



*The Listed
Companies (Code
of Corporate
Governance)
Regulations, 2019*
A new governance
regime

Comply or explain



The Listed Companies (Code of Corporate Governance) Regulations, 2019

On September 25, 2019, the Securities and Exchange Commission of Pakistan (SECP) issued the Listed Companies (Code of Corporate Governance) Regulations, 2019 (“2019 Code”) under the powers conferred under section 156 read with section 512 of the Companies Act 2017, superseding the Listed Companies (Code of Corporate Governance) Regulations, 2017 (“2017 Code”).

The 2019 Code is based on a ‘comply or explain’ approach which is a new governance regime in Pakistan. Since the introduction of the corporate governance in Pakistan for listed companies in 2002 and subsequent revisions in 2012 and 2017 the specific provisions were mandatorily required to be implemented with any exception reported as a ‘non-compliance’. Resultantly, the corporate governance implementation and monitoring has been based on the “mandatory” approach. It is believed that the corporate governance in this new regime will be more driven by principles than rules, therefore, decision making process of listed companies would be under the spotlight. We believe that this new regime would be providing the companies the opportunity to learn and improve the governance parameters, while explaining the progress towards compliance of a provision. Further, the flexibility allows organizations to think out of the box as an alternate course of action could be followed, while ensuring transparency. This approach recognises that what works well in one company, for one investor or a particular stakeholder may not necessarily be generally applicable to companies, investors and stakeholders that operate in another context and under different circumstances.

The 2019 Code requires that it shall be the responsibility of board of directors of listed companies (the Board) to use ‘comply or explain’ principle wisely and of investors to assess differing company approaches thoughtfully.

The significant changes brought in by the 2019 Code to the corporate governance applicable in Pakistan up to September 24, 2019 via the 2017 Code are set out in this document. It is understood that the complete regulations covering the 2019 Code and 2017 Code shall be referred to where detailed understanding of the changes is required. Further, through this document it is not intended to address the questions of law that may arise and therefore, a formal legal advice may be sought where necessary or the SECP may be approached to obtain the necessary clarification.

October 17, 2019

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1. Introduction

1.1. Issuance of the 2019 Code under section 156 of the Companies Act, 2017

Section 156 of the Companies Act, 2017 states that the Securities and Exchange Commission of Pakistan (SECP) may provide for framework to ensure good corporate governance practices, compliance and matters incidental and axillary for companies or class of companies in a manner as may be specified. Accordingly, as was the case with the 2017 Code, the SECP through SRO 1163(I)/2019 dated September 25, 2019 issued the regulations, 'the Listed Companies (Code of Corporate Governance) Regulations, 2019', here-in-after referred to as '2019 Code'.

1.2. The 2019 Code is applicable to listed companies only

The 2019 Code is applicable to **listed companies only** while the 2017 Code in its scope also included all other entities, to the extent applicable, where the statutes and underlying licensing requirements requires such entities to comply with the 2017 Code.

The Companies Act, 2017 states that listed company means a public company, body corporate or any other entity whose securities are listed on securities exchange.

1.3. The 2019 Code became effective September 25, 2019

The 2019 Code came into force from the date of its publication i.e. September 25, 2019. Based on the approach similar to the one which was adopted by the SECP in case of the 2017 Code, we understand that:

- as of now, the 2019 Code is already holding the field regardless of the financial year end of the listed companies and therefore the listed companies are expected to ensure compliance of the 2019 Code with effect from September 25, 2019 unless otherwise explicitly allowed by the 2019 Code; and

- the statement of compliance prepared by the listed companies covering the period commencing from September 25, 2019 (i.e. the effective date of the 2019 Code), is to be based on the 2019 Code as now the new regime of governance, i.e. 'comply or explain' vs mandatory, is applicable. For clarity the listed companies may provide additional disclosures in the statement of compliance.

To illustrate in case of listed companies with December 31, 2019 as the financial year end, compliance from January 1, 2019 to September 24, 2019 is to be based on the 2017 Code, whereas for the remaining period from September 25, 2019 to December 31, 2019 compliance with the 2019 Code is to be ensured. However, when the statement of compliance for the year ending December 31, 2019 is prepared, the format as provided in the 2019 Code is to be followed with certain additional disclosures to provide the clarity.

