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"Undue focus on compliance limits the value independent directors can deliver"

Mr. Keki Mistry is the Vice Chairman & Chief Executive Officer of HDFC Ltd. Besides being on the board of several HDFC Group companies including HDFC Bank, Mr. Mistry is also on the Board of several other companies. In a conversation, Mr. Mistry says that independent directors' role should not focus excessively on compliance if they are to effectively support the Board.

Ind AS: A convergence with international standards on accounting and reporting

Overview of Ind AS and convergence with IFRS

On 16 February 2015, the Ministry of Corporate Affairs (MCA) issued the notification regarding the application of Indian Accounting Standards (Ind AS) to a select set of companies in a phased manner with a mandatory application date of 1 April 2016, with a voluntary adoption from 1 April 2015.

Ind AS is now closely aligned with International financial reporting standards (IFRS) as issued by International Accounting Standard Board (IASB). Additionally, MCA has decided to implement new standards on revenue recognition and financial instrument ahead of the global rollout of the same. Furthermore, certain significant carver outs/deviation has also been notified as compared to IFRS.

Ind AS will change the existing accounting in more ways than one and possibly all accounting and disclosure areas will come under significant scrutiny and as a result it becomes all the more important for board members to have a close watch on the plan and progress made by the company to implement such a change.

The road map to adoption of Ind AS

The notification makes it applicable for all companies with a net-worth of INR 500 crore to move to the new accounting framework from 1 April 2016 and remaining listed companies and other companies with a net-worth of INR 250 crore to transition to the new requirement from 1 April 2017.

Moreover, the holding, subsidiary, joint venture and associate companies of above companies are also required to transition under the respective phases. Effectively any company connected with the company, which is required to transition is also required to transition from the same date. The road map for banking, insurance and NBFC companies will be notified by respective regulators and they may have a different transition date than the one as specified above.

Contrast/differences with Indian GAAP

Revenue recognition

Revenue is one of the most important attribute for any company and Ind AS will significantly impact the current practice likely to be followed by several companies.

For example a company, which currently enters a bundled arrangement with its customers may account for such contract according to the contractual terms, which in future will be required to be accounted for, based on the commercial substance of the contract. This can significantly alter the manner and timing of revenue recognition. Furthermore, all incentives as offered to the customers are likely to be presented as reduction of revenue as opposed to the current practice of presenting some of them as part of business promotion costs. For contracts with sales return, variability in consideration, bill and hold, long-term credit arrangement etc., are areas where companies will be required to apply judgement more acutely as compared to the existing practice. Apart from the above, revenue recognition practice in different sectors including real estate, telecom, software, oil and gas, construction, media and entertainment will be affected more significantly than others.

Fixed assets

After revenue, fixed asset is often the most important element in any company's financial statement as considerable amount of external financial borrowing is tied to the fixed assets. Companies will now be required to more closely scrutinise whether the expenditure is capital or revenue in nature. Subsequent to its determination, the company will be required to determine its useful life and residual value. Furthermore, any subset of a large asset (component) whose useful life is different than the main asset is also required to be depreciated separately. So companies will be required to relook the existing process of capitalization and depreciation and align it with the new requirements.

Share-based payments

Companies often consider stock option as an incentive to reward its employees and at times also use the same for dealing with its customers or vendors. Ind AS will require the use of a valuation model to determine the value of such stock options and then it will be required to be accounted as well. This could result into significant costs in the financial statements of several companies, especially those from the IT and e-commerce sector wherein stock options are the most common way of rewarding high performance.

Consolidation of financial statements

The model of consolidation under IND AS 110 is linked to the assessment of control, which is in contrast to either the control or voting interest model under Accounting Standard (AS) 21. Furthermore, the definition of control is very different as compared to the control over the composition of the board of directors of the company. The accounting analysis may not change significantly for a company, which has a simple holding-subsidiary structure. However, this may impact significantly wherever we have any third party investor in the subsidiary company or if the company currently does not have the majority shareholding but exercises control over a majority of a companies activities.

Business combinations

The accounting for business combination will change fundamentally under IND AS 103 as compared to the current practice of accounting and reporting. IND AS 103 requires all business combinations, wherever there is a change in control to be accounted for at fair value. This will require identification of intangibles assets, recognition of tangible assets, liabilities and contingent liabilities at fair value. This can significantly change the balance sheet as well as statement of income in the future period.

Financial instruments

Accounting for financial instruments will be very different under Ind AS as compared to the current practice. All financial instruments will be required to be accounted for at fair value at inception and subsequent accounting of the same will be dependent on the business model of the company. The company may be able to account for the same at amortized costs or at fair value. The impairment requirement for financial assets is now based on the expected loss model as compared to current practice of

following the incurred loss model. Unless exempted, all derivative instruments will be required to be accounted for at fair value. There could be several scenarios in which the company will end up recognizing unrealized gains through the statement of income, which is very rare under the present accounting framework.

