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FREQUENTLY ASKED QUESTIONS ON THE CODE OF CORPORATE GOVERNANCE FOR ISSUERS OF SECURITIES TO THE PUBLIC, 2015

The Capital Markets Authority has developed these responses to frequently asked questions about the Code in order to assist Issuers of Securities to the Public and the market to effectively implement and apply the provisions of the Code.

1. *What is the main objective of the Code?*

The Code sets out the principles and specific recommendations on the structures and processes which companies should adopt in making good corporate governance an integral part of their business dealings and culture. It advocates for the application of standards on corporate governance that go beyond the minimum prescribed by legislation.

2. *Are there benefits accruing to the companies for upholding good corporate governance practices?*

Yes!

Research indicates that good governance leads to better risk management, enhanced performance and sustainability. Good governance also results in increased attractiveness to investors, increase in profitability and effective management of reputational risk.

3. *The provisions of the Code are new to the market. How does the Authority seek to create awareness?*

As part of sensitization project, the Authority has independently, as well as in partnership with the World Bank Group, conducted training and sensitization of trainers on the requirements of the Code who will in turn train other trainers on the provisions of the Code. In addition, the Authority has conducted a Masterclass for senior management (Chief Executive Officers, Chief Financial Officers and Company Secretaries) of listed companies and it will conduct further trainings for Board Members and Chairpersons in quarter one of 2017 to ensure that companies and their management are fully aware of their responsibilities and requirements of the Code.

4. *Will the sensitizations on the Code be regular?*

The Authority will continue to conduct sensitizations as and when necessary as part of the implementation process and to identify gaps, address issues and respond to challenges arising from the

implementation of the Code. The Code also calls for trainings for board members based on their development needs which includes a 12-hour annual training on governance.

5. *How will the Authority address issues arising from the implementation of the Code?*

For effective corporate governance and whenever circumstances necessitate, the Authority may review the Code with the intention of updating its provisions to reflect the circumstances or policy objectives. However, the Authority notes that the updates will be managed and take into account stakeholder inputs in order to avoid disruptions in effective implementation.

6. *When was the Code gazetted?*

The Code was gazetted on March 4, 2016. It will be deemed to replace the Guidelines on Corporate Governance Practices by Listed Companies in Kenya, 2002 when it comes into effect on March 4, 2017.

7. *When does the Code come into effect?*

The Code was gazetted into law on March 4, 2016 and shall be fully applicable with effect from March 4, 2017. Issuers will therefore be obligated to align their governance structures and reporting arrangements to the standards set in the Code in preparation for that date.

8. *Does the Code apply to all issuers of securities to the public?*

The Code applies to all entities who have received approvals from the Authority to issue securities to the public whether those issues have been listed or not. Issuers of restricted offers of securities to sophisticated, institutional or professional investors are exempted from compliance with the Code but are nonetheless encouraged to adopt the best practices provided.

9. *The Code contains mandatory and best practice requirements. What is the distinction?*

The mandatory requirements are not subjected to the “Apply or Explain” standard and require full compliance. They have therefore been replicated in the Capital Markets (Securities) (Public Offers, Listing and Disclosures) (Amendment) Regulations, 2016. The mandatory provisions are subject to all the enforcement powers and provisions under the Capital Markets Act.

The best practice requirements have the flexibility of allowing issuers to explain any instances of non-application and the steps being taken and commitments being made towards full application of the best practice requirements.

10. *What are some of the mandatory requirements and how can they be differentiated in the Code?*

The mandatory provisions have been replicated in the Capital Markets (Securities) (Public Offers, Listing & Disclosures) (Amendment) Regulations, 2016. The amendment regulations can be found at www.cma.or.ke. The mandatory requirements relate to board composition, independence and evaluation, establishment of board committees, multiple directorships, succession planning, formal and transparent policies and procedures, financial accounts and reporting, conflict of interest policies, shareholders’ rights, risk management, sustainability, related party transactions, risk management and internal controls.

11. What is "apply or explain"?

"Apply or explain" is the regime guiding the enforcement of the best practice components of the Code. This provides that a company is expected to apply the Code in its entirety but allows for some flexibility to explain any instances where a company has not applied the Code as stipulated given the different nature and scope of business. The explanation must be accompanied by a commitment by the company to fully apply the Code within a definite time or to elaborately explain what arrangements it has already put in place to ensure compliance with the principles set out in the Code.

12. What happens if a company fails to apply the best practice provisions of the Code?

Where a company fails to apply the best practices prescribed by the Code, it should disclose the non-application to relevant stakeholders including the Capital Markets Authority with firm commitment to move towards full compliance with the guidelines or principles set out in the Code. The overall intention is full application of the Code. The disclosure on the status of application of the Code should be made in the company's annual report.

Unsatisfactory explanations or failure to implement measures explained will result in enforcement proceedings in accordance with the Capital Markets Act.

13. What is the distinction between the application of Principles, Recommendations and Guidelines in the Code?

The Code provides a clear distinction between Principles, Recommendations and Guidelines. In terms of application, the principles set out the core governance standards while the recommendations set out how the principles can be achieved. The guidelines are meant to provide key pointers for effective application of the principle and recommendation.

14. The Code talks about integrated reporting. How is this different from conventional reporting?

Integrated reporting is a process that brings together the material information about a company's strategy, governance, performance and prospects in such a way that reflects the commercial, environmental, social and governance context within which it operates. It therefore combines the most material elements of information currently reported in separate strands (such as financial report, governance, legal and compliance report, audit reports, etc.) into one coherent whole.