1.4. Types of provisions contained in the 2019 Code

The 2019 Code on an overall basis contains provisions of the following three types:

- i. Mandatory provisions;
- ii. Non-mandatory provisions; and
- iii. Other provisions, which have been referred to as 'recommendatory provisions' in this document.

Mandatory provisions

2. Mandatory provisions

2.1. Mandatory provisions as defined in the 2019 Code

The 2019 Code is based on 'comply or explain approach' except the requirements for which it is explicitly stated as 'mandatory'. 'Mandatory' in relation to the 2019 Code, means such provisions that are construed to be strictly complied with by the company and non-compliance of such regulations leads to penal proceedings under regulation 37 of the 2019 Code.

2.2. List of mandatory provisions as stipulated in the 2019 Code

The mandatory provisions as stipulated by the 2019 Code are as follows:

Regulation No.	Subject	Changes brought in via the 2019 Code
3	Number of Directorships	Yes, details of which are given in paragraph 2.3 below.
6	Independent Directors	Yes, details of which are given in paragraphs 2.4 and 2.5 below.
7	Female Director	No
8	Executive Director	Yes, details of which are given in paragraph 2.6 below.
27	Audit Committee	Yes, details of which are given in paragraph 2.7 below.
32	Terms of appointment of external auditor	No
33	Rotation of auditors	Yes, details of which are given in paragraph 2.8 below.
36	Compliance Statement and Auditor Review	Yes, details of which are given in paragraph 2.9 below.

Details about these mandatory provisions are given in the Annexure to this document.

2.3. Number of simultaneous directorships now in line with the Companies Act, 2017

Section 155 of the Companies Act, 2017 states that no person shall, after the commencement of the Companies Act, 2017, hold office as a director, including as an alternate director at the same time in more than such number of companies as may be specified. Provided that this limit shall not include the directorships in a listed subsidiary.

A person holding the position of director in more than seven companies on the commencement of the Companies Act, 2017 shall ensure the compliance of this section within one year of such commencement.

The 2019 Code has issued its requirements which is subject to the aforementioned section 155 of the Companies Act, 2017. The 2019 Code states that it is mandatory that no person shall be elected or nominated or hold office as a director of a listed company including as an alternate director of more than seven listed companies simultaneously.

As per the 2017 Code this limit was five listed companies simultaneously, i.e. more restrictive than the Companies Act, 2017. However, in the 2017 Code it was explicitly stated that while calculating the limit, the directorship in the listed subsidiaries of a listed holding company shall be excluded. Now as the requirement of the 2019 Code is subject to section 155 of the Companies Act, 2017 accordingly we understand that relaxation of calculating the limit to the extent of the directorships in a listed subsidiary is still available.

Applicability: When the Board shall be reconstituted not later than expiry of its current term.

2.4. Independent director at least two or 1/3 with explanation of fraction not rounded up as one

The requirement on each listed company to have **at least two or 1/3 members** of the Board, whichever is higher, as independent directors remains unchanged from the 2017 Code.

As part of implementation of the 2017 Code, the SECP through its Frequently Asked Questions (FAQs) explained that if there are seven directors on the board of a listed company, the composition as per the 2017 Code would be two independent directors, two executive directors [including the Chief Executive Officer (CEO)] and three non-executive directors.

However, the 2019 Code requires that a listed company shall explain the reasons, in the compliance report, if any fraction contained in such one-third number that is not rounded up as one.

Applicability: When the Board shall be reconstituted not later than expiry of its current term.

2.5. Independent director to submit declaration at first meeting which is held after election of directors

The 2017 Code required that every independent director shall give declaration to chairman of board that the criteria of independence notified under the Companies Act, 2017 have been met at first meeting in every financial year as well as on an event of any change affecting the independence.

In accordance with the 2019 Code the requirement to submit declaration at first meeting in every financial year has been changed and now the requirement to submit such declaration is at the first meeting which is held after the election of directors.

2.6. Executive directors not to be more than 1/3 with explanation of fraction rounded up as one

The maximum number of executive directors, including the CEO, is unchanged from the 2017 Code as not be more than 1/3 of the board of directors.

However, it is now required that a listed company shall explain the reasons, in compliance report, any fraction contained in such one-third number which is rounded up as one.

Applicability: When the Board shall be reconstituted not later than expiry of its current term.