Transition to Ind AS

Ind AS 101 provides the framework to be used by a company for transition from existing accounting framework to the new requirements under Ind AS. The process of transition offers significant challenges as well as opportunities for companies. Accordingly, companies will be required to carefully evaluate the impact of the transition and select the accounting policies and exemptions, which are available at the time of preparation of the opening balance sheet under Ind AS.

Business and organisational implications beyond accounting

Companies will also be required to ensure that the IT systems, business processes and all other different stakeholders are taken on board on a timely basis to avoid any surprise at the time of reporting under Ind AS. Companies will be required to look at its covenants on bank loans to ensure that they proactively address any matters arising out of such change. Certain contracts wherein employees' incentive is linked to revenue or profitability targets needs to be revisited to align with the new requirements.

Tax implications of Ind AS and income computation and disclosure standards

Accounting for Income taxes including deferred taxes will change significantly under Ind AS as compared to the existing practice. Government of India is likely to notify another set of accounting standards, which will provide the framework around computation of taxable income and as a result of that, deferred tax accounting may be significantly affected. More importantly all areas, which will have a measurement impact under Ind AS will also have a consequential deferred tax impact on the same. Certain additional areas, which are currently not being considered for deferred tax accounting will also required to be covered under Ind AS.

Key takeaways

Ind AS is expected to affect every aspect of financial statement of such companies, which are required to implement and transition to Ind AS in the near term. It will require significant effort in analysis and determination of the transition and its impact on ongoing accounting and reporting requirements. Significant effort will be required in training the employees at all levels to ensure that they pick up the critical aspects of the changed accounting framework. Significant amount of effort will likely be required in configuring the technology platform as used by companies for information and data processing and changes in chart of accounts and features such as multi GAAP reporting needs to be enabled. Individuals who are charged with governance will be required to proactively address the various issues arising from such a significant change across the accounting and reporting aspects of the company.

Questions for independent directors

- Has the management commenced planning around implementation of Ind- AS and presented a comprehensive plan to the Board?
- Have action steps been defined for training/ creating awareness within the organisation about impact of Ind-AS?
- Are the IT systems geared up to address changes as required under the new framework?
- Has the management begun engaging with bankers, customers, investors, suppliers with regard to addressing the issues arising from Ind-AS?
- Has the management taken steps to ensure that all subsidiaries/ joint ventures/ associates are prepared for this significant change?
- Has an assessment been conducted of the likely impact on the net worth and future profitability of the organisation?
- Is the organisation prepared to address the changes likely to emerge from the implementation of tax accounting standards?

A changed landscape for independent directors

The regulatory and legal framework for independent directors (IDs) has undergone substantial changes with the application of the Companies Act 2013 (2013 Act) and revised clause 49 (RC49). The 2013 Act requires all listed as well as large non-listed public companies to have independent directors's. Consequently, the concept of independent directors, which was henceforth applicable only to listed companies, also applies to non-listed companies.

Non-listed public companies	
No. of independent directors	Atleast two
Criteria – any one of the following	
Paid-up share capital	INR 10 crores or more
Turnover	INR 100 crores or more
Aggregate outstanding loans, debentures and deposits	Exceeding INR 50 crores

Changes brought by the 2013 Act and RC49 indicate high expectations that regulators and other stakeholders have from independent directors. However, from an independent director's perspective there could be many questions on their minds. These questions include whose interest independent directors are required to serve? Do they have the necessary authority to fulfil expectations? What is the quantum of time an independent director should provide to each company? What should be the remuneration? What is their liability? This articles looks at some of these key challenges from an independent director perspective.

Globally, an independent director is normally expected to play a two-fold role, such as, advisory and monitoring. The independent director is supposed to contribute their business expertise which could be a good value addition to a company. Moreover, independent director's are expected to serve as a watchdog and protect interests of minority shareholders. The role of a strategic advisor and a watchdog is not easy to balance and may run at odds with each other at times.

Schedule IV, Code for independent directors, of the 2013 Act requires independent directors to safeguard the interest of all stakeholders; particularly minority shareholders. It is ironical that independent director's appointed by promoters have to protect the interest of minority shareholders and other stakeholders. In countries such as the US and the UK, where shareholding in companies is largely public, the independent director's can take into account shareholder interest as a common factor. However, in countries such as India, where shareholding is concentrated, there would be two factions - the controlling group and minority shareholders. The controlling group could extract value from minority shareholders through dubious related party transactions or self-dealing transactions, for example, through freeze-out mergers, where the controlled company is merged with another company in which the controlling group has a 100% stake.

While the 2013 Act sets out responsibilities of the independent director in detail, it does not necessarily mean that independent director's have adequate powers or are remunerated commensurately to fulfill those responsibilities. As a consequence independent directors may not have the time, energy, power or the inclination to set things right. For example, in the case of controlled companies, the independent director's may not have voting power to stop wrongdoings of the controlling shareholder. The experience indicates that in some cases after exhausting all efforts to discipline the management, the only realistic option available with independent director may be to offer his or her resignation. Despite the general perception of the public that independent director's should act as a watchdog, it appears that given the actual functioning of the boards, the supremacy of the controlling group and the few Board/Audit committee meetings (assume average of six in a year), the watchdog function is not comprehensively performed. Independent director's argue that they should not be seen as a panacea for everything and a tool to fix all the wrongdoings.

