

# Whistle blower mechanism and fraud monitoring

## Board Leadership Center



In light of recent corporate crises and recent strict regulatory requirements, organisations need to remain focused on the necessity for company-specific measures to handle corporate fraud and misconduct. Although no single approach to fraud risk management may meet the objectives of every company, whistle blower and vigil mechanisms remain two of the most effective ways to detect corporate wrongdoing. As a result of corporate scandals and fraudulent conduct, a slew of new laws and regulations have also been written in recent years.

The Companies Act, 2013 (the 2013 Act) and the SEBI's Listing Regulations<sup>1</sup> require companies to establish whistle blowing mechanism and provide sufficient safeguard to whistle blower. The 2013 Act requires, every listed company and prescribed class or classes of companies to establish a vigil mechanism for their directors and employees to report genuine concerns or grievances. Additionally, CARO 2020 articulates reporting requirements for statutory auditors relating to whistle blower.

Further, Section 143 of the 2013 Act and CARO 2020 includes the reporting requirements for an auditor relating to fraud committed against a company by officers or employees of a company. With the introduction of the requirement of fraud reporting under the 2013 Act, the use of forensic audits in India has gained importance. Forensic audit is a term generally used

for examination and review of financial records of a company or individual in order to identify any illegal or fraudulent activity. Additionally, SEBI Listing Regulations require listed entities to provide specific disclosures to stock exchange in case of initiation of forensic audit (by whatever name called).

### Key considerations relating to whistle blowers and whistle blower complaints



#### Anonymous complaints

Investigating anonymous complaints poses numerous challenges as can be difficult to handle the complaint in a way that continues to protect anonymity. In certain situations, a person who is privy to any wrongdoing can be afraid to come forward and expose the wrongdoing due to fear of reprisal. The process to file a complaint, and the underlying rules, should be made transparent and comprehensive, including the management's response to encourage whistleblowing as part of corporate culture. The company while adopting a whistleblowing framework should ensure that the framework has adequate safeguards for a whistle blower, including maintaining the anonymity of the whistle blower.



#### Frivolous complaints

Whistle blower and vigil mechanism can be misused, resulting in false claims with malicious intent. While defining

the whistle blower policy, the company should have a policy that clearly and specifically defines the terms 'frivolous' and the procedures to follow in case of such incidents. Companies should ensure separation of genuine complaints from malicious or frivolous complaints to improve the effectiveness of their complaint redressal process.



#### Effective Whistle blower hotlines

Companies should have frequent training and advertising of the who, what, when, where, why, and how of reporting suspected unethical or unlawful activities, via the company's whistle blower hotline. Whistle blower tips should be allowed in a variety of formats, such as email, a dedicated website, or a dedicated phone line. Hotlines should be assessed, tested, and audited to verify the way hotline calls are received, recorded, and managed.



#### What and when should public disclosures be made

There are often concerns around whistle blower complaints as to what and when to report externally during the course of internal review or investigation in the process of being conducted. Companies often fear that availability of such information in the public domain may have a negative impact on the company's reputation and this concern impacts the timeliness and completeness of disclosures by such companies.

1. Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015

Companies should remain mindful of both the form and substance of disclosure obligations on the company and not avoid disclosures only because they will need to be explained to various stakeholders.



### Requirement of external investigation

Depending on the nature of the complaints, and the results of the internal examination (if any),

management may be required to enhance procedures and conduct a forensic audit by hiring of external agencies for this purpose.

## Barriers to effective whistle blowing



Fear of trouble, firing etc. may restrict potential whistle blowers from reporting incidents.



Whistle blowing process exists but not fully operational and employees might also not know what to do and what to look for.



Inefficient whistle blower hotlines, i.e. in case hotlines and reporting lines exist but do not actually work.



Whistle blowers and loyalty considered to be contradictory and blowing the whistle considered as breach of loyalty by the employees.



Whistle blowers can be considered as gossipmongers and this perception can create barriers to raised issues/concerns.

## Challenges relating to fraud investigations

A fraud investigation or forensic audit entails a number of procedures and the Board's liability is particularly critical because it requires reporting to the stock exchanges. In certain scenarios, management might face uncertainty regarding the procedures to follow and also lack clarity relating the timing and extent of external reporting of the initiation or the completion of a forensic audit. The information submitted to the stock exchange would be available in public domain and information so provided may contain crucial data such as commercial information or unpublished price-sensitive information relating to the company. Availability of such information in the public domain may have a negative impact on the company's reputation and consequently on the share prices.

## Role of Audit Committee in oversight of whistle blower and fraud investigation

The independent directors, and specifically the Audit Committees, have a crucial responsibility in overseeing the financial information, risk management and vigil mechanism to ensure fraud detection and prevention.