2.7. CEO and CFO not to be part of the Audit Committee

The 2019 Code specifically states that the CEO and the Chief Financial Officer (CFO) shall not be members of the audit committee. We understand that in the 2017 Code as well the board of directors were required to establish the audit committee comprising of non-executive directors.

2.8. Rotation of auditors in case of audit firm which is a sole proprietorship

To address the matter of rotation of auditor by the listed companies, other than those in the financial sector, the auditor of which is a sole proprietorship based audit firm, it has been now specifically stated in the 2019 Code that in case the audit firm is a sole proprietorship then after completion of five years such audit firm shall be changed.

2.9. Changes made to the statement of compliance

The 2019 Code introducing new regime of 'comply or explain' approach (explained in paragraph 3 of this document) requires that the statement of compliance prepared by the listed companies shall be **supported by necessary explanations**. These explanations as we understand will contain details about the impediments faced by the listed companies in ensuring compliance with the **non-mandatory provisions** of the 2019 Code.

The contents of the statement of compliance with the 2019 Code are same as those stated in the statement of compliance with the 2017 Code, except for the following:

- The listed company has to write that the statutory audit firm and the partners of the firm involved in the audit are not a close relative (spouse, parent, dependent and non-dependent children) of the CEO, CFO, Head of Internal Audit (HoIA), the Company Secretary or Director of the company.
- Confirmation that all requirements of regulations 3, 6, 7, 8, 27, 32, 33 and 36 of the 2019 Code have been complied with. These regulations represent mandatory provisions of the 2019 Code.
- Explanation for non-compliance with requirements, other than regulations 3, 6, 7, 8, 27, 32, 33 and 36 (if applicable).

2.10. Penalty now limited to mandatory provisions only

The scale of penalty is same as given in both the codes, i.e. the 2017 Code and the 2019 Code, which is a penalty which may extend to Rs. 5 million and, where the contravention is a continuing one, with a further penalty that may extend to Rs. 100,000 for every day after the first during which such contravention continues.

However, as explained that the 2019 Code has introduced a new regime of 'comply or explain' approach, the penal provision as stipulated in the 2019 Code is restricted to non-compliance of the mandatory provisions only which are enlisted in paragraph 2.2 above.

2.11. Relaxation from requirements of the 2019 Code

Where the SECP is satisfied that it is not practicable to comply with any of the mandatory provisions of the 2019 Code (i.e. regulations 3, 6, 7, 8, 27, 32, 33 and 36), it may, for reasons to be recorded in writing, on the application by the listed company, extend the time for compliance of the same, subject to such conditions as the SECP may deem fit.

Comply or explain approach

3. Comply or explain approach

3.1. The 2019 Code contains non-mandatory provisions as well

The 2019 Code is based on ‘comply or explain approach’ except the provisions for which it is explicitly stated as ‘mandatory’.

Comply or explain approach means discretion of a company with respect to **non-mandatory provisions** of the 2019 Code either to comply or provide appropriate explanation as to any impediment in its compliance in the compliance report alongwith the financial statements. It is the responsibility of the board of directors of listed companies to use this approach wisely and of investors to assess differing company approaches thoughtfully.

In this context, we understand that in regulations / clauses where the word ‘shall’ has been used in the 2019 Code and those provisions have not been marked as ‘mandatory’, such represent ‘**non-mandatory provisions**’ and the listed companies in these cases are required to follow the ‘comply or explain’ approach i.e. either the compliance is to be made or appropriate explanation as to any impediment in its compliance is to be provided in the ‘statement of compliance’.

3.2. The ‘comply or explain’ approach, what does that mean?

The ‘comply or explain’ approach primarily is based on the principle that the 2019 Code is not a rigid set of rules. It consists of certain provisions which are non-mandatory in nature and therefore the listed companies are required to report in the statement of compliance whether those non-mandatory provisions have been complied with; and if not an appropriate explanation as to any impediment in its compliance is provided. The non-mandatory provisions, we believe, are the core of the 2019 Code and the way in which these are applied should be the central question for the board of directors.

Through this ‘comply or explain’ approach it is recognised that an alternate way of fulfilling a non-mandatory provision may be justified in particular circumstances if objective of good governance can be achieved. A condition of doing so is that the reasons for it should be explained clearly and carefully in the statement of compliance. In providing an explanation, the listed companies should aim to illustrate how its actual practices contribute to good governance. It should ideally set out the background and provide a clear rationale for the action it is taking. Where deviation from a particular non-mandatory provision is intended to be limited in time, the explanation may indicate when the listed company expects to conform to that non-mandatory provision.