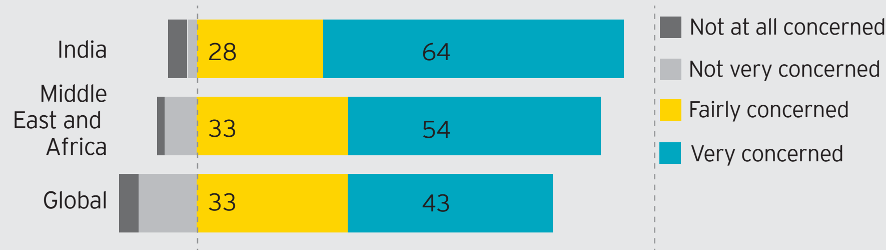
If independent director's develop a close bonding with the promoter group, it may be more difficult for them to ask uncomfortable/ probing questions and challenge the managements judgment. However things have changed in recent times due to high profile instances of fraud and independent director's need to be more independent.

Independent directors generally feel that they are inadequately compensated given higher expectations, the risks involved and possible liabilities which may arise. According to rules framed under the 2013 Act, sitting fees should not exceed INR 100,000. In addition, independent directors are also entitled to profit related commission. However, an independent director cannot receive stock options.

The position of an independent director was never an easy one; however, it will be even more challenging and onerous, involving significant responsibilities, and liabilities in the case of defaults. There are various legislations that can be used against independent directors. For example, under section 245 of the 2013 Act, a group of minority shareholders/ deposit holders can file a class action suit against the directors and claim damages or compensation for any fraudulent, unlawful or wrongful act or omission or conduct. Under section 447 of the 2013 Act, a director can be imprisoned for a maximum period of 10 years for any fraudulent conduct. Any violation of clause 49 to listing agreement may trigger financial and criminal action under the Securities Contract (Regulation) Act, 1956. An independent director may also be held responsible under the SEBI Takeover Code, Insider trading regulations and the Indian Penal Code (IPC).

Section 149(12) of the 2013 Act clarifies that independent director's will be liable only in respect of such acts of omission or commission by a company that had occurred with his or her knowledge, attributable through Board processes, and with the consent or connivance or where he or she had not acted diligently. Hence, the section seeks to provide immunity to independent director's from civil or criminal action in certain cases. However section 166(2) of the Act seems to be a contradiction. It states that the whole board is required to act in good faith in order to promote the objects of the company for the benefit of its members as a whole and in the best interests of the company. This section narrows the distinction between independent director's and EDs, and so does, the definition of an "officer in default" under clause 2(60) of the Act.

In the past, certain independent director's have faced liabilities arising from frivolous claims or bouncing of a cheque. Hence, ndependent director's operate in an environment of high uncertainty and confusion over their role. According to the Eleventh Global Fraud Survey of EY, 92% of the directors in India are concerned about their personal liability.



The 2013 Act and RC49, with all its good intention to ensure good corporate governance, do not provide concrete answers to all of the above doubts of independent director's. This may discourage potentially talented candidates from joining as independent director's. Clear principles that attempt to replicate some of the fiduciary duty concepts may provide IDs with more comfort that their actions in good faith will not land them in prison. Director's & Officers (D&O) insurance is one means to cover independent directors for financial liability, but that does not insulate them from imprisonment. Everyone recognises it to be a big concern, but there doesnt seem to be any agreement on what the solution could be.

The independent directors can bring objectivity to the decisions made by the board of directors by playing a supervisory role. While they need not take part in the company's day-to-day affairs or decision making, they should ask the right questions at the right time regarding the board's decisions.

Questions for independent directors prior to accepting appointment on a board

- Is it a company that I have faith in and can trust?
- Do I have a good understanding of the company's risk profile?
- Am I culturally well suited to work with this company?
- Do the promoters consider the independent director just as a compliance necessity?
- Do I have sufficient time and commitment to discharge my responsibilities as an independent director ?

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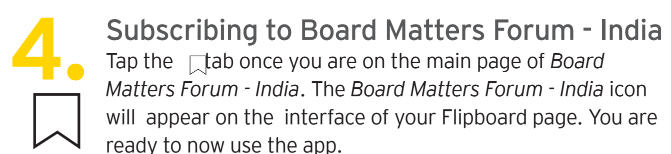

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Corporate social responsibility: on the board agenda

Corporate Social Responsibility (CSR) has evolved over the years, and with the Companies Act 2013, it has emerged as a key action point on the Boardroom agenda. The provisions under Section 135 mandate the qualifying companies to formulate a separate board-level CSR Committee comprising three or more directors, with at least one independent director. This committee is required to formulate and recommend to the board a CSR Policy for the company, the amount of expenditure to be incurred and monitor CSR activities of the company from time to time. Besides approving the CSR Policy for the company, the Board of Directors will have to ensure that activities agreed upon in the plan are undertaken by the company. If the company is unable to spend the allocated amount, the board must specify reasons for the same.

