

Whistle Blower Mechanism: *From a compliance measure to tool of corporate integrity*



The usefulness of whistle blower mechanism has adequately been demonstrated in some recent experiences, where major corporate or banking scandals, insider trading, or prevalence of unsafe practices have been brought to light by whistle blowers. Among tools of internal control that are meant to check fraud and irregularities, whistle blowing mechanism is arguably the least costly, and given the fact that a whistle blower could exist anywhere, is the widest organisation-wide check. Companies may reduce whistle blowing to a pure compliance measure, or, recommendably, use it as a tool of effective corporate governance, because it is adequately clear that less secretive and more ethical organisations in the long run command more respect, and therefore, higher valuations. This article discusses the usefulness of the mechanism, and the steps to make the mechanism effective. Read on...

Need for whistle blower mechanism

Ordinarily, no system is foolproof from fraud and corruption. Irregularities, including unsafe practices, can be found in the most trustworthy set-ups in the world, whether government, NGOs or corporations. This is mainly because, a system is driven by people, and people have a tendency to get motivated by greed, convenience, or short-term incentives. There are several tools of internal control to keep check on such behaviour—from the age-old tools of accounting and auditing, to internal audits, concurrent audits, forensics, risk-based audits, etc. Whistle-blower mechanism is the preparedness of the organisation to allow anonymity and freedom from the fear of reprisal to a person who “blows the whistle”, that is, reports any irregular behaviour or practices. Since almost anyone

can be a whistle blower, whether internal or external to the organisation, the mechanism creates a system of internal check organisation-wide, and brings into effect the widest of audit checks possible, in the most cost-effective manner.

Whistle blowing prevails in organisations—the government sector, corporate sector, or the NGO sector. Our article is concerned with the use of whistle blowing in the corporate sector—hence, the rest of the write-up focuses accordingly.

Defining ‘Whistle Blower Mechanism’ (WBM)

The key task in defining WBM is to identify who can be complainant, and what can be the subject matter of the complaint.

Globally, it seems that the scope of WBM seems limited to complaints by existing or former employees only. OECD defines whistleblower protection as follows: “Legal protection from discriminatory or disciplinary action for employees who disclose to the competent authorities in good faith and on reasonable grounds wrongdoing of whatever kind in the context of their workplace.”¹ The International Labor Organisation (ILO) defines it as “the reporting by employees or former



**CA. Vinod Kothari* and
Ms. Vallari Dubey****

(*The author is a member of the Institute. **The author is a commerce professional. The author duo can be contacted at vinodkotharicompany@gmail.com.)

¹ <https://www.oecd.org/corruption/Committing-to-Effective-Whistleblower-Protection-Highlights.pdf>

employees of illegal, irregular, dangerous or unethical practices by employers.”² Statutory definitions in some global statutes also seem to be pointing to protection in respect of action taken by workers to their employers—see sections 43A onwards of UK Employment Rights Act, 1996.

In India, the scope of WBM, known as vigil mechanism, is different under the Companies Act, 2013 (Act) and the SEBI Listing Obligations and Disclosure Requirement Regulations (LODR Regulations). Section 177 (9) of the Act read with the Rule (7) of the Companies (Meetings of Board and its Powers) Rules, 2014 (MBP Rules) provides for protection against victimisation of employees and directors who avail of the vigil mechanism.

However, Regulation 22 of the SEBI Listing Regulations seems to be referring to access by both employees and others.

Reg 22 (1) *The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.*

(2) *The vigil mechanism shall provide for adequate safeguards against victimisation of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.*

The stance of global regulations or OECD rules seems to be pointing to affording protection. Apparently, victimisation and reprisal are likely in case of employees. However, given the intent and desired objectives of the mechanism, there is no reason why unethical behaviour cannot be noticed by other stakeholders—say, vendors, service-providers or customers. Hence, it seems appropriate to widen the scope of WDM to cover not only complaints by employees but by other persons too.