3.3. List of non-mandatory provisions as stipulated in the 2019 Code

The list of non-mandatory provisions as stipulated by the 2019 Code is as follows:

Regulation No.	Subject	Changes brought in via the 2019 Code
Chapter II: Number of directorship and composition of board		
4	Diversity in the Board	No
5	Representation of minority shareholders	No
9	Chairman of the Board	No
Chapter III: Board of directors, its members and meeting of board		
10	Responsibilities of the Board and its members	Yes, details of which are given in paragraphs 3.4 to 3.8 below.
11	Agenda and discussion in meetings	No
12	Minutes of meeting	No
13	Attendance at meeting	No
Chapter IV: Issues to be placed for decision of the board of directors		
14	Significant issues	No
15	Related party transactions	Yes, details of which are given in paragraphs 3.9 and 3.10 below.
Chapter V: Remuneration of directors		
16	Formal Policy	No
17	Determination of remuneration	Yes, details of which are given in paragraphs 3.11 and 3.12 below.
Chapter VI: Directors' training program		
18	Directors' orientation program	No
Chapter VII: Chief Financial Officer, Company Secretary And Head Of Internal Audit		
20	Approval	Yes, details of which are given in paragraph 3.13 below.
21	Removal	Yes, details of which are given in paragraph 3.14 below.
22	Qualification of chief financial officer	Yes, details of which are given in paragraphs 3.15 and 3.16 below.
23	Qualification of internal auditor	- do -
24	Qualification of company secretary	No
Chapter VIII: Responsibility for financial reporting and corporate compliance		
25	Financial statement endorsed by chief financial officer and chief executive officer	No
26	External Auditor	No

Regulation No.	Subject	Changes brought in via the 2019 Code
Chapter IX: Committees of the board		
28	Human Resource and Remuneration Committee	Yes, details of which are given in paragraph 3.17 below.
Chapter X: Internal audit		
31	Composition of internal audit function	Yes, details of which are given in paragraphs 3.18 and 3.19 below.
Chapter XII: Reporting and disclosure		
34	Directors' report	No

3.4. The placement of code of conduct on the website is not compulsory now

The requirement as stipulated in the 2017 Code to place the code of conduct on the listed company's website has now been removed. The 2019 Code now through its regulation 35 makes the placement of code of conduct for members of board of directors, senior management and other employees on the listed company's website as recommendatory.

3.5. Resolution by the board on certain material transactions not part of the 2019 Code

The 2017 Code required that the decisions on the following material transactions or significant matters are documented by a resolution passed at a meeting of the board:

- investment and disinvestment of funds where the maturity period of such investments is six months or more, except in the case of banking companies, non-banking finance companies and insurance companies.
- determination of the nature of loans and advances made by the company and fixing a monetary limit thereof, except for banking companies.

These requirements have been removed by the 2019 Code. However, we understand that similar requirements are part of section 183 of the Companies Act, 2017.

3.6. Determination of the level of materiality by the board no more required

The 2017 Code required that the board of directors shall define the level of materiality, keeping in view the specific circumstances of the company and the recommendations of any technical or executive sub-committee of the board that may be set up for the purpose.

This requirement has been removed by the 2019 Code.

3.7. The board's responsibility for overseeing succession planning not carried forward from 2017 Code

In accordance with the 2017 Code the board of directors of a company were required to ensure that formal mechanism shall be in place for selecting, compensating, monitoring and, when necessary, replacing senior executives and overseeing succession planning and the remuneration of key executives and the board may be aligned with the long term interests of the company and its shareholders.

These requirements have not been included in the 2019 Code.

3.8. Emphasis on remuneration policy for non-executive directors and code of ethics not made

The 2017 Code stated that the significant policies approved by the board of directors may include:

- remuneration policy for non-executive directors including independent directors.
- code of ethics, managing conflict of interest of management and board members, communication policy and investors' / shareholders' relations.

The emphasis on the above mentioned significant policies has not been carried forward to the 2019 Code.

