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Whistleblowing Mechanism: Nuance of Sarbanes-Oxley Act, 2002 and Intricacy with the Indian Companies Act, 2013

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ABSTRACT

Whistleblowing was intended to originally mean the practice of the British era, when the policemen blew their whistles when they witnessed a crime being committed. Whistle blower mechanism is when the employee or a member of the corporation exposes or discloses any misconduct or illegal conduct of affairs of the same.

It typically means 'calling out' the attention of the key managerial personnel to any wrongdoing taking place in the organization or pinpointing the conduct, unethical behavior that presents to be a concern to the management. Whistle blowing aspect proves to be a 'check and balance' system as it enables the employees to check the management's actions and in turn, delve upon their own.

Whistleblowing mechanism seeks its precedence from the audit committees as well as serves penalties thus establishing the purview of 'comply or explain' approach of functioning.

This Research Paper aims at elucidating the intricacies of the Sarbanes- Oxley Act, 2002; Indian Companies Act, 2013 and the Corporate Governance Voluntary Guidelines, 2009 where the Governments of United States of America and India strove to pinpoint provisions that are critical to both, govern the existing legislation pertaining to whistle blower protection and to regulate the whistle blowing mechanism with reference to any further developments.

Corporate Governance and Whistleblowing are interrelated by means of providing the company with various guidelines and code of conduct by establishing that it is not only the management that is empowered to set rules and seek adherence, but their liability to work without any malafide intent.

Keywords: *Whistleblower protection, Audit Committee, Vigil Mechanism, Stakeholder, Corporation Liability*

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I. LITERATURE REVIEW

Randy K. Chiu (2003)² elucidated that the need for Whistleblowing is through an analytical method adoption called ‘locus of control’. The Research Article states the need for an empirical method of analysing what is “Whistleblowing Mechanism” and the studies that have attempted to establish whistleblowing behaviour, when it comes to individual perceptions and subjective control of judgment. The role of ‘locus of control’ established is for an individual to establish the connection between an ethnicity based ethical judgment and the concept of hypotheses supporting whistleblowing intention.

It is indeed remarkable to note that there were many businesses standing testimony to the fact that there is indeed, an honest practice of ethical business practices and an increasing awareness of workplace whistleblowing encouragement and management³.

Candice Delmas (2015)⁴ made a clear emphasis on the constituents of Governmental Aspects of Whistleblowing and analysed if there was a need to build up on further regulations. There appears to be a dilemma in emphasising on what is whistleblowing as, Governmental whistleblowing is where there is presence of unauthorised use of classified information and the cognitive collection of the enhancing device of legitimacy. This understanding of Government whistleblowing is a paradox and is considered ambivalent when talking about the public opinion on whistleblowing.

Parallelism is drawn on the USA and UK Authorities where the prohibition on whistleblowing was highlighted. The four accounts of whistleblowing when it comes to governmental obligations was elucidated in terms of vigilantism and breach of professional conduct. It can be seen that there is a demarcation drawn between whistleblowing and allied forms of various denunciations. Whistleblowing is an accusation of personal benefit and this, by itself is against many forms of disclosure, as enunciated by various companies.

Nadia Smaili, Paulina Arroyo (2019)⁵ elucidated on the aspects of Corporate Governance where the mechanisms are traditional and external. Internal corporate governance was tied up

² Randy K. Chiu (2003), *Ethical Judgment and Whistleblowing Intention*” Examining the Moderating Role of Locus of Control, *Journal of Business Ethics*, Vol. 43, No. ½, pp 65-74, <https://www.jstor.org/stable/25074976> (last accessed Apr 17 16:35:36).

³ Ibid.

⁴ Candice Delmas (2015). *The Ethics of Government Whistleblowing, Social Theory and Practice*, Vol. 41, No. 1, pp 77-105, <https://www.jstor.org/stable/24332319> (last accessed Apr 17 16:47:45)

⁵ Nadia Smaili, Paulina Arroyo (2019). *Triggering Changes in Corporate Governance: before and after external whistleblowing*, *Journal of Financial Crime*, 1359-0790, <https://www-emerald-com-christuniversity.knimbus.com/insight/content/doi/10.1108/JFC-06-2021-0134/full/pdf?title=triggering-changes-in-corporate-governance-before-and-after-external-whistleblowing> (last accessed Apr 17, 16:50:54)

with the key managerial personnel and their way of regulations. Empirical evidence on the aspects of corporate governance and the experience of the Ontario Securities Commission was listed and the audit committee's power and responsibilities were further highlighted.

