



Compliances with Companies Act, 2013 with respect to Establishment of a Vigil Mechanism – Part VII

The Companies Act, 2013 recognizes the need to encourage accountability and transparency within an organisation. Hence, it has directed all companies that meet a particular threshold to establish a mechanism to enable all individuals to voice concerns internally in a responsible and effective manner when they discover information, which they believe shows serious malpractice.

This write up seeks to provide an overview of the mandate for establishing a vigil mechanism contained in Section 177(9) of the Companies Act, 2013.

Whistle blowing / Vigil Mechanism

There was no requirement to set up a vigil mechanism or a whistle blowers policy for unlisted company as this was governed by the corporate governance norms under Clause 49 of the Listing Agreement.

Earlier this year SEBI amended Clause 49 of the Listing Agreement to bring it in line with the changes in the Companies Act, 2013. The circular dated April 17, 2014 in this regard can be accessed [here](#). These norms will come into force from October 1st, 2014. However the Companies Act requirements have been in force since September 2013.

Constituting a Vigil Mechanism under Section 177(9):

As per Section 177(9) the Companies Act, 2013 read with the Companies (Meetings of Board and its Powers) Rules 2014 (“**Rules**”) stipulate that the following class of companies are required to establish a vigil mechanism for directors and employees to report genuine concerns:

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

Further, the Companies (Meetings of Board and its Powers) Rules 2014, mentions that:

1. The companies, which are required to constitute an audit committee, shall oversee the vigil mechanism through such audit committee.
2. In case of other companies which are not required under the Companies Act to constitute an audit committee, the board of directors shall nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

There is no definition under the Companies Act or any explanation providing a guideline for what would amount to a genuine concern or grievance. The SEBI circular (mentioned above) provides for the revised Clause 49, which requires the constitution of a mechanism for reporting of “*unethical behaviour, actual or suspected fraud or violation of the company’s code of conduct or ethics policy*”.

Conflicts and Mitigation



If any of the members of the audit committee have a conflict of interest in a given case, they should recuse themselves and the others on the committee would deal with the matter on hand as per the Rules. Similarly, an alternative to the director nominated for the purpose by an unlisted company would be recommended to ensure that there arise no conflicts of interest in the process.

Section 177(10) directs the companies to ensure that any person who uses such mechanism is adequately protected from victimization and make provision for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

To mitigate frivolous complaints, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee in case of repeated frivolous complaints being filed, including reprimand.

Penalty for contravention of Section 177(9)

The company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and a continuing fine for every day that the offence continues.

Guidelines for drafting a vigil mechanism policy

The Act also requires companies to mention details of the vigil mechanism established by them on their website and in their board report. The following are broad points on which a vigil mechanism policy should be drafted:

1. The policy shall contain the objectives of the policy and a scope of activities that it covers.
2. The policy shall mention that protection to whistle blowers is extended only to the extent of genuine information provided by them and not to disciplinary action arising out of false or bogus allegations.
3. The policy shall mention how the investigation procedure shall be conducted.
4. The policy should provide contact details of the personnel to whom the information should be reported.

Effectiveness of the vigil mechanism

A vigil mechanism can be extremely beneficial to the organisation, its employees, shareholders, society and the general public at large. Violations, misconduct and malpractices, which would affect company reputation and cost stakeholders dearly, can be mitigated and the transgressors duly punished.

In order to make effective this entire process, it is imperative that the employee has the confidence to report the concern / grievance especially where senior management or their relatives are concerned. This can be done only by ensuring that the process is entirely transparent, independent and impartial.

Many companies are resorting to use third party / external mechanisms for reporting of grievances. These are firms, which manage the whistle-blowing mechanism for companies externally by providing hotlines and other platforms for employees to expose wrongdoing. A recent [article](#) in the business standard reported that employees are more confident if the tip-off goes to someone outside the company, especially if senior management is involved.