3.9. Separate placement of RP transactions not executed at arm's length price not part of 2019 Code

The 2017 Code required that the related party transactions, not executed at arm's length price, shall be placed separately at each board meeting alongwith necessary justification on recommendation of the Audit Committee of the company. Further, the requirements of section 208 of the Companies Act, 2017 were required to be complied with by the board for approval of such transactions.

This requirement of separately placing RP transactions not executed at arm's length price at each board meeting has been taken out of the domain of the 2019 Code. However, we understand the companies shall have to comply with these requirements as part of compliance with section 208 of the Companies Act, 2017.

3.10. Guidance on quorum of the board in case of conflict of interest no more part of the 2019 Code

The 2017 Code stated that for the purpose of consideration and decision by the board of directors on any agenda item, or in respect of any other matter, if any director has a conflict of interest therein in terms of the Companies Act, 2017, then in addition to the provisions of section 207 of the Companies Act, 2017 and notwithstanding anything contained in the articles of association of a company, the directors shall ensure that the quorum of the meeting of the board shall not be deemed to be present unless at least two independent directors are also present at such meeting in person or through video link when such matter comes up for the first time for consideration of the board.

This requirement has been removed by the 2019 Code. However, we understand the companies have to comply with these requirements as part of compliance with section 207 of the Companies Act, 2017.

3.11. Involvement of consultant for determination of directors remuneration not specified

The 2017 Code while stipulating the requirements on the determination of remuneration of directors stated in a proviso that if the company's articles of association authorizes the board to determine director's remuneration, an independent consultant may be engaged to recommend an appropriate level of remuneration for consideration and approval of the board.

This proviso has been removed by the 2019 Code. We understand after this deletion it has been reinforced that the process adopted for determination of director's remuneration shall comply with the provisions of the Companies Act, 2017 including but not limited to section 170 (restriction on director's remuneration) and section 207 (interested director not to participate or vote in proceedings of board) of the Companies Act, 2017.

3.12. Linking of performance evaluation to remuneration of director not specified

The 2017 Code while explaining the requirements in connection with determination of remuneration of director stated that due consideration to performance evaluation (as applicable) should be given. However, this emphasis has not been carried forward to the 2019 Code.

3.13. Determination of employment conditions by board for continued services not specifically required

The 2017 Code required that the board of directors shall determine remuneration, terms and conditions of employment or continued service of CFO, company secretary and HoIA. However, the expression 'continued service' has not been carried forward to the 2019 Code. Hence it appears that the determination by the board of directors is restricted at the time of employment only.

3.14. Removal of HoIA only upon recommendation of the audit committee

The Code 2019 now specifically states that HoIA may be removed **only** upon recommendation of the audit committee.

3.15. Qualification criteria for CFO and HoIA to be considered at the time of appointment only

The 2017 Code inter alia required that no person shall continue to hold position of CFO or HoIA unless the qualification criteria provided for in the 2017 Code have been met. However, the expression 'continue to hold position' has not been carried forward to the 2019 Code. Hence it appears that the qualification criteria for CFO and HoIA given in regulations 23 and 24 respectively of the 2019 Code are to be considered at the time of appointment of CFO and / or HoIA only.

3.16. Determination by the SECP of the suitability of candidate for the CFO and HoIA not required now

In accordance with the 2017 Code, a formal determination by the SECP of the suitability of the candidate was required in case the candidate for the position of the CFO or Head of Internal Audit (HoIA) had at least seven years of managerial experience in fields of audit or accounting or in managing financial or corporate affairs functions of a company and has a suitable degree from a university in Pakistan or abroad equivalent to graduate degree, recognized and approved by the Higher Education Commission of Pakistan (HEC).

In accordance with the 2019 Code, the formal determination by the SECP of the suitability of the candidate is not required.

3.17. Certain changes to the recommended ToRs of HR&R Committee

The 2017 Code stated that the terms of reference (ToRs) of Human Resource and Remuneration Committee (HR&R Committee) as determined by the board of directors may include the following:

- recommend to the board for consideration and approval a policy framework for determining remuneration of directors and senior management preferably taking into consideration that such remuneration commensurate with the performance of the company and evaluation of board and management (as applicable).
- undertaking annually a formal process of evaluation of performance of the members of the board.
- recommending to the board the succession planning of chief operating officer, CFO, Company Secretary and HoIA.

These recommended terms have not been specified in the 2019 Code.

