Deloitte.

Corporate Governance Rules for PSCs

A way to address Public Sector Governance Crisis in Pakistan

By : Syed Asad Ali Shah

Presentation Outline

- Renewed focus on Corporate Governance in Public Sector in the wake of Global Financial Crisis & Sovereign Debt Crisis
- IFAC recommendations to G-20 on public sector
- Public Sector Crisis in Pakistan, and major issues in governance of PSEs
- Overview of Corporate Governance principles in public sector
- Key Features of Rules on Governance of PSEs
- Recommendations / Way forward to public sector reforms

Renewed focus on Corp. Governance in public sector in the wake of financial crisis

- Major challenge in all economies
- After decades of privatization, 2008 global crisis reversed the trend
- Impact of Global Financial Crisis : increase in public debt from $ 23 Trilln (2007) to $ 34 Trln (2010) or 48%
- Sovereign Debt Crisis in Europe : highlights poor accountability, audit, financial management & overall governance in public sector.
- Global Financial Crisis : Need for better govnce in Corp. Sector & better regulation.
- Sovereign Debt Crisis : Need for better governance & financial management in public sector

Indebtedness of 8 mature economies (2011)
(date from MGI)

Country	GDP (USD)	Public Debt as % of GDP	Total debt % of GDP
United States	$14.6 trillion	92.7	279
Canada	$ 1.6 trillion	81	276
Japan	$5.4 trillion	225.9	512
Germany	$3.3 trillion	75.3	278
France	$2.6 trillion	84.2	346
United Kingdom	$2.3 trillion	76.7	507
Italy	$2.0 trillion	118.4	314
Spain	$1.5.0 trillion	71	363

For the 10 largest mature economies (Australia, Canada, France, Germany, Italy, Japan, Spain, South Korea, UK and US), total debt stood at nearly 350% of GDP in 2011

Most governments have negative net worth

Government	Assets minus liabilities
Australia – federal government	negative 53 billion AUD
Canada – federal government	negative 519 billion CAD
UK – whole of government	negative 1,211 billion GBP
France – central government	negative 1,956 billion EUR
US – federal government	negative 13,473 billion USD
Netherlands – central government	negative 14 billion EUR
New Zealand – central government	positive 95 billion NZD

IFAC recommendations to G-20 on public sector

MEETING OF G-20 DEPUTIES AND FINANCE MINISTERS; APRIL, 2012

- The sovereign debt crisis and related government debt issues, potentially affecting many countries around the world, have caused instability in the global financial system. They remain a significant threat to global financial stability and are a cause for major concern for the G-20.
- **The failure of fiscal management in the public sector is widespread and has an economic impact that far exceeds the impact of losses incurred by corporate failures in the first decade of this century.**
- **This crisis demonstrates that the policies chosen to address the global financial crisis may inadvertently have changed the nature of the problem, moving it from the corporate to the government sector.**
- In its most recent Insight Report on Global Risks, the World Economic Forum reported the results of a survey of 469 experts, “the current most significant global economic risk is “chronic fiscal imbalances”.

IFAC recommendations to G-20 on public sector

- The problems highlighted by the sovereign debt crisis include, but go much deeper than, the transparency and accountability of governments and poor public finance management and public sector financial reporting.

- The institutions for fiscal management are clearly deficient in many countries, and fail to create either the constraints or the incentives for governments to manage their finances in a manner that protects both the public interest and investors in government debt.

- Within most existing systems, it is assumed that poor fiscal management will lead to a change of government—this may occur, but incoming governments face the same incentives and constraints, which, not surprisingly, is likely to lead to similar behavior.

IFAC recommendations to G-20 on public sector

- **IFAC is of the view that what is needed is urgent and fundamental work to consider the nature of the institutional changes that are required to protect the public and to protect investors in government bonds.**

- **It strongly encourages the G-20 to initiate such work through the FSB, making it explicit that it is seen as a critical part of the FSB's role.**

IFAC recommendations to G-20

- As noted in IFAC's 2010 submission to the G-20, arrangements that might be considered as part of this work include:
  - High-quality and timely accrual-based financial reporting;
  - Audited financial statements released within six months of year end;
  - Budgeting, appropriations, and reporting on the same accrual basis;
  - Full transparency in fiscal positions ahead of general elections, ensuring that voters are fully informed; and
  - Limitations on deficit spending, or at least full transparency around the reasons for deficit spending and explanations of how, over an economic cycle, fiscal balance will be restored.