The expectations from the board of directors vis-à-vis a company's CSR programs/projects closely emulates their roles and responsibilities toward guiding and directing the company's normal course of business. On a passive and on-going basis the board of directors are expected to monitor the company's CSR activities for risk and assurance-related parameters. Also, it becomes equally important for the Board to ensure that the company is following a transparent approach for contracting services to partners responsible for implementation and that any and all such partnerships are formulated after carrying out a credibility check for prospective partner(s). Active interest from the Board relating to the performance and result aspects of the company's CSR programs/projects will enable it to ensure that there is sufficient evidence to support claims of such programs delivering the desired impact. This aspect assumes significance owing to the board of directors' responsibility towards reporting on the company's CSR programs/projects.

> Shared value is an approach wherein the company creates economic value for itself and simultaneously advances the economic and social conditions in the communities in which it operates.

Furthermore, another aspect that seeks close engagement of the Board is with regard to the design and dimensions of the various CSR programs/projects. Herein, such supervision needs to take into consideration a close assessment of various programs/projects on parameters and principles related to the notions of "shared value" and whether it positively impacts on investors, customers and employees of the company.

As a step forward, companies are expected to support the board of directors with data and information that equips them fully in addressing expectations stemming from the CSR agenda. Well documented risk management and mitigation processes/procedures, third party assurance reports on program/project performance, social return on investment computation for the programs efficiency are some of the mechanisms through which companies can provide structured support to their Board. Companies can also utilize the position of the independent director on the CSR committee to bring in a functional and/or technical expert who can add value to the board room discussions/discourse around CSR.

Companies might be at different stages of creating an impact through their CSR programs and depending on where the company currently is and where they strive to be, the Board members can play an important role in giving direction to CSR activities — much in the same way as they guide the business.

CSR strategy: variable approaches

- Company 1: A CSR strategy that is leading to low impact and visibility, should prompt the board to examine it through the lens of performance improvement. The Board should guide the company's CSR initiatives to align these with its ideology/operations and the government's priorities.
- Company 2: A CSR strategy that is low on impact and high on visibility should prompt the board to examine it from a risk stand point. The situation should not translate into public scrutiny where civil society groups begin questioning the ethos driving the company's CSR initiatives.
- Company 3: A CSR strategy that is high on impact and low on visibility should prompt the board to examine it in terms of possibilities for an increased degree of alignment with the company's strategic intent and operations. The board may also want to examine the impact/results being claimed by the company from the point of view of assurance and evidence.
- Company 4: An ideal situation for a company to be in; a strategy which delivers high impact and high visibility should prompt the board to focus on strengthening the advocacy, dissemination and communication related components of the strategy.

Lastly, a robust communication strategy that engages all relevant stakeholders to comprehend the full import of the CSR agenda is imperative. Interestingly, during a survey conducted by EY amongst the employees of a company, it was found that the employees were more aware about the CSR work of another company perhaps because they were better at communicating about their work, underlining the importance of this aspect.

