

WHISTLEBLOWING AND CORPORATE GOVERNANCE: ACCIDENTAL ALLIES OR LIFETIME PARTNERS?

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Abstract

This paper discusses various issues of whistleblowing, from imposing liability on any employee for failing to act when faced with any corporate wrongdoing, to exploring the legislative protection that would be available to him, should he decide to do so. Whistleblowing has long been seen as a terrible thing to engage in, offering little or no benefit to the whistleblower involved. However, several key legislations, such as the United States Sarbanes-Oxley Act 2002, the United Kingdom's Public Interest Disclosure Act 1998, along with Malaysia's very own Capital Market Services Act 2007, show that whistleblowing has come a long way. All these Acts, while conceived for different purposes, all share common traits, to recognize and legitimize the act of whistleblowing and to provide sufficient protection to whistleblowers. All this is done with the hope that the stigma that is frequently associated with whistleblowing is removed, in order to encourage more employees to bring to light corporate misconduct, as well as to encourage more voluntary whistleblowing in order to promote and enhance transparency and accountability in corporate governance.

Introduction

Corporate governance has, in these past few years, almost become a subject in its own right. All this might allude to the impression that corporate governance itself is a new topic, but this is far from the truth. Corporate governance issues are as old as the companies in which they are situated. An early definition of corporate governance can be found in the Cadbury Committee Report of December 1992, where it states that "Corporate governance is the system by which companies are directed and controlled".¹ Briefly, governance refers to the act or process of governing, and companies that practice said good corporate governance are likely to perform more ably.² That is why corporate governance is now one of the most talked about issues in the world.

¹ Davies, Adrian, "Best Practice in Corporate Governance: Building Reputation and Sustainable Success", 2006, p. 3.

² Colley, John L. Jr. et. al., "What is Corporate Governance?", 2005, pp. 2-3.

2. Corporate Governance and Whistle Blowing

The phrase ‘corporate governance’ itself is rather flexible, for almost every book or article on this subject offers a different view, or most appropriately, a different insight as to what corporate governance means to each individual writer or author. In its broadest definition, it includes corporate accountability, both civil and criminal, and in its narrowest, would only concern those who control the company as well as the relationship governing the shareholders and directors. Concern about good corporate governance has also been largely motivated in recent years by a series of corporate scandals and failures in many countries.³ It is however, a vast and rapidly growing area, with plenty of room for debate, and in discussing it all, we would focus especially on whistleblowing, and its place in promoting good corporate governance in organisations.

As more and more corporate wrongdoings are being exposed around the world, a small, but ever growing group must be thanked for bringing such matters to light. Simply put, whistleblowers are employees who exercise free speech rights to challenge institutional abuses of power or illegality that betray the public trust. Their disclosures may be made internally or externally, either through the chain of command or outside that chain, and though attempts have been made to categorize these “truth-tellers”, they cross all educational, gender, ethnic, and religious lines. Studies have shown that they tend to be the most diligent and that they do not situationalize their morality.⁴

Whistleblowing can be used as an avenue for maintaining and promoting integrity by speaking truthfully about what is right and what is wrong. It is an approach that combines many things, it asserts rights, protects interests, influences justice, and rights wrongs. In other words, whistleblowing can be defined in a number of ways. In its simplest form, whistleblowing involves the act of reporting wrongdoing within an organization to internal or external parties. Internal whistleblowing entails reporting the information to a source within the organization. External whistleblowing occurs when the whistleblower takes the information outside the organization, such as to the media or regulators. Establishment of a clear and specific definition of whistleblowing itself should be a fundamental component of every whistleblower policy⁵ in a corporation.

This is because whistleblowing promotes good corporate governance, which is essential to a corporation’s growth. Simply put, corporate governance is the regulating influence applied to affairs of a company to maintain good order and apply predetermined standards. Corporate governance is an ethical environment which all business processes are undertaken.⁶ As a result of the increased interest

³ Corporate Governance: A Survey of OECD Countries, 2004, p. 10.