Inherent limitations of public sector

- Lack of private ownership reduces incentives for performance
- PSEs : **ownerless organizations**, as TCWGs usually have no stake
- Politicians not trained in governance, are mostly focused on short term results/ fire fighting, rather than long-term sustainability.
- Politicians make promises in elections, without full understanding of the issues, and comprehensive plans to address such issues.
- Lack of effective accountability, & excessive bureaucracy
  - Scattered frameworks of accountability and decision making.
    - CEO
    - Board
    - Secretary
    - Minister
    - Planning Commission / CDWP / ECNEC
    - Ministry of Finance / Ministry of Law
    - Cabinet / Prime Minister
    - Standing Committees of NA & Senate
    - Auditor General of Pakistan
    - Public Accounts Committee
    - NAB, FIA & others
    - Internal & External auditors
- Lack of clarity on objectives, goals and performance indicators.

Inherent limitations of private sector

- **Excessive Greed**
- **Tax evasion**
- **More than one set of books**
- **Corruption / Over & under invoicing**

SOEs Crisis in Pakistan

- ADB report 2012 highlighted public sector losses, as one of the major factors impeding economic growth in Pakistan
- Annual losses of PSEs : Rs. 500 billion due to in-approp. governance, corruption, inefficiencies and inappropriate policy.
- Power Sector nearly Rs. 300 billion (resulting in huge circular debt), other PSEs include PIAC, Pakistan Steel, Pakistan Railways.
- Contrary to general impression, several profit making SOEs such as two Ports, OGDC, PPL, PSO, SSGC, SNGPL, Insurance sector...
- However, even these may be incurring significant losses hidden in large inherent profitability due to monopolies.
- A major positive aspect of PSEs: their contribution to taxes.

Source: http://www.thenews.com.pk/Todays-News-2-84780-Public-enterprises-become-white-elephants-with-Rs600-bn-annual-loss

Key Governance Issues in public sector

- **Inadequate Quality of Boards**
- **Lack of ownership & accountability**
  - **Decision making extremely slow (lack of initiative / incentive for decision making),**
  - **Excessive centralization : most decisions require the approval of the Prime Minister in the Federal & Chief Minister in the provinces.**
  - **Absence of reward and punishment system / poor HR policies**
  - **Inappropriate accountability mechanisms (also scattered, some time excessive & irrelevant scrutiny, Parliament, Standing Committees, PAC, excessive and irrelevant interference of courts)**

Key Governance Issues in public sector

- **Lack of empowerment of the boards**
  - **CEO invariably appointed by the government and not by the Board**
    - **As the appointments of CEO of PSCs is to be approved by the Prime Minister, most positions remain vacant or get appointed after delay of several months**
  - **Several decisions require approval of Islamabad**
- **Lack of transparency**
  - **Lack of policies on conflict of interest, anti-corruption, ethical code etc.**
  - **Most PSEs do not publish financial statements / annual reports : There is complete lack of transparency.**
- **Lack of defined intended outcomes for which the entity exists.**
- **Corruption, Nepotism & “Undue political influence”**
- **Inadequate levels of remuneration**
- **Lack of merit in recruitment & over staffing**

Estimated losses of PSEs

	Rs. in billion
PIAC	44
Railways	30
Pakistan Steel	28
Power Sector	300
Total	**402**

Profitable PSEs

- OGDC
- PPL
- PSO
- SSGC
- SNGPL
- PARCO
- PTCL
- Government Holdings
- Pakistan Security Printing Corporation

- State Bank
- National Bank
- KPT
- Port Qasim
- Civil Aviation Authority
- State Life Insurance
- National Insurance
- Pakistan Reinsurance
- PNSC
- Karachi Shipyard

Contribution to GDP & taxes

- **Aggregate turnover of listed PSEs Rs. 2.2 trillion**
- **Contribution to GDP of listed PSEs 10%**
- **Listed PSCs tax payments (excl import duties) Rs. 400 billion**
- **Tax payments as % of total FBR collections 20%**
- **Clearly, public sector's contribution to taxes is significantly higher than other sectors.**

What mainly constitutes Corp. Governance

- What is the biggest reason for Corporate Failure?
  - Inactive Boards.
- Most CGCs are an effort to define the responsibilities of the BODs so that they understand and perform their responsibilities effectively.