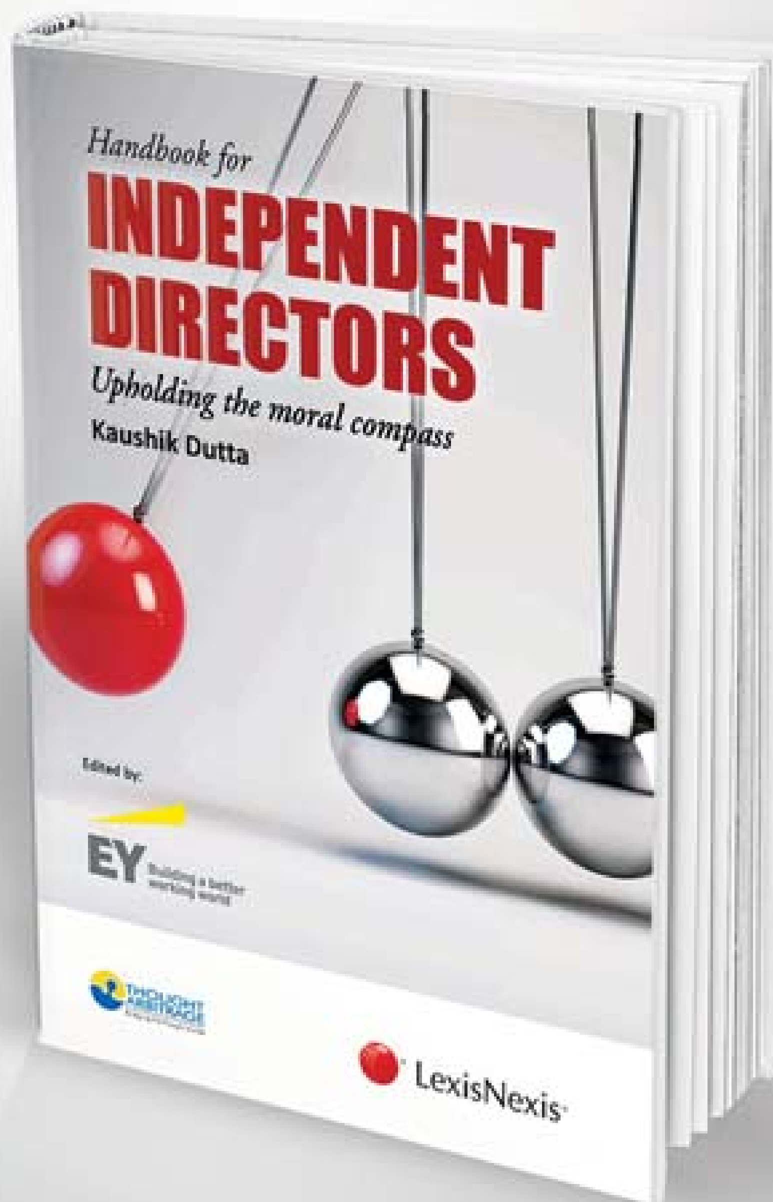
Questions for the independent director

- Has the company defined a CSR policy that addresses expectations stemming from the Companies Act 2013?
- Is the CSR policy benchmarked against metrics that deliver evidence to support program claims?
- Is there a communication strategy in place that effectively engages all stakeholders around purpose and results of the CSR program?

Helping you walk the tightrope

As regulators enhance their oversight and stakeholder expectations build up, are independent directors ready to walk the tightrope? Introducing the *Handbook for Independent Directors*, an extensively researched publication discussing regulatory requirements arising from the Companies Act 2013, SEBI's Clause 49 and more. The handbook, edited by EY, contains analytical reviews of case law, academic studies and global and India best practices.

To know more, write to anil.nim@in.ey.com



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Beyond key committees: boards create committees to support oversight responsibilities

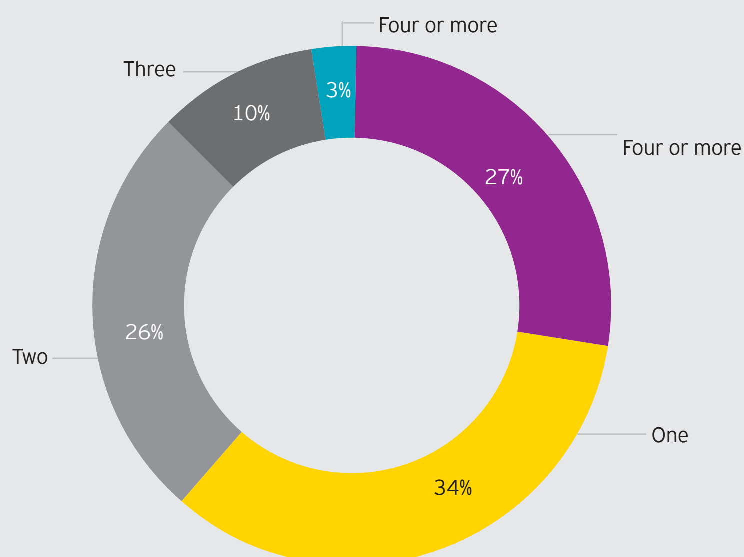
Nearly every S&P 500 company board has three key committees – audit, compensation and nominating – to carry out critical board functions. Many boards also have created additional standing committees to assist with oversight responsibilities. Beyond specific regulatory and exchange-listing requirements associated with key committees, boards often create committees and delegate responsibilities as appropriate, based on company-specific circumstances. This research provides insights on what additional committees we see boards maintaining and the responsibilities assigned to these committees.1

Key findings

Beyond audit, compensation and nomination committees, nearly three-quarters of S&P 500 companies have at least one additional committee. The average number of additional committees is 1.3.

- The most common committees based on function are finance (38%) and executive (37%).
- More than 20% of finance committees are found in the consumer discretionary and financial services sectors.
- Around 20% of executive committees are in these sectors as well. Once common, these committees are in decline. More than 60% of S&P 500 companies had executive committees in 19982 compared with less than 40% today.
- Just over 10% of S&P 500 companies have a separate compliance committee. One-third of these committees are in the health care industry, and nearly one-quarter are in the energy sector.
- Only 8% of S&P 500 companies have a separate risk committee - and more than three-quarters of these companies are in financial services.
- Some boards have created committees to oversee emerging issues:3

> A company's governance practices – including committee organization – should be developed taking into account the specific circumstances at the company and in its industry.



Source: EY Center for Board Matters

- 7% of S&P 500 boards have a sustainability committee. Companies in the materials, financial and consumer staples sectors are most likely to have a sustainability committee.
- 4% have a technology committee and one-third of these are financial services companies.
- Sectors most likely to have additional committees include utilities (averaging 2.5 additional committees per board), financial institutions (1.7), health care (1.5) and materials (1.4).
- The information technology sector averages the lowest number of additional committees - fewer than one per company (0.7).