### Role of Audit Committee vs management

The board of directors has ultimate accountability for fraud, misappropriation, and whistle blower systems, Audit Committees are normally tasked with the primary oversight of these systems, with management having direct responsibility for antifraud initiatives. The members of the Audit Committee are expected to evaluate the design and effectiveness of whistle blowing policies and processes.



### Reporting of whistle blower complaints

The number of complaints/concerns reported through the whistle blowing system, as well as its status, should be communicated to the Audit Committee members on a regular basis as good governance practice. The reporting should include all the details relating to the complaints such as nature and type of complaint, the hierarchical levels of staff involved, the progress of the investigation, its financial impact, and the management's response. Audit Committee members should carefully assess the effectiveness of whistle blower mechanism even in situations where management reports no instances of whistle blower complaints in its report.



### Independent whistle blower hotline

Using independent organisations or agencies to set up whistle blower hotlines may ensure a greater level of transparency, and this would also create credibility and trust that the whistle blower is more likely to remain anonymous.



### Escalation matrix

The escalation matrix should be clearly defined and in cases where the whistle blower is not satisfied with the response of the designated person or committee, he/she can escalate the reportable concern as per the escalation matrix and can also take up the matter with the chairman of the Audit Committee through written communication for reconsideration.

In certain companies there is ombudsman, to whom concern can be raised by a whistle blower. Ombudsman would act independently to investigate complaints and would also attempt to resolve them.



### Investigation and hiring of external auditors

In situations where a whistle blower report financial loss or wrongdoing, organisations undertake number of procedures and where there are evidence or reasons to believe the presence of specific misdoings, board and Audit Committee members are responsible for initiating an investigation to check whether fraud has happened. Management may be required to enhance procedures and conduct a forensic audit as a result of the findings of the initial investigation. The Audit Committee members should study and assess the findings to determine whether the management has initiated and undertaken an appropriate course of action.

In cases where the outside agency or independent forensic accountants have been hired, the Audit Committee should evaluate the scope of the inquiry to ensure that all the aspects in the whistle blower complaints have been covered/addressed. They should also assess that whether the techniques used were thorough enough to detect or uncover fraud, misconduct, or unlawful acts and, if the investigation team discovered evidence of fraud,

misconduct, or illegal acts, then enough effort has been taken to reach a reasonable conclusion and quantification of the potential loss due to such fraud or misconduct.



### Tone at the top

Members of the Audit Committee should ensure responsible business management. The effectiveness of the board of directors and Audit Committee is critical in decreasing the risk of fraud, and if fraud does occur, it should be recognised and reported appropriately. The 2013 Act also puts onus on the organisation, independent directors and the audit committee to ensure that there are safeguards to prevent victimisation or retaliation against the complainant.

The Audit Committee or independent directors should ensure organisations have a rigorous process to deal with such conditions and also ensure compliance with the regulatory requirements. To enforce a zero-tolerance approach to fraud, the Audit Committee must be empowered to analyse, monitor, and influence the tone at the top.



## In a nutshell

Whistle blowing procedures are a major line of defence against fraud and Audit Committees have a role in ensuring such procedures are effective. Countering white-collar crimes requires fundamental changes, sound whistle blower mechanisms and effective fraud risk managements have proven useful in such efforts. Additionally, a forensic audit would be helpful to counter allegations and provide material evidence of the existence of fraud.

Organisations that effectively monitor and respond to potentially damaging situations such as these are in a better position to deal with them quickly and successfully, while reducing adverse financial, reputational or operational impact.

## Questions for the Audit Committee



1

Does the management ensure that whistle blowing policies and procedures documented and communicated correctly? Has the management considered all whistle bower complaints and ensured that they are adequately addressed?

2

Does the whistle blowing policy guarantee that employees can raise concerns about misconduct in a way that is both safe and acceptable?

3

Does the organisation have proper procedures to ensure confidentiality of identity of whistle blowers and prevent the victimisation of whistle blowers?

4

Has the use of an independent external agency been considered as part of the whistle blowing procedures such as whistle bower hotlines?

5

In cases where no instances are being reported through the whistle blowing channel, did the management reassess the effectiveness of the procedures?

6

Is the management considering sufficient responsibility for the fight against fraud and misappropriation? Does the tone at the top emphasise antifraud culture throughout the organisation?

7

Does the management consider the impact of all significant risks on the fraud risk management framework?

8

Transactions such as those with related party can pose fraud risks. Has management ensured that transactions with related parties are correctly reviewed to ensure that such transactions are justified and in the best interests of the company?

9

Have employees of the organisation been given fraud awareness training to impart appropriate skills to identify the signs of fraud?

We would like to thank our Audit Committee Council Members for their time in providing us with their valuable insights and perspectives that have contributed to building this point of view document.

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