

The ACCA logo is a red square with the letters 'ACCA' in white, bold, sans-serif font.

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ACCA Pakistan considers this monthly newsletter to be a worthwhile contribution to discussion but does not guarantee the accuracy of statements made by contributors or accepts any responsibility for any statement which may have been made in this newsletter.

1. Survey of Corporate Governance Practices in Pakistan

The International Finance Corporation, Securities and Exchange Commission of Pakistan and the Pakistan Institute of Corporate Governance commissioned a survey of corporate governance practices of local listed and large unlisted companies and financial sector institutions of Pakistan. The survey was conducted by ACCA Pakistan in 2007. The survey obtained the opinion of different corporate governance practices of 111 companies and financial sector institutions of Pakistan.

Following is the executive summary of the survey.

Executive summary

An effective and efficient corporate governance framework depends on the legal, regulatory, business and institutional environment. There is growing interest in the concept of corporate governance in Pakistan mainly because corporate governance is a key to developing a market economy and civil society in transitioning economies such as Pakistan. The survey findings and recommendations are grouped into the following broad areas:

- i) awareness of and commitment to good corporate governance practices
- ii) board practices
- iii) control environment and processes
- iv) information disclosure and transparency
- v) shareholders' rights.

i) Awareness of and commitment to good corporate governance practices

Even though 98% of the respondents stated that they comply with the National Code of Corporate

Governance, 89% stated that the main reason for compliance was that the Code of Corporate Governance was mandatory. For an overwhelming majority (89%) of the respondents, the most important benefit of adoption of corporate governance practices was compliance with legal and regulatory requirements outlined in the Code of Corporate Governance. As required by the Code of Corporate Governance, 92% prepared and circulated annually a 'Statement of Ethics and Business Practices' and 48% had a vision/mission statement. 86% of the respondents stated that the main barrier in improving corporate governance practices were lack of information/know how about corporate governance practices.

ii) Board practices

It can be concluded from the survey that the board, as envisaged by the Code of Corporate Governance, is a powerful centre of authority and control in terms of the functions it performs. The board of directors is responsible for the election, appointment and dismissal of the chief executive (89%); approving the remuneration of the members of the board (62%); the election, appointment and removal of the chairman of the board (91%); setting corporate strategy (86%); setting the remuneration of the CEO (62%); approving risk management policy (74%); approving transactions (98%); reviewing annual reports (81%); and creating disclosure policies (89%) and succession planning (30%). 69% of the boards did not have any female directors. There is general resistance to the idea of having independent non-executive directors on the board. Respondents were content with having non-executive directors, i.e. who do not work full time with the company, but were averse to the idea of an independent non-executive director, mainly because they could not appreciate the value of such directors. 45% of the boards had 2 to 5 independent non-executive directors.

95% of the respondents had an audit committee but only 34% had a majority of independent non-executive directors as required by the Code. 89% of the respondents did not have a nomination committee and 63% did not have a remuneration committee. 85% of the respondents stated that the positions of CEO and chairman were held by different persons. 29% of respondents did not reply to the question about the amount of payment made to board members for attending board meetings, while 78% of those respondents who did reply stated that the average payment was in the range of PKR 500-1,000. Generally, there was not much evidence of performance-related salaries.

iii) Control environment and processes

96% of the respondents had an internal auditor/audit department and 97% had an external auditor. 65% of the respondents stated that the role of whistle-blower was not performed by either the internal auditor or the external auditor or the audit committee, while 68% stated that use of insider information was not investigated by either the audit committee or the internal auditor or the external auditor. Even though the Code of Corporate Governance of Pakistan states that all listed companies in the financial sector should change their external auditors every five years, 30% of the financial institutions surveyed had not done so.

iv) Information disclosure and transparency

It was observed that the majority of the respondents achieved transparency in information disclosure by fulfilling the requirements of the Code of Corporate Governance of Pakistan and the Companies Ordinance 1984. Thus even though annual reports prepared by the majority of the respondents complied with the provisions of the Fourth and Fifth Schedules of the Companies Ordinance, responding companies were reluctant to provide voluntary information relating to

their articles of association (92%), remuneration of the board as individuals (53%), market share, sales and marketing (57%), environment and social responsibility (58%), biographies of the members of the board (96%), stock options policy (90%) or to provide a 'management discussion and analysis' section (72%) in their annual reports, mainly because 82% of the respondents asserted that there was no legal requirement to disclose such information in the annual reports.