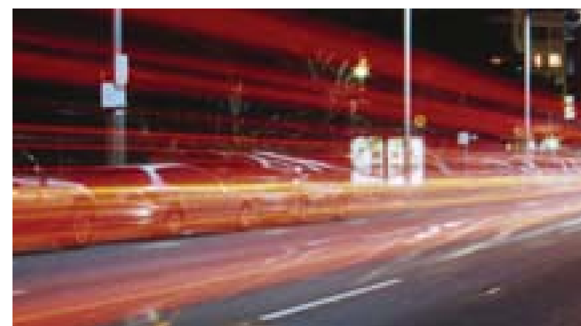
Key committees at S&P 500 boards

	Audit	Compensation	Nominating
Prevalence	100%	100%	99%
Size	4	4	4
Independence	100%	100%	100%
# of meetings/ year	9	6	5

Most common additional board committees at S&P 500 companies

Companies with this committee	Committee function and common responsibilities	Top three sectors with this committee (% of industry)
38%	**Finance** • Oversees financial policies, strategies, capital structure, and annual operating and capital budget • May also oversee investments, dividend policy, credit and other market risks, share repurchases, and mergers and acquisitions • Functions may overlap with risk and strategy committees	• Utilities (84%) • Telecommunications (60%) • Consumer discretionary (43%) • Financial services (43%)
37%	**Executive** • Exercises authority of the board when the board is not in session, except in cases where action of the entire board is required by charter, bylaws or applicable law	• Financial services (51%) • Utilities (45%) • Industrials (43%)
11%	**Compliance** • Oversees programs and performance related to legal and regulatory risks, as well as implementation and maintenance of the company's code of conduct and related matters • May focus specifically on compliance in the following areas: environmental, health, safety and technology • Functions may overlap with risk, public policy and sustainability committees	• Health care (35%) • Energy (27%) • Materials (23%)
8%	**Risk** • Oversees enterprise-wide risk management to identify, assess and address major risks facing the company, which may include credit, operational, compliance/regulatory, interest, liquidity, investment, funding, market, strategic, reputational, emerging and other risks • Reviews and discusses management's assessment of the company's aggregate enterprise-wide risk profile • Recommends the articulation and establishment of the company's overall risk tolerance and risk appetite • Functions may overlap with finance and compliance committees	• Financial services (35%) • Telecommunications (20%) • Utilities (6%)
7%	**Sustainability** • Reviews policies and practices related to significant public issues of concern to shareholders, the company, employees, communities served and the general public, with oversight of corporate responsibility, environmental sustainability, diversity and inclusiveness, and/or brand management program • Functions may overlap with public policy and compliance committees	• Materials (23%) • Telecommunications (20%) • Consumer staples (13%)

Practicing the art of risk oversight



Any meaningful business proposition entails risk. Board directors, and audit committee chairs in particular, are acutely aware of the need to learn and master the art of risk oversight. As one audit committee chair remarked, "Part of the cost of doing business is that we will fail from time to time. You cannot eliminate risk and bat a thousand."

Which risks matter?

Strategic and emerging risks took center stage in recent meetings of audit committee chairs. In one meeting, Morten Friis, former chief risk officer at the Royal Bank of Canada, drew a direct link between risk and strategy: ***"Strategic decisions are the most important risk decisions."*** Most audit committee chairs agreed that strategic risks are frequently not only the most important risks, but also the most difficult to identify.

> " The next great frontier for boards is unknown risk. We have to understand risks as well as we do strategy."
>
> - audit committee chair

Audit committee chairs also grapple with emerging risks, strategic or not. During discussions, they identified a number of emerging risks: shortages of engineers to design competitive products, failure of the government to properly inspect food and drugs, interest rate volatility, and competitors' use of disruptive technology to gain market share. One audit committee chair explained, ***"I'm worried about what is lying in wait. What disruptive technology is coming tomorrow?"***

As difficult as it is to tackle strategic and emerging risks, companies must still contend with ongoing operational, compliance, and fraud risks. Within these categories, audit committee chairs frequently single out cybersecurity as riddled with challenges that warrant constant vigilance, both by senior management and the board.19 Mr. Friis recently cautioned a group of audit committee chairs that traditional risk management practices may not be the most effective way to manage the cybersecurity threat – a risk that requires a strategy all its own and tactics that are frequently implemented almost as soon as they are conceived.

Regulatory and compliance risks are also top of mind for many audit committee chairs. Companies too often bear enormous costs when such risks materialize. In 2014, Intel lost its appeal of a €1 billion antitrust fine in the European Union. 20 In 2012, GlaxoSmithKline agreed to pay $3 billion in fines as part of a fraud settlement.21 And fines in the financial services industry have reached large proportions: for example, by the end of 2013, JPMorgan had set aside $23 billion to pay future fines and legal bills.22

How does culture affect risk?

The culture of an organization can go a long way toward addressing and mitigating risk. No matter the particular type of risk – operational, compliance, or fraud – audit committee chairs observed that the right talent and human resources strategy is an invaluable element in any risk mitigation. The board's oversight of the culture of an organization requires careful observation of management. Several audit committee chairs said that they pay very close attention to how management teams communicate with each other; these board directors look for ***"a degree of transparency and openness in answering questions posed by a skeptical board,"*** which can provide comfort about the organization's culture.