Principles of Good Governance in Public Sector

Governance comprises the arrangements put in place to ensure that intended outcomes for stakeholders are defined and achieved.

The Fundamental function of good governance in public sector is to ensure that entities achieve their intended outcomes while acting in the <u>public interest</u> at all times.

Acting in the public interest requires:
A. Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
B. Ensuring openness and comprehensive stakeholder engagement.

Principles of Good Governance in Public Sector

In addition to the overarching requirements for acting in the public interest in principles A. & B, achieving good governance in the public sector also requires effective arrangements for:

C. Defining outcomes in terms of sustainable economic, social, and environmental benefits.
D. Determining the interventions necessary to optimize the achievement of intended outcomes.
E. Developing the entity's capacity, including the capability of its leadership and the individuals within it.
F. Managing risks and performance through robust internal control and strong public financial management.
G. Implementing good practices in transparency, reporting, and audit to deliver effective accountability.

Key features of Corporate Governance Rules for PSCs

- **Definition of Public Sector Company**

- **Public or Private Company, not less than 50% voting rights or which is directly or indirectly controlled by the government or where the government has power to elect majority of the directors on the Board.**
- **The definition is rather legalistic, and could have been simpler primarily based on whether or not government has the controlling authority, rather than voting rights.**
- **Inconsistent with "principle" of bringing in government controlled companies under its ambit.**
- **Companies like PTCL, JV financial institutions that are not within the ambit of government control, have been brought under this definition.**

- **Applicability of the Rules to listed public sector companies**

- **In the case of listed Public Sector Companies, where there is any inconsistency with the Code of Corporate Governance, the provisions of these rules shall prevail.**

- **In other words, all requirements that are in addition to listed company code, are to be complied with by listed public sector companies.**

- Definition of Independent Director

- Comprehensive definition of "Independent Director"
- Not in service of Pakistan (govt employees excluded)
- Largely consistent with Revised Code of listed companies

- "Independent Director" means a Non-Executive Director who is not in the service of Pakistan or of any statutory body or any body or institution owned or controlled by the Government and who is not connected or does not have any other relationship, whether pecuniary or otherwise, with the PSC, its associated companies, subsidiaries, holding company or directors. The test of independence principally emanates from the fact whether such person can be reasonably perceived as being able to exercise independent judgment without being subservient to any form of conflict of interest.
- Government nominee / creditor nominee directors appointed u/s 182 & 183 are considered not independent under CCG, but this provision does not apply for PSCs.

- **Composition of the Board**
  - **Shall consists of executive & non-exec directors, including independent directors, with the requisite range of skills, competence, knowledge, experience …… so that the Board as a group includes core competencies and diversity considered relevant in the context of the PSC's operations.**
  - **40% of the Board to be Independent Directors within two years, and in next two years time, majority to be independent.**
  - **Restriction of directorship of upto 5 PSE & listed companies (excl subsidiaries)**
  - **Casual vacancy to be filled within 90 days.**
  - **Appointing authority / govt. and other shareholders, shall apply "fit and proper criteria", in making nominations for election as Board members**

Fit & Proper Criteria

The person proposed for the said position —

(a) is at least graduate;

(b) is a reputed businessman or a recognised professional with relevant sectoral experience;

(c) has financial integrity;

(d) has no convictions or civil liabilities;

(e) is known to have competence;

(f) Has good reputation and character;

(g) Has the traits of efficiency and honesty;

(h) Does not suffer from any disqualification to act as a director stipulated in the Ordinance.

