Update

Vigil mechanism - will it lead to overdrive of vigilance under the Companies Act, 2013?

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Note

In what had been only recommended for listed companies, the Companies Act, 2013 ("**Act, 2013**") now prescribes *vigil mechanism* for listed company and such classes of prescribed companies to put in place a mandatory vigil mechanism for directors and employees.

According to a study by Association of Certified Fraud Examiners in their 2012 Global Fraud Study, a typical organization loses 5% of its revenues to fraud each year. Also, nearly half of victim organizations do not recover any losses that they suffer due to fraud. In what is an even more alarming discovery is that it took 18 months for frauds to be reported from the time that it first occurred.

Whistle blowing – elsewhere and in India

In United States of America, Section 806 of Sarbanes Oxley Act, 2006 requires every public company to provide a whistle blowing mechanism to all its employees. In United Kingdom, The Public Interest Disclosure Act, 1998 protects *workers* that disclose information about any suspected malpractice at the workplace.

In the Indian context, Equity Listing Agreement under Annexure 1D of Clause 49 required listed companies to put in place a whistle blower policy and the Audit Committee was to review the working of the same.

The draft rules issued by Ministry of Corporate Affairs on 09.09.2013, under para 12.5 of Chapter XII, has prescribed vigil mechanism for:

1. Listed companies
2. Companies which accept deposits from the public; and
3. Companies which have borrowed money from banks and public financial institutions in excess of Rs. 50. 00 crores

What is alarming is the scope envisaged for *vigil mechanism* by virtue of point 3 as states above. By prescribing *vigil mechanism* for companies with borrowing of Rs. 50.00 crores, probably, very few companies have been left out of the ambit of establishing *vigil mechanism*. This on the one hand can be viewed positively as it gives an option to employees and directors to detect and report genuine concerns to companies and also be guarded against any victimization as a result of such disclosure.

What is voicing of *genuine concern*?

Surprisingly, *genuine concern* has not been defined. The Public Interest Disclosure Act, 1998, workers are free to report even on suspected criminal activities. In fact,

section 43B of the stated Act, even allows workers to disclose regarding any injustice or endanger of health or safety of any individual.

In its zeal to bring out rules, the Ministry has left out the scope for the blowing of the whistle. Although, it allows reprimanding any director or employee against any frivolous complaints, yet it is a matter of subjectivity when it comes to voicing any concern which can be termed as *genuine* and the Act, 2013 and the rules are silent on this.

What the rules has done is in fact placed additional burden on companies which require setting up of a vigil mechanism. When exposure to banks has been prescribed as an applicability criterion, this only means that even where irrespective of whether any public interest is involved or not, vigil mechanism has to be instituted. The very reason for setting up a vigil mechanism is to rule out any emblazonment of funds of a company or any other prejudicial act, in which any stakeholders' interest or most importantly, public interest is involved. In this day and age, borrowing from companies to the extent of Rs. 50.00 crores will possibly filter out very few companies from this applicability. Further, by necessarily mandating *vigil mechanism* for companies with borrowing of Rs. 50.00 crores, the Ministry has unnecessarily regulated such companies which may in nature be closely held companies, in which such a need may not arise at all.