61% of the respondents complied with IAS/IFRS. 80% of the responding companies had a website and 67% of these made their annual reports available on their website.

v) Shareholders' rights

67% stated that voting at the Annual General Meeting (AGM) takes place by means of a show of hands, and 52% stated that a proxy voting mechanism was also available to shareholders. An electronic voting mechanism had not been used by any of the respondents. 45% of the respondents declared that they did not have a clause relating to equal treatment with respect to voting rights and subscription rights in their articles and 91% did not have clear policies with respect to treatment of shareholders when changes of control occur. 67% of the respondents stated that their company's/bank's governing documents require the board members and management to disclose, and abstain from voting on issues where there is a conflict of interest.

There was evidence of increasing related-party transactions among responding companies, with 80% of the respondents stating that under a governing document or law it was mandatory to disclose related-party transactions. Even though there is currently no requirement to have the related-party transactions certified by the external auditors, 49% of the respondents stated that they should be verified by the external auditors.

Recommendations

Following are some of the recommendations of the survey.

- 1.1) Over the last five years, the Code of Corporate Governance, built upon a sound framework of company law, has developed a culture of compliance with corporate governance practices. Even though Pakistan must continue to press forward with the enhancement of its corporate governance while taking care not to stifle the nation's entrepreneurial flair with a burgeoning volume of counterproductive regulation the country should nevertheless follow the practice elsewhere across the world and reviews its Code of Corporate Governance.
- 1.2) Lack of qualified staff to implement corporate governance practices and lack of information/know-how about corporate governance were identified as the main barriers to the implementation of corporate governance practices. It is suggested that corporate governance as a subject should be taught at universities to develop qualified staff able to implement corporate governance practices effectively.
- 1.3) In order to ensure effective implementation of corporate governance practices in Pakistan, along with SECP, the stock exchanges and the courts have to play a critical and more active role. The stock exchanges have to be stricter in implementation of the listing rules relating to corporate governance. The courts also have to play a key role in enforcement of corporate governance practices.
- 1.4) The business community needs to be made aware of the business case for implementing corporate governance best practices.
- 1.5) There should be a sharpening up of the current statement of compliance with the Code of Corporate Governance. This should be a narrative statement, providing sufficient explanation to enable shareholders to evaluate how the principles of corporate governance have been applied.
- 1.6) There is also a need to further strengthen the Pakistan Institute of Corporate Governance so that it becomes a centre of excellence in terms of corporate governance research and professional development programmes.
- 1.7) The difference between 'non-executive' and 'independent' needs to be better understood within companies. Inclusion of independent non-executive directors on the board of directors should be encouraged and a 'comply or explain' policy needs to be adopted with regard to inclusion of independent non-executive directors on boards in the revised Code of Corporate Governance.
- 1.8) There may be a case for a better mix-of-skills and types of directors, i.e. mix between executive, non-executive and independent directors, as well as more representation of qualified and experienced women on boards of directors.
- 1.9) The Code of Corporate Governance of Pakistan should progressively come into line with other leading Codes in influencing the more general establishment of corporate governance, nomination and remunerations committees.
- 1.10) The role of institutional investors needs to be reviewed and SECP should consider incorporating a section on the role of institutional investors in the Code. This is essential so as to make the institutional institutions aware of their duties and responsibilities. This may also be helpful in ensuring that the institutional investors as active board members play a pivotal role in effective implementation of corporate governance practices.

