



## **Corporate social responsibility under Companies act 2013: A study**

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### **Abstract**

Corporate Social Responsibility has gained much attention in the recent past. CSR or citizenship aims at invoking the corporate conscience whereby companies incur short-term costs that do not provide an immediate financial benefit to them, but instead promote positive social and environmental change.

The New Companies Act 2013 has come up with the concept of mandatory CSR and this Act will replace the archaic, almost 60yrs old Companies Act, 1956. This paper is focused on Companies Act, 2013 & its provision on mandatory spending and disclosure of Corporate Social Responsibility activities. The paper also discusses the major loopholes in the provision that can prove as a hindrance in its practical applicability.

**Keywords:** CSR activism, section 135, legislation

### **Introduction**

Over the last three decades, India has undergone a process of economic liberalization and is amongst the fastest growing economies in the world. The Industrial sector has been able to create abundant wealth over the years. Yet, the growth has not trickled down to the masses leaving a large proportion of population with limited access to basic amenities such as clean sanitation, clean water, health facilities etc. As per the latest human Development report it is ranked as 135 amongst 187 countries. Despite being characterized as the emerging global player, the country is still home to largest number of poor, malnourished children with poor access to health, education facilities.

The uneven distribution of income can be the root cause of social unrest. As rich continues to get richer and poverty statistics not improving, the government has sought to bring the corporate sector into the picture as an important contributor to social development activities. The Indian state has also made bold steps to help channel the economic successes of business to those who need it most. With introduction of corporate social responsibility (CSR) guidelines under the New Company's act it became the first country to have CSR legislation. The government has mandated corporations over a certain net worth to spend two percent of their last three years' net profit on social development, report on the activities or explain in case they failed to spend. The CSR clause within the Companies Act, 2013 seems to be an honest attempt to achieve the goals of equitable development and at the same time promoting greater transparency and disclosure.

### **Objectives**

- To understand the meaning and importance of CSR
- To study the CSR status in India
- To highlight the provisions of New Companies Act related to CSR mandate
- To study the key areas in the current CSR legislation which can be a hindrance for applicability of the CSR legislation

### **Research methodology**

The research paper is an attempt of exploratory research, based on the secondary data sourced from journals, magazines, articles and media reports. Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type. Available secondary data was extensively used for the study.

### **Meaning and definition of corporate social responsibility**

"The Father of CSR movement" Howard Bowen in his book 'Social Responsibilities of the Businessman' defined CSR as 'obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.'

### **Definition**

Chairman of the CSR Committee while proposing the Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013, defined CSR as "CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is not charity or mere donations. CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits. They use CSR to integrate economic, environmental and social objectives with the company's operations and growth."

### **Corporate social responsibility in India**

India is bestowed with tradition of following "Jan Kalyan" (welfare of the masses) as a part of running a business enterprise since many centuries. Kautilya's Arthashastra stated that "in the welfare of the people lies the king's welfare and in their happiness his happiness" (cited in Jose

et al., 2003). In India, Jamshedji Nusserwanji Tata established the J.N Tata endowment which offered scholarship to eligible students to pursue studies overseas. He founded the town of Jamshedpur in the early 20th century. The community development and social welfare programs of the Tata group highlighted the concepts of "Social Responsibility." And gradually the concept gained acceptance and became part of the management of the enterprise. The government realized a need of collective effort by all resourceful companies and not a few of them. Given this backdrop, in 2009, the Government announced the voluntary guidelines for the companies to encourage best practices in corporate social responsibility activities and corporate governance. Care for all stakeholders, Ethical functioning, Respect for worker's right and welfare, Respect for human rights, Respect for Environment and activities for social and Inclusive development were identified as the core elements for the companies to address. In 2011, the government announced that it was considering mandating CSR under clause 135 of Company's bill. And in 2013, the section 135 of New Company's Act, 2013 which replaced the 56 year old Companies Act 1956, made it mandatory for the 'targeted' Companies to contribute towards social development activities.

#### **Practical reasons for CSR implementation <sup>[1]</sup>**

Historically, many CSR practices were not considered to be true business responsibilities of any single firm. In the current economic and social climate, however, organizations are embracing the idea that CSR activities, policies, processes, and procedures are noteworthy and should be executed for the benefit of not only corporations' reputations and profits, but also for the benefit of employees, customers, and the community in general. CSR "humanizes the company in ways that other facets of the job cannot; it depicts the company as a contributor to society rather than as an entity concerned solely with maximizing profits" (Bhattacharya, Sen, & Korschun, 2008, p. 37). Including customers, suppliers, and employees, are demanding more information about how businesses are conducted.