The next element of definition is what is the action complained against? It may be useful to cite from section 43B of the UK Employment Rights Act which may be a useful guide to the scope of WBM:

- (a) that a criminal offence has been committed, is being committed or is likely to be committed,
- (b) that a person has failed, is failing or is likely to fail to comply with any legal obligation to which he is subject,
- (c) that a miscarriage of justice has occurred, is occurring or is likely to occur,
- (d) that the health or safety of any individual has been, is being or is likely to be endangered,

- (e) that the environment has been, is being or is likely to be damaged, or
- (f) that information tending to show any matter falling within any one of the preceding paragraphs has been, is being or is likely to be deliberately concealed.

Having considered these global statutes, our preferred definition of WBM will be as follows:

*“A mechanism which undertakes **encouraging and enabling an internal or external person, coming in communication with the company by virtue of an office, engagement or transactions, to report, in good faith, some internal fraud, criminal action, irregularity, unethical behavior; taking appropriate measures to redress the same while affording protection to the complainant.**”*

Elements of the above definition

- **Encouraging and enabling**—the mechanism must provide for an effective means of communication, assuring anonymity and/or protection. Enabling is through a systemic framework of officers/entities within the company and well-defined redressal and investigative procedures.
- **Internal/external person**—The whistle blower mechanism must not be limited to the internal workers, employees or officers of the company. Considering the provisions of the SEBI Listing Regulations, even outsiders, such as dealers, shareholders, creditors, government officials or anyone else, who does not participate in the day to day working of the organisation, must be entitled to file a complaint. It, however, must be noted, that this should not encourage frivolous or malicious complaints. Hence, the necessary ingredient of good faith must be there.
- **Coming in communication with the company**—The stress is on first-hand awareness; mere hearsay or random gossip should not be the basis of a complaint. The complaint must originate from a personal experience, possession of proof or documents establishing a case or witness encounters.
- **Internal fraud, criminal action, irregularity, unethical behaviour**—The complaint must be with respect to an act of failure consisting of any or more of the following:
 - o Internal fraud—Fraud is a deliberate action, with due awareness of the action and its consequences. This may include fraud against

² ILO Thesaurus

Corporate Governance

the company or its stakeholders, fraud against the government, etc.

- o Criminal action– WBM is not concerned with internal complaints against acts not amounting to a criminal act. For example, a senior not promoting or not granting a leave to a subordinate is not a matter for WBM. It may also be important to note that even if a matter is covered by other procedures – say a breach of insider trading norms, there should be no hesitation in using the WBM merely because there is a process of reporting or prosecution of such issues.
- o Irregularity– The term is wide enough to include any behaviour which is not regular as per the well-established principles, standards or practices within the culture of the organisation or around it such the industry in which it operates.
- o Unethical behaviour– This may include gratification, whether monetary or otherwise, any other breaches of either the Code of Conduct of the company or ethical principles.
- **Appropriate measures to redress**– Enabling a complainant to file a redress/complain necessitates provision of appropriate measures to redress such complaint. The framework for this is discussed in later sections.
- **Anonymity or protection**– The stress of WBM is affording protection against reprisal, or anonymity. Some WBMs do not encourage or permit anonymous complaints—even where they require the complainants identity; the WBM must protect anonymity where the same is desired by the complainant.

Advantages of a Whistle Blower Mechanism

The key feature of WBM is an all-pervasive vigil. Vigilance usually comes at a cost, and is typically carried by agencies assigned with the task of keeping vigil. The efficiency of such vigil mechanism depends on that of the vigilance agency. Global experience proves that despite existence of several layers of internal controls and audits, several frauds and breaches of law have been reported by whistle-blowers. Thus, WBM becomes an effective, and yet least costly mechanism of internal controls.

Very often, the fear of a wrong being reported becomes a very significant deterrent against wrongful action. WBM amounts to installing the invisible watchful eye across the organisation—hence, the mechanism becomes very effective in keeping check on internal frauds and irregularities.

There have been several instances of WBM succeeding in unearthing major frauds. For instance, a junior accountant in a company was privy to the transactions carried on by a senior member of the accounts department, embezzling money into a third party account on a regular basis for over a year. The junior chose to report the same using the whistle blower mechanism, while staying anonymous of his identity. The investigation led to a finding that the accused was not merely embezzling money from the organisation but was also guilty of using the money for personal gains by routing the money to a group of companies, owned and controlled by him, and also transferring the money to the accounts of organisations using the same for drug and illegal trafficking. It was also found that senior management personnel colluded with the accused to carry out the transactions.