The complete survey is available on:
www.accaglobal.com/pakistan/publicinterest/TA/CG/

2. Corporate Governance and Wealth Creation

ACCA has conducted a survey to find out the opinions held by chairmen and finance directors of UK listed companies about corporate governance. Its particular focus is on the generation of wealth, exploring respondents' perceptions of the relationships between corporate governance and corporate effectiveness. It also investigates views on the new elements of the UK Combined Code of Corporate Governance (www.fas.gov.uk/pubs/ukla/lr_comcode2003.pdf).

Following is the executive summary of the survey.

i) Attitudes of directors to corporate governance

It was found that 30% believed the 'main purpose of corporate governance' to be 'protecting shareholders against loss' and another 30% believed it to be 'optimising the long-term financial ability of the organisation to create wealth'. The remaining 40% viewed both purposes as 'equally important'.

Relatively more directors from larger companies linked the purpose of corporate governance with generating wealth. Within the FTSE 100¹, 47% of directors viewed the 'main purpose of corporate governance' as 'optimising' compared with only 20% of directors from companies outside the FTSE 350¹. Also, within the FTSE 100 twice as many directors believed the main purpose to be 'optimising' than 'protecting'.

More negative comments than positive were made about the purpose of corporate governance, eg, referring to corporate governance as 'over-prescriptive', 'burdensome' and 'box ticking'.

When asked to rank other purposes of corporate governance, almost all directors ranked 'ensuring accountability of management to organisation owners' as most important and 'improving share price' as least important. There were some interesting variations, however, the biggest being on the importance of 'satisfying the needs of regulators'. Directors who viewed the main purpose of corporate governance as protecting shareholders ranked 'satisfying the needs of regulators' as most important, whereas those who believed that the main purpose is to 'optimise wealth' ranked this as least important.

FTSE 350 directors believed 'satisfying the needs of regulators' to be third most important, whereas FTSE 100 directors and directors from outside FTSE 350 ranked this eleventh out of 13.

ii) Aspects of corporate governance important to companies now and in the next five years

Respondents were asked to rate the importance of 14 aspects of corporate governance to their organisation now and in the next five years. The four most important aspects of corporate governance to directors responding to the survey were '*strategy and goals*' and '*financial reporting (disclosure)*' followed by '*relationships with institutional shareholders*' and '*the quality of the external auditors*'.

iii) The influence of corporate governance on factors relevant to the generation of wealth

Using a scale of one to five (where one is not at all influential and five is very influential), respondents were asked to indicate how much influence they think good corporate governance practice has on various aspects of a company's ability to generate wealth. Responses are summarised in Table 1.

¹ the FTSE 350 index is a stock market index incorporating the largest 350 companies by capitalisation which have their primary listing on the London Stock Exchange. It is a combination of the FTSE 100 index of the largest 100 companies and the FTSE 250 index of the next largest 250 companies.

Table1: The influence of corporate governance on factors relating to the generation of wealth

	How influential is corporate practices in terms of...	Average
1	Maintaining or improving relationships with the investment community	3.71
2	Contributing to the organisation's overall reputation	3.67
3	Obtaining investment from institutional investors	3.53
4	Contributing to the organisation's long-term share price	3.16
5	Contributing to the organisation's strategic and / or operational effectiveness	2.99
6	Obtaining other finance at a reasonable cost of capital	2.98
7	Contributing to the organisation's profitability	2.50
8	Contributing to the organisation's attractiveness as a potential employer	2.37
9	Contributing to the organisation's attractiveness as a potential supplier	2.27

iv) Do independent NEDs play an important role in establishing effective corporate governance practice?