*Alexander Dyck, Adair Morse, Luigi Zingales (2010)*⁶ published a research paper on Corporate Fraud vis-à-vis Corporate Fraud and stated that the mechanisms to curb corporate fraud are those involving Whistleblowing. Detection of fraud through whistleblowing was held to be possible only through providing monetary incentives and the prediction that the existing incentives must be increased manifold. The Securities and Exchange Commission is said to account for auditors and other securities regulators where the interpretation of whistleblowing itself is financial. The summarisation of the fraud detection and traditional imbibing of values is measured by the relevance of information and the incentives that come out of various residual claims.

*Terry Morehead Dworkin (2007)*⁷ stated that the impact of Whistleblowing on corporate governance can be elucidated by the use of the Sarbanes- Oxley Act. The inception of the Whistleblowing Provisions represents the USA Congress efforts after the occurrence of the Enron and WorldCom scams where the whistle-blower provisions were compared as per S. 806 of the Sarbanes- Oxley Act. Discovering someone from within the organisation who reports something and has an authority of being an employee of the organisation is covered here. The key concept to be noted in relation to the practices that is disclosed by the employee is reasonability of the covered violation and the aspect of 'illegality in practice'.

*Sandra C. Vera (2005)*⁸ published a research article on the Corporate Governance Reforms, mainly the Refined Expectations of the Audit committee and the aspects of Whistleblowing predominantly mentioning the same. The Research Article mainly focuses the reforms adopted by the United States Stock Exchanges and the Securities Exchange Commission where the aspects of Whistle blower mechalegal nism is listed in the Sarbanes-Oxley Act, 2002.

*Eva E. Tsahuridu, Wim Vandekerckhove (2008)*⁹ linked references that evidenced the Whistleblowing Provisions and placed emphasis on the employee's Responsibility and

⁶ Alexander Dyck, Adair Morse, Luigi Zingales (2010). Who Blows the Whistle on Corporate Fraud, *Journal of Finance*, Vol. 65, No. 6, pp 2213-2253, <https://www.jstor.org/stable/23324409> (last accessed Apr 17, 16:56:45)

⁷ Terry Morehead Dworkin (2007), SOX and Whistleblowing, *Michigan law Review*, Vol 105, No. 8, pp 1757-1780, <https://www.jstor.org/stable/40041565> (last accessed Apr 17, 18:51:12).

⁸ Sandra C. Vera (2005), Corporate Governance Reforms: Redefined Expectations of Audit Committee Responsibilities and Effectiveness, *Journal of Business Ethics*, Vol. 62, No. 2, pp 115-127, <https://www.jstor.org/stable/25123650> (last accessed Apr 17, 18:55:25).

⁹ Eva E. Tsahuridu, Wim Vandekerckhove (2008), Organisational Whistleblowing Policies: Making employees Responsible or Liable, *Journal of Business Ethics*, Vol. 82, No. 1, <https://www.jstor.org/stable/25482276> (last accessed Apr 17, 21:49:45)

Liability. Legal developments on the ethics of the society were catalysed with the legislative whistle blower policies and the accountability of the organisations aspects that circumvent the phenomena. The management tool which pertains to whistle blower protection is the assumption of autonomy of the key managerial personnel in elucidating the examination of the whistle blower at the workplace. Whistle blower protection is needed for two extremities: the legislation in force today aims at the individual responsibility at the work place and the policies of the organisation that allow them to control the employees and increase their liability at the work place.

II. ISSUES INVOLVED

The Research Paper adopts a secondary form of research where the resources are journals, research publications and bare act- prima facie reading.