Source: EY Center for Board Matters

> " The keys to mitigation are culture, tone, and the people you choose to manage the business."
>
> - audit committee chair

Mr. Friis recommended that boards review incentive structures and performance measures as critical indicators of a company's culture: ***"Look at who is getting ahead in the organization and why. If someone is not living the values of the organization, is there a decent chance of finding out?"***

Getting the talent strategy right is particularly important for organizations currently doing business or planning to do business internationally. Finding the appropriate admixture of "headquarters expats" and local employees is a key to success in international operations. On the domestic side, audit committee chairs might want to ask management how it plans to bring those with international experience back to the home country in order to foster diversity of thinking and inject an international perspective into domestic practices.

What should the audit committee do?

The way that risk oversight is coordinated at the board level often depends on the industry of the company. At some companies the audit committee is responsible for risk oversight, while at others – including financial institutions – there is a separate dedicated risk committee. Still other companies distribute specific risks among the committees best suited to address them and give the remaining risks to the full board.

Some audit committee chairs agreed that it is best to reserve for the whole board only the top six or seven risks for the entire company. And regardless of how risks are allocated among the full board and its committees, the audit committee frequently ***"owns the process,"*** if only to ensure that there are no oversight gaps.

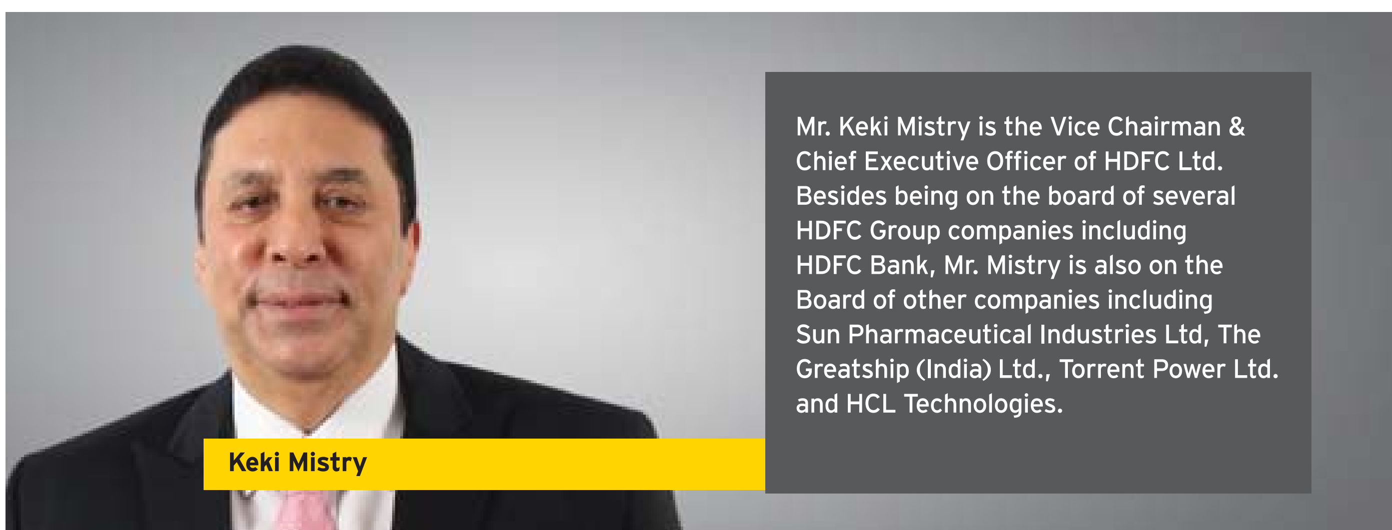
Audit committee chairs have observed that an effective risk oversight process requires board directors to remain steadfastly objective and to ask good questions. Reliance on presentations from senior management is not enough. One audit committee chair recommended asking divisional heads to present their risks to the board: ***"If you meet the people, it gives you a better feel for what they are dealing with."***

No matter the risk governance structure, audit committee chairs agreed that risk oversight remains more art than science, and, in the words of one audit committee chair, "Despite all the charts and models, it still requires intuition."

Questions for audit committee chairs: risk oversight

- What emerging risks are most relevant to your company?
- What types of disruptive risk are you most concerned about for your company?
- How often does your board or audit committee conduct a full review of large strategic risks?
- How does your board coordinate risk oversight responsibility between the audit committee and the risk committee (if there
- is a separate risk committee)?
- With whom do you speak in management about operational, compliance, and fraud risks, respectively?
- How do you verify that mangement is living up to the company's stated culture and values expecations?

"Undue focus on compliance limits the value independent directors can deliver"



Keki Mistry

Mr. Keki Mistry is the Vice Chairman & Chief Executive Officer of HDFC Ltd. Besides being on the board of several HDFC Group companies including HDFC Bank, Mr. Mistry is also on the Board of other companies including Sun Pharmaceutical Industries Ltd, The Greatship (India) Ltd., Torrent Power Ltd. and HCL Technologies.