(i) Not been subject to an Order passed by the SEC cancelling certificate of registration granted individually or collectively on the ground of insider trading, fraud and unfair trade practices, market manipulation, illegal banking, forex or deposit tacking;

(j) Is not a stock broker;

(k) **Does not suffer from conflict of interest, this includes political office holders in a legislative role.**

- **Separation of Chairman and CEO and their roles**

- ❑ **Separation of Chairman and CEO**
- ❑ **Chairman from Independent Directors**
- ❑ **Responsibilities of Chairman**
  - ✓ Leadership of the Board & ensuring its efficient & effective working, setting its agenda and appropriate number of board meetings
  - ✓ Ensuring all directors are enabled and encouraged to fully participate in the deliberations and decisions of the Board.
  - ✓ Ensure effective functioning & Continuous Professional Development of the Board
  - ✓ Should not be involved in day to day operations
- ❑ **Responsibilities of Chief Executive**
  - ✓ Management under the oversight & direction of the Board.
  - ✓ Implementation of strategies and policies approved by the Board
  - ✓ Making appropriate arrangements to ensure that funds and resources are properly safeguarded and used economically, efficiently and effectively in accordance with any statutory obligations.

- Directors to Act in the best interest of the Company (and not for their nominating organizations)
- Security of tenure in line with law
- Provisions apply to ex-officio directors as well

- Exercise its powers and carry out their fiduciary duties with a sense of objective judgment & independence in the best interest of the company.
- This provision shall apply to all directors, including ex-officio directors.
- A director, once appointed / elected, shall hold office for a period of three years in accordance with the provisions of the Ordinance, unless he resigns or is removed in accordance with the provisions of the Ordinance.
- Removal of a director should only take place, in the event of misconduct or substandard performance determined through a performance evaluation.
- Term "misconduct" specifically defined.

“Misconduct”

(a) indulging in a competing professional or personal conflict of interests‘ situation;
(b) using the funds, assets and resources of the PSC without due diligence and care;
(c) failing to treat the colleagues and the staff of the PSC with respect, or using harassment in any form of physical or verbal abuse;
(d) making public statements without authorization by the Board;
(e) receiving gifts or other benefits from any sources external to the PSC offered to him in connection with his duties on the Board; or
(f) abusing or misusing his official position to gain undue advantage or assuming financial or other obligations in private institutions or for persons which may cause embarrassment in the performance of official duties or functions.

- **Appointment of CEO**

- **Succession planning**

- ❑ **Appointment of CEO through application of fit & proper criteria.**
- ❑ **Three candidates to be shortlisted for selection of one by the Government / Shareholders**
- ❑ **Also responsible for development & <u>succession planning</u> of CEO**

- **Assess & Monitor performance of CEO**

- ❑ **Board responsible to assess and monitor performance of CEO & Senior Management periodically, but at least once in a year, and hold him accountable for accomplishing objectives & goals.**

- **Obligations to all shareholders**

- ❑ **Ensure that:**
- ✓ **Obligations to <u>all shareholders</u> are fulfilled**
- ✓ **Shareholders duly informed in a timely manner of all material events through shareholder meetings and other communications.**

- **Board’s Responsibilities with regard to Code of Conduct, and Internal Control System**

- **Ensure that professional standards and corporate values are in place that promote integrity for the Board, senior management and other employees in the form of “Code of Conduct”**
- **“Code of Conduct” articulates acceptable and unacceptable behavior.**
- **Communication throughout the company including posting on the website.**
- **Adequate controls for the identification and redressal of grievances arising from unethical practices.**
- **Nominate a committee, a Board member or senior Executive for investigating, where necessary, on a confidential basis, any deviation from the company’s code of ethics.**
- **Establish sound system of internal control, which is effectively implemented at all levels to ensure compliance with fundamental principles of probity, propriety, objectivity, integrity & honesty in relationships with the stakeholders.**

"Conflict of Interest"