⁴ Gaultieri, Joanna, “Should I Tell When It Hurts: Conflict and Conscience in Whistleblowing”, Canadian Corporate Counsel Annual Meeting, Winnipeg, August 16 2004

⁵ Eaton, Tim and Akers, Michael, “Whistleblowing and Good Governance: Policies for Universities, Government Entities and Nonprofit Examinations”, CPA Journal Online, June 2007, <http://www.nysscpa.org/cpajournal/2007/607/essentials/p58.htm>, (accessed 30/10/2008)

⁶ See Knell, Alex, “Corporate Governance: A Practical Implementation Guide for Unlisted Companies”, CIMA Publishing, p. 6

in whistleblowing, the media and public focus on corporate governance continues, and directors of all types of businesses are being asked to demonstrate a clear commitment to their legal and ethical responsibilities in governing their companies. Management and key staff are also being held accountable and asked to act responsibly.⁷

As organisations seek to enhance standards and controls for better and more effective corporate governance, the important role of whistleblowing has become increasingly evident. The reason is very simple. Employees often witness incidents and situations in corporations that are immoral and unethical, but are powerless to do anything about it. It is not because of lack of want, but rather due to the lack of opportunity. Not many corporations prepare an outlet for employees to voice their findings or concerns, and this is further compounded by the fact that not only corporations, but society in general are intolerant of whistleblowers, which they see as people who tell and spread tales. This attitude is never truer in Malaysia, where the culture here is more to the look the other way, rather than face everything in the open. As such, because of this very approach, whistleblowing has been subjected to a rather tepid, and at best, lukewarm reception in Malaysia.

3. The Whistleblowers Dilemma

Whistleblowing has come very far from its humble beginnings, from merely an idea to promote awareness about various misdeeds that happened in society, it has now grown to become an enormous potential to be used as a mechanism for exposing and controlling organizational misconduct. However, as with anything else, there are always costs and benefits associated with the decision to blow the whistle.⁸ The problem that lies here therein is weighing between this two, and seeing whether blowing the whistle, and thereby doing the right thing, would indeed be worth it in the long run.

The dilemma of whether or not to blow the whistle is not only faced by those in the adult world, but at times, can start at a more juvenile level. According to Katie Sutliff, a consultant for The Ethics Resource Center located in the US, “Common ethical decisions in a first part-time job include the use of employee discounts (such as whether or not to buy items for friends using the discount), honesty in reporting hours worked, and reporting misconduct by co-workers”. Furthermore, whistleblowers are also commonly assigned a low social status, being called a dobber, traitor, incompetent, etc. Rejection by coworkers is common, and rejection by family and friends sometimes occurs too.⁹ It would seem then that the issue of whether or not to blow the whistle on wrongful conducts by fellow

⁷ Olander, Susan, “Whistleblowing Policy: An Element of Corporate Governance”, *Management Quarterly*, 22 December 2004, http://goliath.ecnext.com/coms2/gi_0199-3566791/Whistleblowing-policy-an-element-of.html, (accessed on 30/10/2008)

⁸ Miethe, T & Rothschild, J, “Whistleblowing and the Control of Organizational Misconduct,” *Sociological Inquiry*, Vol 64, p. 322-347, (1992).

⁹ Martin, Brian, *Valuing Whistleblowers*, *The Whistle*, May, 1998, pp 9-10.

employees could start when you are still young, and such situations will only become more difficult as the years go by.

The term “whistleblower” was first used in the 1963 case concerning one Otto Otopoka and this was also the first time the term whistleblowing was used in the USA. Otopoka was an American public servant had given classified documents to the chief counsel of the Senate Subcommittee on Internal Security, which could pose as a threat to the government administration. Mr. Otopoka’s disclosure gesture was severely punished by the then Secretary of State who dismissed him from his functions for conduct unbecoming.¹⁰ Ralph Nader legitimized the term “whistleblower” in 1971 to denote insiders who exposed scandal.¹¹ Since then, the term has become widely used to describe people, more often than not employees, who exposed issues such as public health and safety, or frauds within their institutions to the outside world. Thus, the topic of whistleblowing is becoming increasingly important, and whistleblowers are slowly but surely gaining a more positive image. Before, revealing wrong within an organization or corporation was considered to be in bad form, but nowadays, the very act of whistleblowing can be seen as a positive and admirable deed.