It seems that NEDs' main role is in establishing the appearance of governance practice rather than contributing to strategy and performance. There was strong agreement that independent NEDs play an important role in 'establishing effective corporate governance practice': 79% of respondents agreed and only 3% disagreed with this statement.

v) Independence criteria

The revised UK Code of Corporate Governance introduced new and more demanding criteria for establishing whether or not an NED is independent. Of those respondents who agreed that 'it is difficult to appoint truly independent NEDs', the highest proportion (35%) were from companies outside the FTSE 350. Many respondents accused the new approach of encouraging a 'tick box' attitude: 94%

agreed and only 1% disagreed that '*independence of mind* (ie objectivity and integrity) is more important than *independence in appearance* (ie meeting the compliance criteria)'.

vi) Two sides of corporate governance

Some respondents viewed corporate governance simply in terms of a bureaucratic exercise while others viewed it as checks and balances to protect shareholders. A third group, however, viewed corporate governance as having a significant role in strategy and profitability.

Conclusion

This study suggests that Corporate governance should be considered in the context of achieving objectives, how objectives are achieved and how risks are managed as well as how boards are accountable to, and engage with, shareholders. This research highlights the need to reconsider the approach to corporate governance and ensure that all parties in the process (including boards, shareholders and regulators) share a common understanding of what corporate governance is, what it should be expected to achieve and what it cannot be expected to achieve.

Complete research report is available on:
www.accaglobal.com/pubs/publicinterest/activities/research/research_archive/2281284.pdf

3. Useful corporate governance resources

Corporate Governance in Pakistan: Results from the Corporate Governance ROSC
 Visit: www.sbp.org.pk/bsd/conf/ppt/Session-22.ppt

Code of Corporate Governance of Pakistan
 Visit: www.secp.gov.pk/rc/Codes/Code%20of%20Corporate%20Governance.pdf

OECD Principles of Corporate Governance
 Visit: www.oecd.org/dataoecd/32/18/31557724.pdf

Basel committee on Banking Supervision- Enhancing Corporate Governance for banking organisations
 Visit: wb-cu.car.chula.ac.th/papers/bis/bcbs03.pdf

4. NEWS UPDATE

4.1) Monthly WHT Statement Date Changed

The Federal Board of Revenue has changed the date for filing of monthly withholding tax statement from 15th to 10th of each month. For example withholding statement for the month of April, 2008 shall now be filed by 10 May 2008.

For this purpose, Rule 44 of the Income Tax Rules, 2002 has been amended.

For further information visit:

<http://www.fbr.gov.pk/newdt/Sros/2008/2008SR0353.pdf>

4.2) EOIs invited for the privatisation of SME Bank

As part of the privatisation process of the public sector entities, the Privatisation Commission (PC) has invited EOIs (Expressions of Interest) for the sale of 93.88 % government shareholding in the SME Bank Limited. The government will maintain the right to appoint at least one director on the board of directors of SME bank after privatisation. The potential buyer will have to retain the name 'SME Bank Limited' for one year and the Bank's charter will remain the same for at least three years after privatisation.

4.3) Consortium buys majority stake in Saudi Pak Bank

On 1 April 2008, a consortium of IFC (International Finance Corporation), Bank Muscat, Nomura International and Sinthesis Capital has acquired 85.10 percent stake in the Saudi Pak Commercial Bank (SPCB) at the purchase price of \$0.47 per share (Rs.29.30) totalling \$213 million.

4.4) PSO announces 293% increase in net profits

On 22 April 2008, PSO (Pakistan State Oil) announced its nine monthly results, showing an extraordinary increase of 293% in its profit after tax. The profits for the period amount to Rs.8.4 billion with an earning per share of Rs.49.30 (2007: Profits Rs.2.15 billion: EPS: Rs.12.53). The increase in profits has been attributed to huge inventory gains on furnace oil and diesel, growing margins and a 35% increase in net sales.

5. Accounting and Auditing Standards Update

5.1) International Public Sector Accounting Standards Board (IPSASB) issues Standards on Employee Benefits and Cash-Generating Assets

IPSASB has issued two new standards as part of its program to converge with International Financial Reporting Standards.

For further information, please visit

www.ifac.org/Members/Downloads/IPSAS25.pdf and www.ifac.org/Members/Downloads/IPSAS26.pdf

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