The issues this research paper aims to enunciate are:

- The Provisions of Whistleblowing protection dealt with under the Sarbanes- Oxley Act, 2002 and its relation with Comparative Coverage
- The Vigil Mechanism enunciated by the Indian Companies Act, 2013 and its inter-relation with the Companies Act, 1956. The issue of, if the whistleblowing mechanism being implemented as per the provisions enunciated by the Legislature is to be analysed.
- The Analysis of the Whistleblowing Framework is catalysed by various misappropriations, frauds and inappropriate behaviour by any member of the organisation. This leads to chaos and confusion. The Research Paper aims to entail if the companies' mandatory principle of whistleblower protection can be made voluntary or remain to be so.

III. CONCEPTUAL FRAMEWORK

Whistleblowing Mechanism, an aspect of Corporate Governance can be defined as the action that involves reporting any and all types of wrongdoings, exposed in such a way that the internal and external organizational framework is affected¹⁰.

Whistleblowing is subject to a lot of definitions and various forms of explanations¹¹. Whistle blowers are the employees of the organisation who are, the representatives of exercising free

¹⁰ Archie B. Carroll (2003). Fighting workplace fraud is huge daily problem, OnlineAthens.com. <http://www.onlineathens.com/stories/062203/bus.20030622014.shtml> (last accessed Apr 06, 22:14:15)

¹¹ 15 U.S.C. § 78j-l(m)(4) (Supp. II 2002). According to the Association of Certified Fraud Examiners, employee tips "are the single most effective means of detecting fraud." Archie B. Carroll, Carroll: Fighting workplace fraud is huge daily problem, OnlineAthens.com, (last accessed Apr 17, 16:44:45)

speech and confront the organisational abuses of power and any illegality that is made against the interest of those involved in that particular misconduct.

The assertion of rights and various duties are made by way of establishing a clear procedure for the whistleblowing and the promotion of corporate governance as a whole. Corporate Whistleblowing, though a great tool for whistleblowing, is more often than not, used as a tool for the governance of business and companies in such a way that it influences the working of the same. The responsibility for such a commitment paves way to both ethical and social duties, in such a way that the focus of the public and the media based efforts are made on the aspects of corporate governance and the interests either individual or joint in whistle blowing.

Corporate Governance has elucidated on the importance of bringing into effect, an effective system of corporate governance where the stakeholders interest and the legal sanctions that are imposed, go hand in hand with whistle blower protection and enforcement.

The key aspect of whistleblowing¹² is the strategizing of any inappropriate behaviour and its disclosure in such a way that it works as both a tool for great corporate governance and in imposing an organisational culture that is more open, than closed. Employees are the ones, responsible for the disclosure of any immoral or unethical measures that are in existence in the organisation followed by their constant presence in witnessing the manifold events that have occurrence in the organisation.

Thus, it is important to bring to light five key measures in an organisation that are important for the effective perusal of Corporate Governance mechanisms:

- Board of Directors and key managerial personnel who are independent in functioning.
- The Auditors and the audit committee's Role
- Whistleblowing aspects followed by whistle blower protection.
- Activism and protection of Stakeholders
- The Redressal must be speedier and the complaint takers and givers must act on their independent volition.

More and more corporate scams are being exposed because of whistle blowers. The protection given to better disclosure highlights the provision of stakeholders being able to trust and foster the growth of various whistle blower requisite based processes in disclosure and transparency. Though there is S. 177 (9) of the Companies Act, 2013 which speaks about aspects of Vigil

¹² Committee on Standards in Public Life as elucidated in the 2005 Summit.

Mechanisms and the recording of genuine concerns in working of the organisation, the non-compliance of the same leads to penalties, which serves to be a smaller compensation for a massive crime occurrence.

Whistleblowing is being used as an arena for responsibility and the focus of bringing out discrepancies, rather than working towards achieving organisational goals, set by the top management. Thus, it is pertinent for all employees to focus on the work to be accomplished and allot disclosing any wrongdoing as a secondary facet, at the workplace.

IV. LEGAL REGIME

Whistleblowing Mechanism is empowered under the Sarbanes- Oxley Act, 2002:

The Sarbanes- Oxley Act was significant in the area of Whistleblower mechanisms and governed decisions like *Gilmore v. Parametric Technology Company*¹³ where employee protection was held integral and not to be applied retrospectively from before the inception of the act.

In this regard, it is important to bring to light S. 806 where whistleblowing employees are to be given adequate protection as they helped bring to light any and all fraudulent security or corporate governance violations.