However, becoming a whistleblower is not without risk. Some minor repercussions could involve losing their jobs, while careers might be destroyed, ostracized by their peers and in some extreme cases, even receive threats that involve bodily harm. A questionnaire study involving white-collar workers investigated the effects of the threat of retaliation, seriousness of malpractice and occupational status of the observer on the likelihood and method of whistleblowing chosen.¹² Furthermore, in another survey conducted out of 87 whistleblowers, 17 percent lost their homes, 8 percent filed for bankruptcy, 15 percent became divorced, and 10 percent attempted suicide.¹³ Yet in another survey of 161 whistleblowers, many of them faced severe retaliation and professional hardship.¹⁴ Hence, unless the whistleblowers are afforded more security and protection, they might be too afraid to blow the whistle, due to fear of repercussions and the violations that might conceivably go unchecked.

4. Legislative Protection

Whistleblowers who make disclosures often put their careers and livelihoods at risk, particularly if legislative protection is weak or lacking. When in all good conscience whistleblowers reveal corruption, dishonesty or improper conduct in

¹⁰ See generally Vinten, Gerald, *Whistleblowing-Subversion or Corporate Citizenship?*, New York: St Martin’s Press, 1994.

¹¹ See generally Johnson, Roberta Ann, *Whistleblowing-When it Works and Why*, Colorado: Lynne Rienr Publishers Inc, 2003.

¹² Masser, Barbara & Brown, Rupert, *When Would You Do It?*, An Investigation into the Effects of Retaliation, Seriousness of Malpractice and Occupation on Willingness to Blow the Whistle, Volume 6, Issue 2, John Wiley and Sons, 1996, <http://www3.interscience.wiley.com/cgi-bin/abstract/23752/ABSTRACT?CRETRY=1&SRETRY=0>, (18/3/2008).

¹³ Vinten, Gerald, *Whistleblowing-Subversion or Corporate Citizenship?*, New York: St Martin’s Press, 1994, pp 10-11.

¹⁴ Ibid.

an organisation, they do us all a favor. Often the only way evidence of improper or corrupt conduct can be brought to the attention of proper authorities is by employees 'blowing the whistle.' However such action can lead to victimisation and protection is needed so that if a person is bullied, demoted and even sacked because they made a genuine and warranted disclosure, then they need processes that allow for investigation, and restitution or damages. People should be encouraged to draw attention to wrongdoing, not punished. They should not have to risk their livelihoods, or endure personal suffering. Fortunately people of conscience continue to make disclosures in the public interest, but nowhere near the number that could if there were better disclosure systems, or better legal protection.¹⁵

Previously, it was mentioned that many whistleblowers faced a difficulty whenever they wanted to make a disclosure, as they were worried about the dichotomy between their private contractual duty and public duty. Many countries soon realized that this posed a big problem and took certain steps to bring an end to it. A good example would be the United States, where whistleblowers are not only protected, by virtue of the Sarbanes-Oxley Act 2002, but is in fact celebrated as heroes for their brave and selfless disclosures. Whistleblowing in the United States is an accepted part of the cultural landscape.¹⁶ Whistleblowing has been on the increase in the United States. Johnson cites the reasons as being, among them, changes in the bureaucracy which is more educated and professional, the wide range of laws that encourage whistleblowing, federal and state whistleblower protection, institutional support for whistleblowers, and a culture that often values whistleblowing.¹⁷

The most relevant titles to look at in accordance with this discussion would be Titles III, IV and VIII. Title III deals with corporate responsibility and mandates that senior executives take individual responsibility for the accuracy and completeness of corporate financial reports. For example, Section 302 implies that the company board (Chief Executive Officer, Chief Financial Officer) should certify and approve the integrity of their company financial reports quarterly. This helps establish accountability. Title III consists of eight sections.¹⁸

Title IV consists of nine sections. It describes enhanced reporting requirements for financial transactions, including off-balance-sheet transactions, pro-forma figures and stock transactions of corporate officers. It requires internal controls for assuring the accuracy of financial reports and disclosures, and mandates both audits and reports on those controls. It also requires timely reporting of material changes in financial condition and specific enhanced reviews by the SEC or its agents of corporate reports.¹⁹ Finally, Title VIII consists of seven sections and it

¹⁵ Senator Allison, Lyn, Whistleblower Protection-Australian Democrats Action Plan Whistleblower Protection Accountability, Parliament House, Canberra ACT 2600, http://www.andrewmurray.org.au/documents/391/Accountability_Whistleblower.pdf, (30/3/2008).