- Directors and executives do not allow a conflict of interest to undermine their objectivity and they do not use their position to further their personal interest.
- Where actual or potential conflict of interest exists, there should be appropriate identification, disclosure and management of such conflict.
- An appropriate conflict of interest policy is developed and duly enforced. Such a policy shall clearly lay down circumstances or considerations when a person may be deemed to have actual or potential conflict of interest, and the procedure for disclosing such interest.
- Where a director, executive or other employee has a conflict of interest in a particular matter, such person shall play no part in the relevant discussion, decision or action.
- A "register of interests", shall be publicly available.
- A declaration by the directors and executives that they shall not offer or accept any payment, bribe, favor or inducement which might influence, or appear to influence, their decisions and actions;
- Disclosure of interests by directors & executives in any contract or arrangement required (rule 18) through communication to the company secretary.
- If a director or an officer has an interest before joining, the same should be disclosed, so that it is appropriately considered by the board in future.

"Anti-corruption Policy"

- Board shall develop and implement a policy on "anti-corruption" to minimize actual or perceived corruption in the company.

Merit based recruitment

- Ensuring equality of opportunity by establishing open and fair procedures for making appointments and for determining terms and conditions of service.

Procurement, and payment for supplies

- Ensuring compliance with law & internal rules and procedures relating to public procurement, tender regulations, purchasing & technical standards, when dealing with suppliers of goods & services.
- Quality standards are followed with due diligence and that suppliers comply with the standards specified and are paid for supplies or services within agreed time.

- Vision & mission
  - Board shall adopt a vision or mission statement and corporate strategy for the PSC
- Policies to be approved by the Board
  - Formal approval and adoption of the annual report, including the financial statements;
  - Effective communication policy with all the stakeholders;
  - Identification and monitoring of the principal risks and opportunities ensuring that appropriate systems are in place to manage these risks and opportunities;
  - procurement of goods and services so as to enhance transparency in procurement transactions;
  - determination of terms of credit and discount to customers;
  - write-off of bad or doubtful debts,
  - acquisition or disposal of fixed assets and investments;
  - borrowing of moneys up to a specified limit, exceeding which the amounts shall be sanctioned by a general meeting of shareholders;
  - Corporate social responsibility initiatives including, donations, charities, contributions and other payments of a similar nature;

- **Policies to be approved by the Board**

- **determination and delegation of financial powers to Executives and employees;**
- **transactions or contracts with associated companies and related parties**
- **Health, Safety & Environment**
- **Development of whistle blower policy & protection**
- **Capital Expenditure Planning & Control**
- **<u>Protection of public interest.</u>**
- **Human Resource Policy including succession planning.**
- **Any service delivered or goods sold by a Public Sector Company as a public service obligation where decisions are taken in fulfilling social objectives of the Government but are not in its commercial interests, outlay of such action shall be quantified and request for appropriate compensation there-for shall be submitted to the Government for consideration.**

- **Board's Role**

- **Board shall concern itself with policy formulation and oversight and not the approval of individual transactions except which are of an extraordinary nature or involve materially large amount.**

- **Meetings of the Board**

- **Once in a quarter. In case of non-compliance, it should be reported to the commission, with reasons.**
- **Except for emergency meetings, 7 days notice for the meetings.**
- **Chairman to ensure appropriateness of minutes of the meetings, will also approve the same.**
- **Board member can have his dissenting note recorded as part of the minutes.**
- **Meetings through video conferencing are permitted.**

Key information to be placed for the decision of the Board

(a) annual business plans, cash flow projections, forecasts and long term plans; budgets including capital, manpower and expenditure budgets, along with variance analyses;

(b) internal audit reports, including cases of fraud or major irregularities;

(c) management letters issued by the external auditors;

(d) details of joint ventures / collaboration agreements / agreements with distributors, agents, etc;

(e) promulgation or amendment of a law, rule or regulation or, enforcement of an accounting standard or such other matters as may affect the PSE;

(f) status and implications of any lawsuit or judicial proceedings of material nature, filed by or against the PSC;

(g) any show cause, demand or prosecution notice received from any revenue / regulatory authority, which may be material;

(h) material payments of govt dues, including income tax, excise and customs duties, and other statutory dues including penal charges;

(i) inter-corpte investments in and loans to / from associated concerns in which the business group, of which the PSC is a part, has significant interest;