3.18. Coordinator no more required in case IA function is performed by IA staff of holding company

The 2017 Code required that the company shall appoint or designate a fulltime employee other than CFO, as HoIA holding equivalent qualification prescribed under the 2017 Code, to act as coordinator between firm providing internal audit services or holding company staff, as applicable and the board. However, the requirement to appoint or designate a fulltime employee when the internal audit function performed by the internal audit staff of holding company has not been carried forward to the 2019 Code.

3.19. Restriction on outsourcing of IA function

While stipulating the pre-requisites in connection with the outsourcing of internal audit function by a listed company both the codes, i.e. the 2017 Code and the 2019 Code required that the company shall not appoint its existing external auditors as internal auditors.

However, this limitation has been extended by the 2019 Code which states that in addition to the above, the company shall not appoint its existing external auditors or any of its associated company or associated undertaking, as internal auditors.

Recommendatory provisions

4. *Recommendatory provisions*

4.1. The provisions in the 2019 Code with words such as ‘may’ and / or ‘encouraged’

In addition to the **mandatory** and **non-mandatory** provisions stipulated in the 2019 Code, there are certain regulations / clauses in the 2019 Code in which word ‘may’ and / or ‘encouraged’ have been used. We understand that these clauses remain recommendatory in nature and therefore neither are mandatory nor fall into ‘comply or explain’ approach.

4.2. List of recommendatory provisions as stipulated in the 2019 Code

The recommendatory provisions included in the 2019 Code are as follows:

Regulation No.	Subject	Changes brought in via the 2019 Code
Chapter VI: Directors’ training program		
19	Directors’ training	Yes, details of which are given in paragraphs 4.3 and 4.4 below.
Chapter IX: Committees of the board		
29	Nomination Committee	No
30	Risk Management Committee	No
Chapter XII: Reporting and disclosure		
35	Disclosure of significant policies on website	No

4.3. Certification for directors under DTP not compulsory now

In accordance with the 2017 Code it was compulsory for all companies to ensure that all the directors on its board have acquired the prescribed certification under any Director Training Program (DTP) offered by institutions, local or foreign, that meet the criteria specified by the SECP and approved by it. For this purpose certain compliance dates were also specified.

The 2019 Code has made this DTP as recommendatory as the 2019 Code now uses the word 'encouraged'.

Consequently, the requirement for a newly appointed director on the Board to acquire, the DTP certification within a period of one year from the date of appointment as a director on the Board is also recommendatory.

Further, the SECP's role in granting exemption to directors keeping in view the relevancy of minimum of 14 years of education and 15 years of experience on the board of a listed company has been removed.

Additionally, the provisions relating to exemptions from the requirements of the DTP certification which were available in the following cases are deleted in the 2019 Code:

- An individual having at least 25 years of post-qualification experience in fields of law, audit, tax, finance, corporate affairs, regulatory or government sector experience and is a member of professional body of accountants whose qualification is recognized as equivalent to post graduate degree by HEC.
- An individual having at least 30 years of experience in fields of law, audit, tax, finance, corporate affairs, regulatory or government sector experience and has a postgraduate degree in the above mentioned fields from a university in Pakistan or equivalent recognized and approved by HEC.

4.4. Trainings under DTP for female executives and head of departments not compulsory now

In accordance with the 2017 Code it was compulsory for every company to arrange training every year under the DTP for:

- at least one female executive from the year starting June 30, 2019; and
- at least one head of department from the year starting June 30, 2021.

These trainings are recommendatory and, therefore, now the listed companies are encouraged to arrange training every year for:

- at least one female executive – from July 2020; and
- at least one head of department – from July 2022.

*Annexure specifying the
mandatory provisions of the
2019 Code*

Annexure specifying the mandatory provisions of the 2019 Code

Following are the mandatory provisions of the 2019 Code:

Regulation No.	Requirements
3	Number of Directorship Subject to the requirements of section 155 of the Companies Act, 2017, it is mandatory that no person shall be elected or nominated or hold office as a director of a listed company including as an alternate director of more than seven listed companies simultaneously: Provided that the said limit on directorship shall be effective when the Board shall be reconstituted not later than expiry of its current term.
6	Independent Director <ul style="list-style-type: none">• It is mandatory that each listed company shall have at least two or one third members of the Board, whichever is higher, as independent directors. Explanation — For the purposes of this sub-regulation, a listed company shall explain the reasons, in the compliance report, if any fraction contained in such one-third number which is not rounded up as one.• For the purpose of electing independent director, the Board shall be reconstituted not later than expiry of its current term.• It is mandatory that the independent director shall submit his consent to act as director, along with declaration to the company that he qualifies the criteria of independence notified under the Companies Act, 2017 and such declaration shall be submitted to chairman of the Board at first meeting which is held after election of directors as well as on an event of any change affecting his independence.
7	Female Director Subject to section 154 of the Companies Act, 2017, it is mandatory that the Board shall have at least one female director when it is reconstituted after the expiry of its current term.
8	Executive Director <ul style="list-style-type: none">• It is mandatory that the executive directors, including the chief executive officer, shall not be more than one third of the Board.• For the purpose of compliance with the requirement of the above sub-regulation (1), the Board shall be reconstituted not later than expiry of its current term. Explanation I — For the purposes of this regulation, a listed company shall explain the reasons, in compliance report, any fraction contained in such one-third number which is rounded up as one. Explanation II – Executive director means a director who devotes the whole or substantially the whole of his time (whether paid or not) to the operations of the company.

Regulation Requirements
No.

27 Audit Committee

- It is mandatory that the audit committee shall be constituted by the Board keeping in view the following requirements:
 - the Board shall establish an audit committee of at least three members comprising of non-executive directors and at least one independent director;
 - chairman of the committee shall be an independent director, who shall not be the chairman of the Board;
 - the Board shall satisfy itself that at least one member of the audit committee shall be ‘financially literate’;

Explanation:- for the purposes of this clause the expression, “financial literate” means a person who,-

- is a member of a recognized body of professional accountants; or
 - has a post graduate degree in finance from a university or equivalent institution, either in Pakistan or abroad, recognized by the Higher Education Commission of Pakistan; or
 - has atleast ten (10) years of experience as audit committee member; or
 - atleast twenty (20) years of senior management experience in overseeing of financial, audit related matters.
- The Audit Committee of a company shall appoint a secretary of the committee who shall either be the company secretary or head of internal audit.
- It is mandatory that meetings of the audit committee shall be held as per the following requirements,-
 - the audit committee of a company shall meet at least once every quarter of the financial year. These meetings shall be held prior to the approval of interim results of the company by its Board and after completion of external audit;
 - a meeting of the audit committee shall also be held, if requested by the external auditors, head of internal audit or by chairman of the audit committee;
 - the head of internal audit and external auditors represented by engagement partner or in his absence any other partner designated by the audit firm shall attend meetings of the audit committee at which issues, if any, relating to accounts and audit are discussed:

Provided that chief executive officer and the chief financial officer shall not be members of the audit committee but should be available to attend its meetings at the invitation of the chairman of audit committee:

Provided further that at least once a year, the audit committee shall meet the external auditors without the chief financial officer and the head of internal audit being present:

Provided also that at least once a year, the audit committee shall meet the head of internal audit and other members of the internal audit function without the chief financial officer and the external auditors being present.

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- It is mandatory that the Board of every company shall determine the terms of reference of the audit committee.
- It is mandatory that the Board shall provide adequate resources and authority to enable the audit committee to carry out its responsibilities effectively and the terms of reference of the audit committee shall be explicitly documented which shall also include the following,-
 - determination of appropriate measures to safeguard the company's assets;
 - review of annual and interim financial statements of the company, prior to their approval by the Board, focusing on,-
 - major judgmental areas;
 - significant adjustments resulting from the audit;
 - going concern assumption;
 - any changes in accounting policies and practices;
 - compliance with applicable accounting standards;
 - compliance with these Regulations and other statutory and regulatory requirements; and
 - all related party transactions;
 - review of preliminary announcements of results prior to external communication and publication;
 - facilitating the external audit and discussion with external auditors of major observations arising from interim and final audits and any matter that the auditors may wish to highlight (in the absence of management, where necessary);
 - review of management letter issued by external auditors and management's response thereto;
 - ensuring coordination between the internal and external auditors of the company;
 - review of the scope and extent of internal audit, audit plan, reporting framework and procedures and ensuring that the internal audit function has adequate resources and is appropriately placed within the company;
 - consideration of major findings of internal investigations of activities characterized by fraud, corruption and abuse of power and management's response thereto;
 - ascertaining that the internal control systems including financial and operational controls, accounting systems for timely and appropriate recording of purchases and sales, receipts and payments, assets and liabilities and the reporting structure are adequate and effective;
 - review of the company's statement on internal control systems prior to endorsement by the Board and internal audit reports;
 - instituting special projects, value for money studies or other investigations on any matter specified by the Board, in consultation with the chief executive officer and to consider remittance of any matter to the external auditors or to any other external body;
 - determination of compliance with relevant statutory requirements;
 - monitoring compliance with these Regulations and identification of significant violations thereof;