¹⁶ See Johnson, Roberta Ann, "Whistleblowing: When It Works and Why", Lynne Rienner Publishers, London, 2003, p. 4

¹⁷ Ibid

¹⁸ Sec 302 Sarbanes-Oxley Act 2002.

¹⁹ Ss 401, 404 & 409 Sarbanes-Oxley Act 2002.

describes specific criminal penalties for fraud by manipulation, destruction or alteration of financial records or other interference with investigations, while providing certain protections for whistleblowers, such as imposing penalties of fines and/or up to 20 years imprisonment for altering, destroying, mutilating, concealing, falsifying records, documents or tangible objects with the intent to obstruct, impede or influence a legal investigation.²⁰

Meanwhile, in the UK, there is also one such law, which is the UK's Public Interest Disclosure Act (PIDA) 1998. PIDA 1998 protects employers who have blown the whistle about any corporate wrongdoings. Essentially, PIDA 1998 consists of 18 sections, most of which add new sections to, or amend current sections of, Britain's Employment Rights Act 1996 (hereinafter referred to as the ERA 1996). Subject to limited exceptions, the PIDA 1998 protects workers under contracts of employment (i.e., employees, including Crown servants), those who work personally for someone else (under a "worker's" contract) but who are not genuinely self-employed, home workers; certain agency workers, National Health Service (NHS) professionals such as general practitioners, certain dentists, pharmacists and opticians and certain categories of trainees. Generally, the only workers who are not protected under the legislation are those who are genuinely self-employed, volunteers, police officers, those ordinarily working outside Britain, and those in the armed forces or in the security or intelligence services.²¹

It would apply where an employee has a reasonable or strong belief that their disclosure would show one or more of the following offences or breaches. They would include criminal offences, breaches of any legal obligation, miscarriages of justice, dangers to the health and safety of any individual, damages to the environment as well as the covering up of any information regarding any of the above.²² If an employee has the belief that the corporation is involved in any kind of corporate misconduct such as the above, then he would be protected under PIDA if he decides to make a disclosure regarding those wrongdoings. Although it is important to note that these provisions apply to all such information, regardless as to whether or not it is confidential, this certainly does not mean that corporations' trade secrets can be disclosed frivolously.

Finally, looking to the Malaysian position in relation to corporate governance, it initially may seem a little tame as compared to their Western counterparts. This of course is to be expected, as other countries such as the US and UK has made vast inroads in the area of whistleblowing, whilst Malaysia is still in its infancy in this area. This situation however, has now changed, courtesy of the amendments made in the Malaysian Securities Industry (Amendment) Act 2003. It has been commended as being the right step in implementing the idea of whistleblowing in Malaysia. However, the 2003 Act was repealed and replaced by the Capital Market Services Act (CMSA) 2007.

²⁰ Sec 802 Sarbanes-Oxley Act 2002.

²¹ Johansen, David, Legislative Protection for Whistleblowers in Britain, Law and Government Division, 2000, <http://dsp-psd.pwgsc.gc.ca/Collection-R/LoPBdP/BP/prb9939-e.htm>, (3/4/2008).

²² Sec 43(B) ERA 1996.

Section 320 of the Capital Market Services Act 2007 emphasizes the duty of the auditor who, “in the course of the performance of his duty...is of the professional opinion that there has been a breach or non-performance of any requirement or provision of the securities laws, rules which may adversely affect to a material extent the financial position of the listed corporation, the auditor shall immediately submit a written report on the matter”.

It must be noted that by strict definition of whistleblowing, section 320 which imposes a duty on the company’s auditor to report any findings of breach of securities laws and laws of the stock market cannot be whistleblowing, but imposing a duty on the auditor to report on any matter which may adversely affect to a material extent the financial position of the company may approach closely to whistleblowing. This is because when a report has been submitted to the relevant authorities prescribed in section 320, the auditor may be required to carry out ‘additional duties’ in respect of the company’s audit, and these additional duties may go beyond the usual traditional functions of mere financial accounting.