- **Key information to be placed for the decision of the Board**

(k) policies related to the award of contracts and purchase and sale of raw materials, finished goods, machinery etc;

(l) default in payment of principal or interest, including penalties on late payments and other dues, to a creditor, bank or financial institution or default in payment of public deposit;

(m) failure to recover material amounts of loans, advances, and deposits , including trade debts and inter-corporate finances;

(n) any significant accidents, dangerous occurrences and instances of pollution and environmental problems involving the PSC;

(o) significant public or product liability claims made or likely to be made against the PSC, including any adverse judgment on the conduct of the PSC;

(p) disputes with labor and their proposed solutions, any agreement with the labor union or CBA and any charter of demands on the PSC;

(q) payment for goodwill, brand or intellectual property;

(r) annual, quarterly, monthly or other periodical accounts;

(s) reports on governance, risk and compliance issues;

(t) whistle-blower protection mechanism;

(u) report on Corporate Social Responsibility (CSR) activities; and

(v) related party transactions.

- Board Evaluation
- Evaluation of Senior Management

- The performance evaluation of the members of the Board including the chairman and the chief executive shall be undertaken for which the Board shall establish a process, based on specified criteria.
- The chairman shall take ownership of such an evaluation.
- The committees shall also carry out their evaluation on an annual basis.
- The Board shall monitor and assess the performance of senior management on a periodic basis, at least once a year, and hold them accountable for accomplishing objectives, goals and key performance indicators set for this purpose.

- **Related party transactions**

- **Comprehensive requirements on related party transactions- disclosure and approval by Audit Committee & Board in line with the requirements in listed company Code.**
- **RPTs which are not executed at arm's length price shall also be placed <u>separately</u> at each Board meeting along with necessary justification for consideration and approval of the Board on recommendation of the audit committee.**
- Board shall approve the pricing methods for RPTs made on the terms equivalent to those that prevail in arm's length transaction only if such terms can be substantiated.
- **Party-wise record of RPTs**

- **Annual Report & Interim Financial Statements**
  - **Quarterly Accounts to be prepared and approved by the Board.**
  - **Annual report including annual financial statements be placed on the website.**
  - **Monthly accounts, whether audited or otherwise, for circulation amongst the Board members.**

- **Board Orientation & Learning**
  - **Required to hold Orientation Courses : At least one Orientation Course per year**
  - **Encouraged to have certification under an appropriate director training/education program offered by any institution, local or foreign.**
  - **The following information to be provided in writing:**

    (a) PSC's aims and objectives;

    (b) control environment and control activities;

    (c) key policies and procedures;

    (d) risk management and internal control framework;

    (e) background of key personnel, including their job descriptions;

    (f) delegation of financial and administrative powers;

    (g) board and staff structure; and

    (h) budgeting, planning and performance evaluation systems.

- **Formation of Board Committees**

- **Formation of Board Committees, including:**
- **Audit Committee: standard TOR**
- **Risk Management Committee (for financial sector & entities with assets in excess of Rs. 5 billion) : to effectively review the risk function.**
- **HR Committee**: to deal with all employee related matters including recruitment, training, remuneration, performance evaluation, succession planning ….
- **Procurement Committee :** to ensure transparency in procurement transactions and in dealing with the suppliers
- **Nominating Committee :** to identify and recommend the candidates for the Board for the consideration of shareholders after examining their skills and characteristics that are needed in such candidates.

- **Formation of Board Committees**

- **Chaired by non-executive directors and the majority of their members should be independent.**
- **Written terms of reference that define their duties, authority and composition.**
- **Carry out their performance evaluation on annual basis and submit such assessment to the board.**
- **Chairman of the board shall take leadership role in ensuring completion of such evaluation process.**
- **Minutes of the committee meetings shall be circulated to the Board.**

CFO, Company Secretary & Chief Internal Auditor

- Appointment, remuneration and terms and conditions of the CFO, the company secretary and the CIA shall be determined with the approval of the Board.
- Can not be removed without Board Approval.
- CFO & Company Secretary to attend all board meetings, except where matters relating to them are discussed.

CFO Role & Qualifications

- CFO shall be responsible for ensuring that appropriate advice is given to the Board on all financial matters, for keeping proper financial records and accounts, and for maintaining an effective system of internal financial control.