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- review of arrangement for staff and management to report to audit committee in confidence, concerns, if any, about actual or potential improprieties in financial and other matters and recommend instituting remedial and mitigating measures;
- recommend to the Board the appointment of external auditors, their removal, audit fees, the provision of any service permissible to be rendered to the company by the external auditors in addition to audit of its financial statements, measures for redressal and rectification of non-compliances with the Regulations. The Board shall give due consideration to the recommendations of the audit committee and where it acts otherwise it shall record the reasons thereof;
- consideration of any other issue or matter as may be assigned by the Board;
- It is mandatory that the secretary of audit committee shall circulate minutes of meetings of the audit committee to all members, directors, head of internal audit and where required to chief financial officer prior to the next meeting of the Board:

Provided that where this is not practicable, the chairman of the audit committee shall communicate a synopsis of the proceedings to the Board and the minutes shall be circulated along with the minutes of the meeting of the Board.

32 Terms of appointment of external auditor

- It is mandatory that no company shall appoint an external auditors, a firm of auditors, which has not been given a satisfactory rating under the Quality Control Review program of the Institute of Chartered Accountants of Pakistan and registered with Audit Oversight Board of Pakistan under section 36I of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997).
- It is mandatory that no company shall appoint as external auditors, a firm of auditors which or a partner of which is non-compliant with the International Federation of Accountants' Guidelines on Code of Ethics, as adopted by the Institute of Chartered Accountants of Pakistan.
- It is mandatory that the Board of a company shall recommend appointment of external auditors for a year and its remuneration, as suggested by the audit committee and such recommendations shall be included in the Directors' Report and in case a recommendation for appointment of an auditor is other than the retiring auditor, the reasons for the same shall be included in the Directors' Report.
- It is mandatory that no company shall appoint its external auditors to provide services in addition to audit except in accordance with these Regulations and shall require the auditors to observe applicable International Federation of Accountants guidelines in this regard.
- It is mandatory that the company shall ensure that the auditors do not perform management functions or make management decisions, responsibility for which remains with the Board and management of the company.
- It is mandatory that no company shall appoint a person as an external auditor or a person involved in the audit of a company who is a close relative (spouse, parents, dependents and non-dependent children) of the chief executive officer, the chief financial officer, the head of internal audit, the company secretary or a director of the company.
- It is mandatory that every company requires the external auditors to furnish a management letter to its Board within 45 days of the date of audit report:

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Provided that any matter deemed significant by the external auditor shall be communicated in writing to the Board prior to the approval of the audited accounts by the Board.

33 Rotation of auditors

- It is mandatory that all listed companies in the financial sector shall change their external auditors every five years:

Provided that all inter related companies/ institutions, engaged in business of providing financial services shall appoint the same firm of auditors to conduct the audit of their accounts.

Explanation:- Financial sector, for this purpose, means banks, non-banking financial companies (NBFCs), modarabas and insurance or takaful insurance companies.

- It is mandatory that all listed companies other than those in the financial sector shall, at the minimum, rotate the engagement partner after every five years:

Provided that in case the audit firm is a sole proprietorship then after completion of five years such audit firm shall be changed.

36 Compliance Statement and Auditor Review

- It is mandatory that the company shall publish and circulate a statement, as given under Annexure A to these Regulations, along with their annual reports to set out the status of their compliance with the requirements of these Regulations and the said statement shall be specific and supported by necessary explanations.
 - It is mandatory that the company shall ensure that the statement of compliance is reviewed and certified by statutory auditors as per relevant Regulations specified by Commission.
 - It is mandatory that the statutory auditors of company shall highlight any non-compliance with these Regulations in their review report.
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