Moreover, subsection (2) of section 320 provides immunity after proceedings to the auditor for acting in good faith in compliance with the duty imposed on him. A broader provision, which is approximately very close to whistleblowing, though not whistleblowing per se, is to be found in section 321 of the same Act. Section 321 provides:

“Where the chief executive, any officer responsible for preparing or approving financial statements or financial information, an internal auditor or a secretary of a listed corporation, has in the course of the performance of his duties reasonable belief of any matter which may or will constitute a breach or non-performance of any requirement or provision of the securities laws, or breach of any rules of the stock exchange, or any matter which may affect to a material extent the financial position of the listed corporation “AND ANY OF THE AFOREMENTIONED PERSONS SUBMITS A REPORT ON THE MATTER”.

Unlike section 320, which imposes a duty to report, this section makes reporting a voluntary act, not a duty. In this respect, this section embodies the true essence of whistleblowing. However, such act of whistleblowing and the protection it offers to the whistleblower, under section 321(1)(c) which states that no removal, discrimination, demotion, suspension or interference with lawful employment or livelihood, and section 321(2) immunity against any legal proceedings for reports submitted in good faith and in the intended performance of his duties, is limited to only a recognized category of persons, that is, “officers of responsible for preparing or approving financial statements or financial information”. This is to ensure a threshold level of credibility.

A recent amendment to the Companies Act 1965 in the form of section 174A (2A), introduced in the Companies (Amendment) Act 2007, provides the much needed protection to an auditor, who in the course of his duties under section 174 of the Act reports any breaches or non-observance of the provisions of the Companies Act, in particular on the matters required to be reported under sub-

section 2 or his opinions on matters under sub-section 3 of section 174 of the CA. Similarly, where a report has been made forewith to the Registrar, under the circumstances of sub-section 8 and 8(A) of the CA 1965, broad protection is afforded to the auditor. The introduction of section 174A (2A) is to provide the auditor immunity against being sued in any court of law, or be subject to any criminal or disciplinary proceedings for any report under section 174 made in good faith and in the intended performance of any duty imposed on him. Clearly this new provision, though technically not whistleblowing per se, nevertheless encourages transparent reporting of the state of the company's finance and directly impacts on corporate liability.

Another provision, which encourages whistleblowing type of reporting, is to be found in section 368B of the Companies Act 1965. This section provides:

- (1) Where an officer of a company in the course of performance of his duties has reasonable belief of any matter which may or will constitute a breach or non-observance of any requirement or provision of this Act or its regulations, or has reason to believe that a serious offence involving fraud or dishonesty, as defined under paragraph 174(8C)(b) has been, is being or is likely to be committed against the company or this Act by other officers of the company, he may report the matter in writing to the Registrar.
- (2) The company shall not remove, demote, discriminate against, or interfere with the lawful employment or livelihood of such officer of the company by reason of the report submitted under subsection (1).
- (3) No officer of a company shall be liable to be not sued in any court nor be subject to any tribunal process, including disciplinary action for any report submitted by him under subsection (1) in good faith and in the intended performance of his duties as an officer of the company.

It must be noted that 'any matter' "which may or will constitute a breach", is wide enough to cover pre-emptive reporting. This is consistent with the broad essence of whistleblowing. The same element of pre-emptive reporting is also found in the CMSA as referred to earlier. The only drawback in both sections 320 and 321 of the CMSA but not section 368B of the Companies Act 1965 is that the reporting and the attendant protection it affords to the reporter is confined to a defined category of persons. It does not protect the ordinary employee (who is not within the defined category) against reprisals and possible legal action for purported breach of contract of employment and even possibly, an action for defamation. Section 368B of the Companies Act is therefore a wider application since it extends to any officer, meaning every employee of a corporation.

In this respect, the provisions of CMSA, though in spirit approximate whistleblowing; they are in essence not whistleblowing. Nevertheless, the positive side of these provisions is that they constitute a 'guarded' recognition of the need for whistleblowing in corporate governance. This can be seen in the fact that all these provisions are qualified by the need to prove 'good faith', (section 320(2) of the CMSA 2007 as well as section 321(2) of the same Act and 'reasonable belief' and 'good faith' in section 368B(1) and (3) of the Companies Act 1965.