Qualifications of CFO

a) member of a recognized body of professional accountants with five years relevant experience, in case of PSC having total assets of five billion rupees or more; or

b) a person holding a masters degree in finance from a university recognized by the HEC with at least ten years relevant experience, in case of other Public Sector Companies.

c) Also, fit & proper evaluation is required.

Company Secretary

- Responsible for ensuring that Board procedures are followed, and all applicable statutes and regulations and other relevant statements of best practice are complied with.
- Role of CS can be combined with that of CFO or any other senior management position.

Qualifications.

(a) member of a recognized body of prof. accountants; or

(b) member of a recognized body of corporate or chartered secretaries; or

(c) person holding a master degree in bus administration or commerce or being a law graduate from a university recognized by the HEC with five years relevant experience.

(d) Fit & proper evaluation required.

Reporting framework

&

Annual Report

Approved accounting standards /IFRS that are applicable to listed companies.

Board required to submit an annual report to the shareholders, containing statements on:

a) Board has complied with the relevant principles of corp govnce, and has identified the rules that have not been complied with, the period in which such non-compliance continued, and reasons for such non-compliance;

(b) Fin stats, prepared by mangt, present fairly its state of affairs, the results, cash flows and changes in equity;

(c) proper books of account have been maintained;

d) appropriate accounting policies have been consistently applied in preparation of fin stats and accounting estimates are based on reasonable and prudent judgment;

e) recognize their responsibility to establish and maintain sound system of internal control, which is regularly reviewed and monitored; and

f) the appointment of chairman and members of Board and the terms of their appointment along-with the remuneration policy adopted are in the best interests of the PSC as well as in line with the best practices.

Disclosures in the Annual Report

- Disclosure of Executive Remuneration.
- Disclosure of Remuneration Policy & details of remuneration of board members
- where the PSC is reliant on a subsidy or other financial support from the Govt, a detailed disclosure of the fact;
- significant deviations from last year in operating results of the PSC shall be highlighted and reasons thereof shall be explained;
- Summary of key operating and financial data of last six years;
- KPIs of the PSC relating to its social objectives and outcomes which significantly reflect the work and impact of PSC and a comparison of actual results with the budgeted figures. Such indicators shall focus on as to how well the PSC has responded to accountability requirements, improved service delivery, reduced costs and adherence to the principles of environmental and corporate social responsibilities;
- where any statutory payment on account of taxes, duties, levies and charges is overdue or outstanding, the amount together with a brief description and reasons for the same ;

Disclosures in the Annual Report

- significant plans and decisions, such as corporate restructuring, business expansion and discontinuance of operations, shall be outlined along with future prospects, risks and uncertainties surrounding the PSC;
- a statement as to value of investments of provident, gratuity and pension funds, based on their respective audited accounts;
- number of Board meetings held during the year and attendance by each director; and
- Pattern of shareholding.

Disclosure of interest by directors & officers

- Every director of PSC, if he or his relative, is in any way, directly or indirectly, concerned or interested in any contract or arrangement entered into, or to be entered into, by or on behalf of the PSC shall disclose the nature of his concern or interest at a meeting of the directors.
- Any other officer (including the CEO and other Executives) of PSC, if he or his relative, is in any way, directly or indirectly, concerned or interested in any proposed contract or arrangement by **the** company shall disclose to the Company through a communication to the company secretary, the nature and extent of his interest in the transaction. Such officer **and the** company shall ensure that such information is properly placed and considered by any forum where the matter relating to such proposed contract or arrangement is to be discussed and approved

- Directors' Remuneration

- A formal and transparent procedure for fixing the remuneration packages of individual directors. No director shall be involved in deciding his own remuneration.
- Remuneration packages shall encourage value creation, and shall align their interest with the PSE.
- Require prior approval of shareholders or board, as per articles of association.
- Sufficient to attract and retain directors needed to run the company successfully.
- Shall not be at a level perceived to compromise their independence.
- Annual report shall contain criteria and details of Remuneration of each director, including salary, benefits and performance linked incentives.