In a conversation with Neville Dumasia, Deputy Advisory & RISK Leader, Advisory Services, EY, Mr. Mistry shares his views on the rights, duties and liabilities of independent directors. He believes that although the Satyam incident happened years ago, it seems companies are still being viewed through the same lens and are bearing the brunt of the impact from the incident. He says that corporate India does not need to be assessed entirely from the perspective of what happened in the past, and instead, the focus now needs to be on how independent director's as part of the Board, can more effectively contribute to supporting the organisation on strategy.

ND: *There seems to be a heightened focus on regulatory compliance at the Board level. To what extent do independent directors need to scale up their engagements on that front?*

KM: The critical question that we need to consider and be clear about with regard to independent directors is, do we want them to be restricted to compliance or is their role much larger? I believe compliance, although a critical aspect of the overall governance process, should not take up an undue share of the attention of independent directors and the Board. Another concern would be that not all independent directors' might be well versed on the finer nuances of compliance and instead have been chosen for their expertise in wider facets of business, such as marketing, brand building etc.

I believe our primary focus should continue to be on providing strategic direction to the organization. As an independent Director, I would rather focus on introspecting how much time we really spend deliberating on the products we need to develop, the markets we need to be in or how we should grow and create a competitive advantage. Compliance with the law and ensuring that sound business practices are maintained by the Company is a definite requirement and hence understanding the requirements, setting up a framework are all important aspects and fall within the responsibilities of ID's, the question is finding the right balance between executive or day to day running of the business and stewardship.

ND:*The regulatory environment has definitely created scope for increased liability for independent directors, especially with regard to*

their responsibilities around fraud management. Is it something you feel increasingly concerned about?

KM: Fraud management is definitely a top priority for Boards today, which was the case earlier as well, but the urgency around it has increased significantly. However, rather than tying this aspect to Boards and independent directors, what needs to be ensured is that effective controls and processes are put in place, and appropriate external specialists are engaged to review and their advice sought on these aspects. Rather than just focusing on holding independent directors responsible, it is important to ensure that fraud management has been addressed by establishing an effective framework, including a robust whistle-blower policy. Bringing independent directors down to a granular level would limit them from performing their role at a Board level. independent directors can do a better job from an oversight perspective. Increasing their liabilities may not bring out the desired outcome.

ND: *Do you see a larger role for independent directors from a risk management perspective?*

KM: I certainly do not envisage a more expansive role on this aspect than what already exists. I believe risk oversight at a functional level can be entrusted as a dual responsibility to the Company Secretary or the Compliance Officer.

ND: *What are the top three concerns from a corporate governance standpoint?*

KM: It is clear that the life of an independent director has become more challenging from a liability perspective. I suspect this would make independent directors view aspects with a lot more scepticism now. One needs to increasingly use the right level of objectivity, stemming from a sceptical mind set.

Secondly, limiting the appointment of an independent director to the Board of a specific company up to 10 years is a significant constraint. I believe the timeline is short, since it takes a fairly longer time for an individual to develop a comprehensive understanding of a company's diverse aspects. In order to add significant and lasting value, an independent director's association with the Board needs to be comprehensive and long term, since many strategic decisions have a bearing that goes much beyond a few years.

Thirdly, it is important to assess and address the concern around the quality of the person being considered for appointment as an independent director. The potential impact stemming from the liability associated with being an independent director would tend to make knowledgeable individuals reluctant from taking up an independent director role.

I believe setting specific conditions makes it much more difficult to get high quality individuals to join boards. For instance, if a company defaults on payment to a financial institution, any person on the board of that company cannot assume a role on the board of other companies, a declaration that individuals have to give each year. The risk of smaller companies potentially being in similar situations would discourage individuals from taking positions on the board of these companies.

ND: *Presumably activist investors exist because Boards are often seen as being inadequately equipped to take care of shareholders' interests in Western markets. Do you believe an activist investor is a phenomenon India will never find itself confronted with?*

KM: I believe activist investors are already a reality in our country, although the form they take may be different.

Several external advisors/organisations exist who have well defined parameters

on the basis of which they recommend good governance practices or otherwise. These reports are generally available and are useful for a well-informed investor to understand the state of governance within the Company. The only aspect wanting is that these entities base their reports not on qualitative matters but very quantitative aspects which sometimes may not yield the correct information. Similarly, most pension funds that are investors in financial services companies, based on their mandate, are required to follow the objective parameters set by external third party corporate governance solution experts.

ND: *International markets are witnessing similar regulations. How different do you find the regulatory environment in there?*

KM: In the US and Europe, the environment is more mature and markets are more stable than in other regions. Regulations have evolved over time and the environment is relatively easy to do business in. In India, we are on a journey to ensure that we can be as sophisticated and evolved as them on this front. It is not that all is well in the mature markets and vice versa, they have their own set of challenges which they are grappling with. Closer home, I am personally optimistic that the intent is correct in trying to ensure better standards of governance within Corporate India, it is simply that one should clearly distinguish between the roles envisaged and progress accordingly.

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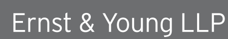

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