concerning the
Shariah Disclosures**

#	Existing Provision	Proposed Provision	Rationale for the Changes
	<p align="center">FOURTH SCHEDULE (See Section 225)</p> <p align="center">DISCLOSURE REQUIREMENTS AS TO FINANCIAL STATEMENTS OF LISTED COMPANIES AND THEIR SUBSIDIARIES</p> <p align="center">PART I GENERAL REQUIREMENTS</p>	<p align="center">FOURTH SCHEDULE (See Section 225)</p> <p align="center">DISCLOSURE REQUIREMENTS AS TO FINANCIAL STATEMENTS OF LISTED COMPANIES AND THEIR SUBSIDIARIES</p> <p align="center">PART I GENERAL REQUIREMENTS</p>	No Change
	<p>I. II. . . . VI. The following shall be disclosed in the financial statements, namely:___ 1. 2. . . .</p> <p>10. Sharia compliant companies and the companies listed on Islamic index shall disclose:</p> <p>(i) Loans/advances obtained as per Islamic mode;</p> <p>(ii) Shariah compliant bank deposits/bank balances;</p> <p>(iii) Profit earned from shariah compliant bank deposits/bank balances;</p> <p>(iv) Revenue earned from a shariah compliant business segment;</p> <p>(v) Gain/loss or dividend earned from shariah compliant investments;</p>	<p>I. II. . . . VI. The following shall be disclosed in the financial statements, namely:___ 1. 2. . . .</p> <p><u>VII. Every listed company and its subsidiary, which is not engaged in Shariah non-permissible business activities as their core business activities, shall disclose the following in their standalone and consolidated financial statements as per Section 228 of the Act, as separate disclosures by way of a note that is cross-referenced with relevant notes:</u></p> <p><u>Disclosures Required in relations to the Statement of Financial Position—Liability Side:-</u></p> <p><u>(i) Financing (long-term, short-term, or lease financing) obtained as per Islamic mode;</u></p>	<p>To bring clarity to the scope and applicability of the requirement, existing clause 10 is proposed to be replaced with clause VII.</p> <p>This information is required before the inclusion or exclusion of any company from Islamic indices; hence, every listed company having a halal business objective shall make this disclosure.</p> <p>To introduce groupings of disclosure requirements for ease.</p> <p>To add an explanation to the existing clause 10(i).</p>

<p>(vi) Exchange gain earned from actual currency;</p> <p>(vii) Mark up paid on Islamic mode of financing;</p> <p>(viii) Relationship with shariah compliant banks; and</p> <p>(ix) Profits earned or interest paid on any conventional loan or advance.</p>	<p><u>(ii) Interest or mark-up accrued on any conventional loan or advance;</u></p> <p><u>Disclosures Required in the Statement of Financial Position – Asset Side: -</u></p> <p><u>(iii) Long-term and short-term Shariah compliant Investments;</u></p> <p><u>(iv) Shariah-compliant bank deposits, bank balances, and TDRs;</u></p> <p><u>Disclosures Required in relation to the Statement of Comprehensive Income: -</u></p> <p><u>(v) Revenue earned from a Shariah-compliant business segment;</u></p> <p><u>(vi) Break-up of late payments or liquidated damages;</u></p> <p><u>(vii) Gain or loss or dividend earned on Shariah compliant investments or share of profit from Shariah-compliant associates;</u></p> <p><u>(viii) Profit earned from Shariah-compliant bank deposits, bank balances, or TDRs;</u></p> <p><u>(ix) Exchange gain earned from actual currency;</u></p> <p><u>(x) Exchange gains earned using conventional derivative financial instruments;</u></p> <p><u>(xi) Profit paid on Islamic mode of financing;</u></p> <p><u>(xii) Total Interest earned on any conventional loan or advance;</u></p> <p><u>(xiii) Source and detailed breakup of other income, including breakup of other or miscellaneous portions of other income into Shariah-</u></p>	<p>To identify outstanding Riba included in liabilities.</p> <p>To segregate investments and deposits on the asset side. To add an explanation to the existing clause 10(ii).</p> <p>Same existing clause 10(iv).</p> <p>Add to cover other income linked with revenue</p> <p>To expand the existing clause 10(v).</p> <p>To add an explanation to the existing clause 10(iii).</p> <p>To add an explanation to the existing clause 10(vi) and its break up viz-a-viz Shariah compliant and non-compliant gains .</p> <p>To segregate existing clause 10(ix).</p> <p>Same as above.</p> <p>To address the need to review the other income to check its compliance with the specified threshold.</p>
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	<p><u>compliant and non-compliant income; and</u></p> <p><u>Other Disclosure Requirements:-</u> <u>(xii) Relationship with Shariah-compliant financial institutions, including banks, takaful operators and their windows, etc.</u></p> <p><u>Explanation:</u> <u>For the purposes of this provision, Shariah non-permissible business activities shall include but not be limited to business of conventional financial institutions, including conventional banks, insurance, interest-based lending, gambling and betting, liquor and liquor-related activities, pork and pork-related activities, non-halal food and beverages, Shariah non-compliant entertainment, tobacco and tobacco-related activities, and other activities that are deemed Shariah non-permissible.</u></p>	<p>To add an explanation to the existing clause 10(viii).</p> <p>Added to provide clarity on Shariah non-permissible business activities</p>
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