- **Certification by CEO & CFO**

- **No PSC shall circulate its fin stats unless the CEO & CFO, present such fin stats, duly certified under their respective signatures, for consideration and approval of the audit committee and the Board. The Board shall, after consideration and approval, authorize the signing of fin stats for issuance and circulation.**

Audit Committee

- Members shall be financially literate and majority of them, including its chairman, shall be Independent Non Executive Directors. (in the first four years, the independent directors shall be proportionate to the total number)
- The names of members of the audit committee shall be disclosed in each annual report of the PSC.
- Chairman of the board & CEO shall not be members of the audit committee.

- Other requirements on the Audit Committee, are largely similar to the Code of Corp. governance for listed companies.

Internal Audit & Chief Internal Auditor

- Internal audit function mandatory in every PSC. The chief internal auditor, shall be accountable to & have unrestricted access to the audit committee.
- Qualifications of CIA
  - Fit & proper evaluation
  - Five years relevant experience & :
    - A member of recognized body of accountants; or
    - Certified Internal Auditor, Certified Fraud Examiner, Certified Internal Control Auditor; or
    - Master's degree in finance from HEC recognized university.
  - Persons serving as CIA in a PSC for the last five years are exempt from above requirements.
- IA function shall have a charter duly approved by the Audit Committee, and shall work, as far as practicable, in accordance with IIA standards.

External Auditors

- **Restriction on non-audit services consistent with the IFAC guidelines, where as Listed company code specifies specific services that are not permitted.**
- **The provisions are largely similar to those of Code of Corporate Governance applicable to the listed companies.**

Compliance with Rules

Compliance statement to be reviewed by external auditors

- PSC shall publish and circulate a statement along with its annual report to set out the status of its compliance with these rules, and shall also file with the Commission and the registrar concerned such statement alongwith its annual report.
- PSC shall ensure that the statement of compliance with the rules is reviewed and certified by external auditors, where such compliance can be objectively verified, before publication by the PSC.
- Where the Commission is satisfied that it is not practicable to comply with any of these rules, the Commission may, for reasons to be recorded, relax the same subject to such conditions as it may deem fit to impose.

Penalty for contravention

- **Whoever** fails or refuses to comply with, or contravenes any provision of these rules, or knowingly and willfully authorises or permits such failure, refusal or contravention shall, in addition to any other liability under the Ordinance, be punishable with fine and, in the case of continuing failure, to a further fine, as provided in sub-section (2) of section 506 of the Ordinance.

- **(Rs 50,000 fine plus Rs. 500 per day for continuing default)**

Recommendations / Way forward to public sector governance reforms

- **PSC Governance Rules, is the first important step for enhancing efficiency, effectiveness and transparency of PSEs.**
- **Further reforms are required, that include:**
  - **Appointment of appropriate board or commission that will help government in identification and appointment of right people as board of directors of PSCs.**
  - **Empowering boards to appoint the CEOs of PSEs, using fit & proper criteria.**
  - **Developing appropriate framework of incentives and accountability mechanisms so as to enable improved performance of PSC boards.**
  - **Make governance rules mandatory for PSEs that are not companies (such as PIAC, Railways, Ports, CAA etc., preferably through promulgation of appropriate statute. Pending the statute, this should be done through a cabinet decision.**

Way forward to public sector governance reforms

- **Government needs to decide its policy of what is to be privatized, when and what it will retain.**
- **Privatization should be through a comprehensive plan, which is an essential part of an overall "Economic Development Plan"**
- **While most business entities may be privatized in the long-run, it may be impractical to privatize all, as many PSEs may have strategic reasons to be retained in public sector.**
- **PSEs retained in public sector for short / long-term need to be managed on sound commercial principles, separated from the Govt's function of policy making, market regulation and social obligations.**
- **While good governance principles will help enhance transparency, efficiency, effectiveness, reduce losses etc., a substantial portion of recurring losses arise owing to other reasons, including policy and investment decisions of the govt.**
- **Total transformation of PSEs will require broader reforms much beyond the implementation of governance rules, which should also include transformation of the way government works.**

Deloitte.

Thank You