In *Zinn v. American Commercial Airlines*¹⁴, it was decided that whistleblower mechanisms are not to be misused by the employee and the act of the company by terminating an employee because of insubordination and not for an action of whistleblowing was held to be valid.

Whistleblowing Aspects under the Sarbanes- Oxley Act are elucidated by the Three fold effect provided by the Sections 806¹⁵, where the ambit of whistleblowing is specified to that of the federal legislation¹⁶. The common parlance of this section is that, whistleblowing is that intricate disclosure made by the members of the organization in breaking the illegal or deceptive practices that are made by the employers of the company, to be able to get the adequate action.

This section is different¹⁷, as it elucidates on the internal action that is applicable when it comes

¹³ *Gilmore v. Parametric Technology Corp*, USDOL Case No. 2003-SOX-00001, 2/05/03.

¹⁴ *Zinn v. American Commercial Airlines, Inc*, ARB No. 10-029, ALJ No. 2012-SOX-025 (ARB March 28, 2012). American Bar Association. Section of Labour and Employment law, Committee on federal Labor standards Legislation, 2016 MidWinter Meeting Report

¹⁵ Marcia Parmerlee Miceli & Janet P. Near (1984), *The Relationships Among Beliefs, Organizational Position, and Whistle-Blowing Status: A Discriminant Analysis*, 27 ACAD. OF MGMT. J. 687, 701.

¹⁶ In re *JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d 1127 (N.D. Cal. 2002) (holding that based on the public policy behind SOX, employee silence agreements required by the employer could not be used to prevent employees from voluntarily reporting or discussing wrongdoing)

¹⁷ S. 806 an employee engages in protected whistleblower conduct by providing information that he or she believes

to the use of the perfect channel. The whistleblower practice that is benefited from this section is the scope for correction of the conduct that is wrongful and the costs of the organization minimized by exposing those who are facing the wrong 'music' and the preventive disruption between the employer and the employees. The possibility of any misunderstanding is cleared by the provision of S. 301, where the audit committees of the covered companies are required to put into force the procedures of whistleblowing mechanisms where the employees themselves, anonymously submit the organizational issues that they are concerned about¹⁸.

S. 1107 also provides for retaliation against any whistleblower provisions where the law enforcing officer is made known about such an occurrence and the members including NGO, Individuals are scrutinized for the issues relating to any possibility of manipulation within the company¹⁹.

Part VI of the Corporate Governance Voluntary Guidelines, 2009 provide a narrow understanding of 'whistleblower protection^[5]', where the aspects of

- Unethical behaviour
- Fraud, that has not been committed, but has also been suspected.
- Code of conduct of a company is not followed
- The policy of ethics in a company is disrupted.

V. ANALYSIS

The Section 231 to Section 251 of the Companies Act, 1956 dealt with the concept of Whistleblowing protection in India, which is now replaced by section 210 to Section 229 of the Indian Companies Act, 2013. Anonymity of the whistleblower and protection have gained momentum.

The concept of vigil mechanism has gained parlance, followed by draft rules and investigation into affairs of the company. The tri-fold effect of investigation, inspection and inquiry are dealt with, under the New Act.

It is pertinent to bring to light a draft policy enunciated by the TATA Power Company²⁰ where

is a violation of federal mail, wire, bank, or securities fraud. Section 806 of SOX extends its protection to any whistleblower who is an officer, employee, contractor, subcontractor, or agent of a publicly traded company etc.

¹⁸ Elletta Sangrey Callahan & Terry Morehead Dworkin (1994), Who Blows the Whistle to the Media and Why: Organizational Characteristics of Media Whistleblowers, 32 AM. Bus. L.J. 151, 153-58.

¹⁹ 15 U.S.C. § 78j-1(m)(4) (Supp. II 2002). According to the Association of Certified Fraud Examiners, employee tips "are the single most effective means of detecting fraud."

²⁰ TATA Power Company Limited, Whistleblower Policy and Vigil Mechanism, <https://www.tatapower.com/pdf/aboutus/whistle-blower-policy-and-vigil-mechanism.pdf> (last accessed Apr 17, 23:26:25)

the preface deals with the conduct of the company's affairs in such a way that the Directors, Employees and stakeholders are required to follow the same in the stipulated manner, irrespective of their position in the organisation. Employees are encouraged to raise suitable concerns and are required to be aware of the conditions that come under stipulations and the avenues that are available to raise any concerns or address the questions.