Another interesting aspect of this ‘may report’ provision is that, are there any special circumstances where the ‘may’ will become ‘must’? The case of *RGB Resources plc (in liquidation) v Rostogi*²³, seems to shed some light on this. In that case, a certified accountant was employed as a financial controller of an unlisted public company, but he was not on the board. The chief executive officer, his deputy and an executive director were implicated in the misappropriation of several hundreds of millions of pounds of loan capital. The company, through liquidators, took action against the directors and against the financial controller for recovery of the misappropriated funds. The financial controller defended that he was unaware of the misappropriation and was not a party to it. The company argued that as a senior executive, he was subject to a duty to make enquiries and report any suspicious conduct both internally and externally. The court held that while there is no universal duty to investigate suspected fraud, there may be such a duty in particular cases. The court stated that a general manager would be under such a duty to investigate and report, whereas a junior executive may not be under such a duty.

Looking at section 368B of the Companies Act 1965 broadly, it is suspected the decision in *RGB Resources* can indeed enhance the effectiveness of that section if the decision is adopted in Malaysia.²⁴

As have been discussed earlier in the context of PIDA (UK) the judicial interpretation of ‘good faith’ is very crucial in determining the availability of the protection afforded by both Acts to the reporter. The guarded approach to whistleblowing is more than evident in the fact that public disclosure is not protected. Disclosure must be made to the relevant authorities provided under both Acts which in the case of CMSA, either to the Securities Commission alone or to both the Commission and the relevant stock exchange and in the case of the CA 1965, to the Registrar of Companies. Both CMSA and the CA emphasize and protect internal whistleblowing.

However, a major source of possible difficulty is to be found in section 368B, which allows an officer of the company who, “has reason to believe that a serious offence involving fraud or dishonesty as defined under paragraph 174 (8)(c)(b) has been, is being, or is likely to be committed...”. The words ‘has reason to believe’ does not in any way imply good faith. It could also be an erroneous decision by an incompetent officer. The phrase ‘has reason to believe’ can be interpreted in the light of several other laws having similar requirements, so this area of potential difficulty may be resolved.

On the other hand, as this is a relatively new area in Malaysia, additional caution and understanding must be used when tackling it. This is exemplified in s

²³ [2002] EWHC 2782 (Ch)

²⁴ Similar effect may be achieved in respect of the discretionary reporting in section 321 of the CMSA 2007

99(f),²⁵ where it states that only senior officers or those holding high positions in a corporation are able to make protected disclosures. For persons in the lower levels within the corporation, this is not the case. The reasoning could be that with persons in positions of power, their disclosures are likely to hold more credibility and weight, as they've been at the corporation long enough to hold such positions, while those on the lower tiers might seem to be less knowledgeable or less sincere. Thus, these issues must be handled delicately, as corporate governance is an ever evolving area, and extra care is needed in handling it, in order to avoid confusion. As such, the rules may be different, but the game stays the same.

5. Conclusion

The increased recognition of the positive role that whistleblowing play in promoting corporate accountability and corporate governance has led many governments to legislate provisions to regulate whistleblowing and to protect the honest whistleblowers from reprisals. The US SOX 2002, the UK PIDA 1998 and Malaysia's very own CMSA 2007 are such examples of these positive legislative measures.

It is inevitable that when Acts are enacted, their provisions will be interpreted by the courts. In the UK particularly, there is a strong body of judicial decisions on PIDA touching on some fundamental issues on whistleblowing, in particular the definition of honest belief. Some provisions in the Malaysian CMSA 2007 may one day come to the Malaysian courts for interpretation and it is highly probable that the body of judicial decisions on PIDA may help our courts to evolve our very own paradigm of honest belief in matters of whistleblowing. Naturally, this scenario would be possible only when whistleblowing becomes gradually acceptable as the better alternative to anonymous disclosures.

²⁵ Securities Industry (Amendment) Act 2003. Now see sections 320 and 321 of the CMSA which repealed and replaced the SI(A)A 2003.