

## **New Companies Act compels firms to conduct background checks on potential board members**

The Economic Times, 16<sup>th</sup> January 2015

[http://articles.economictimes.indiatimes.com/2015-01-16/news/58149805\\_1\\_independent-director-background-checks-such-directors](http://articles.economictimes.indiatimes.com/2015-01-16/news/58149805_1_independent-director-background-checks-such-directors)

MUMBAI: The days when nomination of an independent director solely depended on his or her personal relationship with the promoter of any company could soon become a thing of the past.

As the new Companies Act makes independent directors more accountable, many listed as well as unlisted firms are undertaking background checks through forensic experts on professionals they intend to induct as board members. Professionals, who get calls to join boards as independent directors, are becoming more selective too, as they will be liable for company decisions.

"Increasingly, Indian companies are placing more rigor around the selection of appropriately qualified independent directors on their boards to deal with the myriad of regulatory and compliance requirements and the increased role that is being asked of directors," said Amry Junaideen, senior director, enterprise risk services, at Deloitte, India. "All companies should have a well-defined process for selecting independent board members."

In November, one of the top-50 listed companies was looking for an independent director. After zeroing in on a person, it hired one of the big four consultancy firms to do a background check. "It was more of a formality than a serious intention to put the director under scrutiny," said a senior partner in the consultancy. "The director had claimed that he is a graduate from a premier management institute in a particular batch. We found otherwise, and reported back to the company," he added. The company didn't nominate him to its board.

"In most cases, the information that we look up is whether there is an ongoing court case, or police case against the person, or if he is on the board of any other company that has anything which goes against the interest of the shareholder. However, we have to be cautious that while digging up the background information, we do not infringe on the person's personal space," said Mukul Shrivastava, partner, fraud investigation and dispute services, at Ernst & Young.

And, it is definitely not a one way street, say industry experts. Professionals are increasingly hiring financial experts to examine the companies from where they get offers to join the board because an independent director too would be liable for any financial or other fraud the company may involve in.

"It is much tougher to be an independent director on the board of companies under the new Companies Act regime. Liability for an independent director has increased significantly, particularly because of financial and regulatory issues that the company may face," said Akshay Chudasama, senior partner at law firm J Sagar Associates, who is also an independent director on the board of Bata India and Apollo Tyres.

"Such directors are no longer entitled to have stock options which make the risk-reward ratio unfavourable for independent directors. Further, activist investors and fund houses have started to voice their concerns when a company appoints related (conflicted, not only in a legal sense) persons as an independent director," said Chudasama. "However, things are becoming more transparent which will be good for the business ecosystem in the long term."

Industry experts say that as a result of the new rules, industry would see a dearth of eligible independent directors over the next two years.

"Given that the number of professionals who qualify to be directors and the increased scrutiny that they would face, there is a potential for a shortage of independent directors in the coming years. Therefore, it is imperative that companies and Indian business as a whole pay more attention to board training and succession planning," said Junaideen of Deloitte.

Under the Act, independent directors have little or no defence against any misdeeds by the company since they would still be treated equivalent to the other directors by holding them responsible for decisions made through board processes.

"It is the individuals who have become more cautious and selective in being appointed as independent directors due to the additional responsibilities that the Act imposes on independent directors," said Sanjay Asher, senior partner at law firm Crawford Bayley & Co, who is also an independent director at Ashok Leyland and Shree Renuka Sugars.

"Independent directors are more cautious, selective and vigilant and, while choosing to be on the board of any company, they look at things such as the auditors of the company, whether they are one of the big four, what are the internal control mechanisms, who are the internal auditors and the constitution of the board, among other things."