Mandates for abiding by the whistleblower policy as per S. 177(9) are stipulated to be as a listed company having the mandate along with any other company that accepts public deposits. Regulation 4(2)(d)(iv) of the SEBI Disclosure Regulations, 2015 states that a company must have an efficient whistleblower mechanism prevalent in such a way that there is ample scope for employees and other stakeholders to register their complaints about any possible illegal or unethical, immoral practices prevalent in the organisation.

Apart from the domestic legislations, there is also an active presence of the OECD Convention on Bribery of Foreign Officers where Whistleblower protection is considered a matter of Corporate Global Concern and the mandate of Complaint procedures is present for both the public and the private sectors²¹.

The Whistleblowers Protection Bill of 2011 has now turned into an age old criteria which provides for protection from any government related disclosure, though exemptions do contain provisions related to national security or foreign espionage.

The Bill has been under discussion from 2011, thus signifying that the 'adequate protection' is still whimsical and subject to the discretion of the legislature by itself.

From a prima facie reading of the Bill, it is evident that anonymous complaints are not taken not entertained. Such a perusal only leads to the conclusion that anonymous reporting might lead to investigation related difficulties which in itself seems to be the biggest concern. The aspect of disclosure as enunciated in the bill seems to be related to complaints and corruption charges of criminal offenses, leaving less to no scope of matters relating to other white collar crimes which are the hub of corporate scandals in India today.

It is a well-endowed fact that the Ramon Magsaysay Award²² that was recently awarded to a Whistleblowing officer is testimony to the fact that the whistleblowers are the most important people when it comes to working in a disclosure-needed ethic based environment. At the time

²¹ 3:26:25) Transparency International, Whistle Blower Protection, http://archive.transparency.org/news_room/in_focus/2007/whistleblowers (last accessed Apr 17, 23:32:34)

²² Jayant Saran, Whistleblower Act India: whistleblower Protection in India, <https://www2.deloitte.com/in/en/pages/finance/articles/whistleblower-protection-in-india.html> (last accessed Apr 17, 23:23:23)

of awarding the private sectors with their measures and the need to focus on the government governing areas, the need for measures like the USA Sarbanes- Oxley Act or the Whistleblower Protection Enhancement Act, 2012, such allied acts be enunciated in India, where there is confidentiality in the enforcement process and continuance of the battle against corruption and fraud.

VI. FINDINGS, CONCLUSION AND SUGGESTIONS

As a way forward, it is important to see that though many employees witness the wrongdoings and misconduct in an organisation, they choose to eye-wash it, either because of the management pressure or due to apprehended retaliation. It is during such times that vigil mechanism and whistleblower protection gains momentum. Though the legislature did pass the Whistle Blowers Protection Act of 2011, the aspects of protection are dealt with in a more carefree manner, where there are discrepancies both in the drafting and implementation. Clause 49 also has CEO- CFO certifications and various other Board of Director related provisions, where the beneficiaries (stakeholders) are yet to receive the fruits of their hard labour. When it comes to corrupt practices, it is not new that India's Corporate scandals like the satyam Computer Scam, Harshad Mehta Scam, Vijay Mallya- Kingfisher scam come to the forefront. RBI Circular of 2003 is standing testimony to the fact that amendments made to aspects of corporate governance and audit committees, eventually do have lacunae in the kind of reporting they entail.

The basic understanding of the principles of whistle blower protection as used in the Sarbanes- Oxley Act and the Companies Act, 2013 are almost similar to each other. However the new Companies Act of 2013 has paved way for better changes and the amendments, modifications made ensure that the administrative interference is minimum, but better and the concept of pre-emptive fraud and misconduct are better reformed. The complaint mechanisms are better drawn with penalties and compensation reaching the forefront. Taking into account the abundant number of corporate scandals in occurrence today, it is only fair for the vigil mechanism to be drawn better and the statutory regime to be made more stringent. Implementation of the new Companies Act and the provisions of whistleblowing is what add more flavour to put a check on the effectiveness of the legislation and the legislature.