It is surprising that a small initiation with genuine intent and honesty, with limited but true knowledge of an irregularity, could lead to unearth a massive fraud within the organisation. This led to the attachment of all the properties bought out of the embezzled money, track down on illicit drug dealers and traffickers and bring back the funds to the company, thereby protecting the interest of millions. This was possible because of a strong whistle blower mechanism of the company which made the internal control systems even stronger.

Effective WBM contributes to transparency and non-secretive corporate culture, promotes ethics and strong internal values. Irrespective of whether these virtues lead to profits in the long run or not, organizational values are far bigger an asset than any wealth accretion.

As per a 2014 OECD Foreign Bribery Report, about 31% of the unearthing sourced from internal audit, while 17% sourced from whistle blower. A detailed share of various sources is below:

Constituents of a Whistle Blower Mechanism

An effective WBM consists of the following elements:

Whistle Blower Policy

A whistle blower policy is an important document towards adopting WBM. It is guidance document that defines the approach of the organisation towards WBM, defines its scope, and directs the actions/inactions and also the measures of handling of complaints in the company. Importantly, a whistle blower policy must have the following elements:

- Objectives
- Definitions and Scope, primarily of the complaint matter, complainant, etc.
- Reporting/Redressal process

Corporate Governance

- Roles and responsibilities of Nodal Officer
- Investigation process
- Access to Chairman/ CEO/ MD or Chairman of the Audit Committee or other committee ultimately responsible for WBM
- Records and documentation
- Reporting
- Review of policy
- Illustrative list of events warranting action
- Protection to the complainant
- Action against frivolous and vexatious complaints
 - o Defining *Mala fide* and vexatious complaints
 - o Prosecution and disciplinary action.

Whistle Blower Framework

The framework consists of the officers/agencies responsible for reporting, investigation and redressal of complaints. The framework essentially includes the following:

- **Board of Directors (BoD/Chairman/CEO)**– BoD is the top most authority within the company, and the ultimate responsibility of supervision and direction. If the organisation has committed to implement an effective WBM, the ultimate initiative and preparedness has to be seen at the Board level. Also, where are complaints which are not properly dealt with an audit committee level (for example, where the CEO or a Director is one of the accused), the complaint may be dealt with at Board level.
- **Audit Committee**– In India, generally the Audit Committee performs the function of overseeing the vigil mechanism in the company, and therefore, without undermining the overall responsibility of the Board, the audit committee should be the apex responsibility centre for effective implementation and operation of WBM. The audit committee is mainly responsible to take reports from the executive machinery on a periodic basis. Generally, the Chairman of the Audit Committee shall be responsible to address specific concerns/complaints forwarded to him by the Nodal Officer.
- **Whistle Blower Committee**– Companies may have a focused committee responsible for WBM. While the Audit Committee is a committee of members of the Board. A Whistle Blower Committee, if any, may comprise of HR head, Compliance officer, Risk Management officer, Legal Head, CFO, Actuary officer, Chairman of Audit Committee etc. The terms of reference should clearly lay down the rights and responsibilities of the committee. The committee

may meet at least half yearly or at such intervals as may be deemed appropriate. If such a committee exists, the committee is responsible to carry on the investigation of a whistle blower complaint as forwarded to it by the Nodal Officer.

- **Nodal Officer/Vigilance Officer/Ombudsperson**–A Nodal Officer is the point from where all the complaints route through. He refers the matters to the upstream committees based upon the nature and materiality of the complaints received. While, he has to report on the consolidated complaints received over a period to the upstream committees, annually or half-yearly, he may not forward every complaint to them, every time. The job may ideally be handled by a Company Secretary (CS) or the Compliance Officer. It cannot be refuted that a CS has an important role to play in the entire process of whistle blower mechanism. In fact, he is one of the keys to ensure that the system is working effectively. A CS is the centre-point connecting the stakeholders with the management of a company and vice versa. Moreover, he is also vital for ensuring that the company does follow good corporate governance by taking legitimate enforcing actions.