15. Issuers are required to carry out governance audits. What does this entail?

A governance audit is an annual assessment of the level of compliance of a company with sound governance practices as prescribed by the Code. It is carried out by a competent and recognized professional accredited for that purpose by the Institute of Certified Public Secretaries of Kenya (ICPSK)

16. Has the Authority accredited any governance auditors and legal/compliance auditors?

The list of accredited governance auditors is available upon inquiry to the Institute of Certified Public Secretaries of Kenya (ICPSK). It is important for the issuer to ensure that the lawyers they select to do their legal and compliance audits have the necessary competence and experience for the audits.

17. The Code also calls for biennial legal and compliance audit. What does this entail?

The Code requires the Board to carry out independent legal and compliance audit at least once every two years. The audit seeks to establish the level of adherence to applicable laws, regulations and standards. The independent legal and compliance audit must be carried out by a legal professional in good standing with the Law Society of Kenya (LSK). The Board is required to ensure that any non-compliance findings are acted upon expediently.

18. So, what is the difference between a governance audit and a legal and compliance audit?

The governance audit seeks to establish the level of compliance with the governance practices set out in the Code. Some areas to be audited include leadership, transparency, disclosures, stakeholder engagement, board systems and compliance with laws, among other areas.

On the other hand, a legal and compliance audit is principally focused on compliance with the law applicable to the entity. It is worth noting that a governance audit has an element of assessment of compliance with laws, but this is not as exhaustive as a legal and compliance audit.

While a governance audit is conducted by a recognized and accredited by ICPSK professional, a legal and compliance audit is done by a legal professional in good standing with LSK. In some instances, an accredited ICPSK professional may also be a member of LSK hence competent to do both audits but the issues to be assessed will remain distinct.

19. Issuers are now required to conduct three audits: Financial, Legal/compliance and governance audits. How are they aligned/interrelated?

All these audits seek to assess and confirm that the issuer's financial, governance and legal requirements are met. Each audit is distinct. Where an accredited governance auditor is also a lawyer in good standing with the Law Society of Kenya, the lawyer can conduct the governance as well as legal/compliance audits.

20. Does the Authority have in place a structured process and standards on how governance audits shall be carried out?

Yes!

The Authority is working in collaboration with ICPSK to develop governance audit standards, guidelines, manuals and toolkits which shall be used in the governance audit exercise which shall be in place to guide all governance audits under the Code.

21. What does independent director mean?

An independent director is a member of a board of directors who does not have a material or pecuniary relationship with the company or related persons, is compensated through sitting fees or allowance and owns not more than five percent of the shares of the company. The Authority has noted that there is some inconsistency in the Code where Article 1.1.2 provides that an independent director should not hold any shares in the company.

The Authority has clarified that a holding of not more than five percent of the shares of the company will allow a director to be considered as independent.

After nine years of continuous service, an independent director is deemed to cease to be independent and if he or she remains on the board he or she will be required to be re-designated as a non-executive director.

22. *What is the definition of a non-executive director?*

A non-executive director refers to a member of the board of a company who does not form part of the management team and who is not an employee of the company or affiliated with it in any other way but can own shares in excess of 5% or may be a board member in excess of nine years.

23. *What are some of the Board Committees that the Code requires to be established?*

The Code requires that the Board should establish relevant committees with written terms of reference. Some of the key functions that committees should be established to cover include audit, nominations, risk management, remuneration, finance and governance.

Some of the committees specifically mentioned in the Code include nominations committee, audit committee and the remuneration committee. Each company has discretion to set up such committees as it requires to meet its business needs.

24. *The Code requires the rotation of independent auditors every six to nine years. Is it the audit firm or the individual auditors that are to be rotated?*

It is the audit firm. The requirement for rotation seeks to enhance independence, objectivity and professional critique of the auditor.

25. *Will the period for rotation be calculated commencing from March 2017 or take into account the period served as at March 2017?*

Rotation will be assessed based on the period served even prior to March 2017 in order to promote the principles of transparency and independence that are central to effective external audit.

26. *What are some of the Board policies mentioned in the Code that facilitate effective governance?*

Some of the Board policies mentioned include those on diversity, remuneration, communication, related-party transactions, conflict of interest, voting, stakeholder relations, whistle-blowing, disclosure, corporate social responsibility, environmental, social and governance, information technology, procurement, among others.

These policies need not be in separate documents. Some policies can be merged. The fundamental requirement is for companies to have guiding documents to inform effective and transparent decision-making.

27. *Should the policies required be stand-alone documents or can some be consolidated into one policy?*

Some policies, given their scope and volume, may need to be stand-alone documents in the interest of accessibility and understanding but this shall be at the discretion of each issuer subject to being able to evidence the specifics of relevant policies within the CG Scorecard.

28. How will the Authority assess the level of compliance with Code?

The Authority is developing a corporate governance scorecard, reporting templates, checklists and guidelines that will be used in assessing how and to what extent a company has applied the Code. In addition, the annual governance audit tools will be aligned to those used by the Authority in order to ensure consistent assessment of the soundness of corporate governance practices of an Issuer.

29. Will the scorecard templates and forms be available on CMA Website?

Yes!

The Authority will publish the reporting templates, checklists and forms on its website for convenient access and use by issuers and other relevant entities.