Reporting and Review

The Nodal Officer must report problems arising during redressal and addressing of a complaint to the Whistle Blower Committee/Audit Committee, as the case may be. The process of reporting and review is essential to keep up with changing situations. No whistle blower mechanism can be effective, if there are no feedbacks. In case of Whistle Blower Committee, it should work closely with the Audit Committee to discuss, analyse and draw solutions. Once the solutions are drawn, strategy must be planned to incorporate the same in the existing mechanism to ensure that the mechanism is capable to handle similar problems in future. The committee may run trial tests to check the operational ability review up to the decision making level. Based on the nature and materiality, the change and its related information must also be disseminated to the stakeholders, including the officers/employees of the company.

Sensitisation programmes

If the organisation has an internal commitment to effective WBM, the most important element of the mechanism is internal communication. The most important audience for any communication of WBM are the employees. While the senior-most management

Corporate Governance

may be open and committed to WBM, the employees may still be caught by inertia, lack of agility, or fear of retribution. Thus, the organisation may need to communicate the organisation's commitment to effective WBM all over the organisation, to instill confidence. In the initial phases of implementation, even offering a monetary prize to a whistle blower may be effective.

Importantly, it is crucial to inform the stakeholders of their rights and explain them on how they can use it for the benefit of all. In order to ensure continuous learning, sensitisation programmes must be organised at the initial implementation level, when the mechanism is being put in place afresh and then periodically. While communication of WBM is done through intranet, billboard communications at places where employees gather informally, such as cafeteria, etc. may be effective.

Protection or Anonymity

The whole principles of the Whistle Blower Mechanism are based on assurance of anonymity and protection to the complainant, so that she/he, who is acting as Good Samaritan, is not put to any prejudice. One can say that, protection is the essence of the entire mechanism. If the complainant's identity is exposed, it may lead to failure of the mechanism, if his security and interests are prejudiced. Therefore, adequate security must be maintained at each level of the framework.

The complainant must be protected against any detrimental actions including victimisation, harassment, threat etc. Disclosure made by the complainant must be treated confidential and in sensitive manner by all the concerned officers. In case there is a need to disclose the identity or the same is required out of a mutual consensus, the consent of the complainant must be taken in writing.

As per an international OECD survey, around 61% of the companies had a written policy for the protection of whistle blowers from any reprisal.

While adequate protection to a complainant is the key for success of a Whistle Blower Mechanism, this does not stop the authoritative officers/committee to take disciplinary action against a complainant who raises any false or frivolous complaint with malafide intention. Such complaints may have the following elements:

- Malicious or unfounded allegations;
- Non receipt of evidence or required information shall authorise custodian/ whistle blower committee to close the case

- Complaints below the monetary limit
- Vexatious complaints

Procedural steps of WBM

The whistle blower infrastructure is a combination of the redressal system, starting from the receipt of a complaint till the final disposal. Briefly, the steps are:

- Logging complaint
- Acknowledgement of the same and generation of an acknowledgement number
- Verification of the identity of the complainant
- Analysis and study of the supporting documents
- Verification of the allegation
- Recording and entry into log
- Forwarding complaint to the appropriate authority with preliminary findings
- Thereafter, once the authority receives the complaint, appropriate verification measures are adopted to confirm the allegation.
- Once the allegation is proved, a meeting of the Whistle Blower Committee/Audit Committee is called, and based upon the materiality, the matter is then discussed with the Board of the company, with suitable options to handle the same.
- Decision once taken is put to execution.
- While appropriate actions are taken, the complainant is given a preliminary feedback.
- Once the actions have reached a conclusion point, the complainant is forthwith informed of the same.

Conclusion

There has been an irresistible change in the corporate culture in India and worldwide. Statutes have been modified and perspectives have been reshaped. However, the intent of any legislation and a framework has always been to protect and act in, the best interest of all the stakeholders. Whistle blowing is an exceptional tool that can help achieve this objective if incorporated and implemented efficaciously.

Many stakeholders are uninformed of internal operations of a company and if, the company is operating in bad faith using illegal methods to get its way around, such external stakeholders will never be able to make a right decision. Therefore, it is imperative to encourage a culture of confidence among everyone, spread awareness about whistle blowing, so that when the need arises, the ones with the good conscience can correct or at least apprise of the wrong doing in the organization for taking corrective action. The least a company can do is to provide a platform with utmost protection of identity and safety. ■