Given the heightened public outcry for improved working conditions, environmental care, and ethical considerations, companies are being forced to respond. Fuentes-Garcia, Nunez-Tabales, and Veroz-Herradon (2008) reported that there are two reasons why companies have established CSR programs including:

(1) The idea of social awareness is recognized globally; and  
 (2) The focus on companies with CSR activities as a basis for consumer purchasing decisions. As a result, companies are responding to "the new social demands of their interest groups by implementing corporate citizenship actions, which includes all their environmental and safety, and social activities that go beyond mere economic interests and break away from the traditional image of a company that focuses solely on generating value for its shareholders" (Fuentes-Garcia, Nunez-Tabales, & Veroz-Herradon, 2008, p. 27).

The expanded scope of responsibility and ethical consideration also stems from a global backlash against corporate negligence and scandal (Sims & Brinkmann,

2003). Incidents like the Enron scandal prompted the Sarbanes Oxley legislation, which now hold accounting departments much more accountable for ethical decisionmaking (Prawitt, Sharp, & Wood, 2013). While legislation is a step in the right direction, the idea behind CSR is that legal statutes can only carry over so far and it is not enough to merely meet legal responsibilities. The company itself must adopt a sense of good for the betterment of the stakeholders as a fundamental part of company culture that must be carried down from top to bottom on a consistent basis encompassing goals that are both realistic and organized for accountability (Sims & Brinkmann, 2003).

#### **The major provisions of the section 135 of new company's act, 2013**

The CSR provision within the Act is applicable to companies with an annual turnover of Rs. 1,000 crore and more; or a net worth of Rs. 500 crore and more; or a net profit of Rs. 5 crore and more during any financial year. These rules are applicable from the financial year 2014-15 onwards. Sub section 1 of section 135 requires companies to constitute a 'Corporate social Responsibility committee of the board' consisting of their board members, including at least one independent director in order to achieve the CSR objectives for the benefits of the company and for achieving the goals of sustainable development. This composition will be disclosed in the board's report as per sub-section (3) of section 134. The companies shall include the foreign companies having branch offices in India. The Act encourages all such target companies to spend at least 2% of their average net profit made during the previous three financial years on CSR activities. The ministry's draft rules, that have been put up for public comment, define net profit as the profit before tax as per the books of accounts, excluding profits arising from branches outside India. The average net profit shall be calculated as per the provision of section 138 of the companies act, 2013. Also, proviso to the Rule provide 3(1) of the CSR states that the net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Companies Act, 2013.

#### **Activities constituting under the Companies act, 2013**

The Act lists out a set of activities eligible under CSR. The Companies Rules, 2014 has defined the term 'Corporate Social Responsibility (CSR)' as "Corporate Social Responsibility (CSR)" means and includes but is not limited to:

1. Projects or programs relating to activities specified in Schedule VII to the Act; or
2. Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act." As per the Ministry of Corporate Affairs notification dated 27th February, 2014 (effective from 1st April, 2014) these activities include:
  - Eradicating hunger, poverty and malnutrition.
  - Promoting education.

<sup>1</sup> Corporate Social Responsibility And Businesses: Examining The Criteria For Effective Corporate Implementation Utilizing Case Studies; International Journal Of Business And Social Science Vol. 5 No. 3; March 2014

- Promoting gender equality, empowering women.
- Ensuring environmental sustainability.
- Employment enhancing vocational skills.
- Social business project.
- Contribution to the Prime Ministers' National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the
- Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women
- Rural development projects. Etc

As per the provision, the companies which are covered under the provisions of Section 135 shall be required to carry out any one or more of the activities as specified above. The draft rules (as of September 2013) provide a number of clarifications and while these are awaiting public comment before notification, some the highlights are as follows:

- Surplus arising out of CSR activities will have to be reinvested into CSR initiatives, and this will be over and above the 2% figure.
- The company can implement its CSR activities through the following methods: Directly on its own through its own non-profit foundation set-up so as to facilitate this initiative through independently registered non-profit organisations that have a record of at least three years in similar such related activities collaborating or pooling their resources with other companies.
- Only CSR activities undertaken in India will be taken into consideration.
- Activities meant exclusively for employees and their families will not qualify.
- A format for the board report on CSR has been provided which includes amongst others activity-wise, reasons for spends under 2% of the average net profits of the previous three years and a responsibility statement that the CSR policy, implementation and monitoring process is in compliance with the CSR objectives, in letter and in spirit. This has to be signed by either the CEO, or the MD or a director of the company
- The CSR board committee shall: formulate and recommend a CSR policy to the board, indicating the activities as specified in Schedule VII of the Act *et al*, recommend the amount of expenditure to be incurred on the activities indicated in the policy and monitor the CSR policy regularly. The Act also requires that the company shall disclose the contents of their CSR policy in their report and also publish the details on the company's official website, if any, in such manner as may be prescribed.
- Rule 8 of the CSR Rules provides that the companies upon which the CSR Rules are applicable on or after 1st April, 2014 shall be required to incorporate in its Board's report an annual report on CSR containing the following particulars: A brief outline of the company's CSR Policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs; The composition of the CSR Committee; Average net profit of the company for last three financial years; Prescribed CSR Expenditure (2% of the amount of the net profit for the last 3 financial years); Details of CSR Spent during the financial year; In case the company has failed to

spend the 2% of the average net profit of the last three financial year, reasons thereof.

- Under the 'Comply or Explain' approach the companies have been directed to specify the reasons in case they fail to comply with CSR provisions. Failure to explain is punishable with penalty of not less than Rs. 50000 and upto Rs. 25 lakhs. However, penal consequences for not spending on CSR still remain unspecified. It has been estimated that around 14000 companies in India are required to meet the CSR requirements among 9 lakh active companies and they are expected to spend about Rs. 15000 crore annually on various social projects.

Introduction of CSR provisions is undoubtedly a welcome step to make sure that the target companies come under the legislative purview as far as their spending for social cause is concerned. This is certainly a positive step which can ensure corporate sector's contribution to equitable and sustainable development especially in case of India where nearly 400 million people still live on less than US \$ 2 a day and two third of the population lack access to proper sanitation facilities. CSR spending on environment, energy, education etc will in turn boost capital formation in the long run. This will reduce inefficiencies and accelerate investment. Moreover, such initiatives will also build goodwill, fight business competition and build positive image of the company in the public. Thus it can be a win-win situation for both the public and the businesses.

Despite the benefits, there has been wide ranging debate on practical applicability of CSR provisions under the companies act. Some of the highly debated loopholes are:

- **The act has failed to provide a precise definition of CSR:** CSR as defined under the act has a very wide scope including plethora of issues ranging from environment to poverty, from sustainable development to education etc. The list of activities included in the rules seems to be illustrative rather than exhaustive. At the same time, an overall reading of the rules strongly suggests that the scheduled activities alone will be considered for the purpose of CSR. Whether or not social activities falling outside the purview of the schedule form a part of CSR activities still remains doubtful.
- **"Valid explanation" in lieu of non fulfillment of the mandate:** The Clause 'Comply or Explain' prescribes that in case of non compliance with the CSR mandate of minimum 2% spending, the target company should come up with a valid explanation for such non compliance. However there is absence of any guidelines in the Act for classifying any explanation as valid or invalid, hence there could be possibilities of arbitrariness.
- **Absence of a monitory body:** Noteworthy to say that to ensure the compliance of the CSR mandate of the Companies Act there are few clauses incorporated in the Act like presence of independent director in the CSR committee, details about the company's CSR policy to be furnished in the director's report, penalty for failure in meeting the requirements of clause 135, but these are not sufficient to rule out the probability of target companies avoiding the CSR mandate. The standing committee on finance has suggested that a monitoring body should be set up to whom the report for CSR activities could be submitted.

- **Making penal provision more stringent:** If Section 134(8) is read with Section 135(5) it can be very well made out that the penal provision is only for the non-compliance of submitting the report and not for the failure to spend with respect to CSR. Such penalty is going to be in vain as the companies well know how to mould things in their favor to escape the liability.
- **Companies making losses but falling under the ambit of clause 135 :** It is reasonable to think that there could be certain companies which have triggering profits and net worth but incur losses. have incurred a net loss. The language of the Act suggests that even such a company, after incurring losses, would also be required to mandatorily undertake CSR obligations, as the word ‘or’ has been used i.e. if a company falls in either of the three categories, then clause 135 will apply to it.
- **Double taxation:** Many finance experts believe that the biggest concern for the industry is with respect to the impact of CSR contribution from a tax deductibility point of view. Under the current income tax law, the CSR spending cannot be treated as expenditure. It will be part of profit and attract taxes. Also, the provision of Companies Act prescribes that every target company has to part with 2% of 3 year’s Profit before tax. This will automatically result in double taxation for the companies.
- Another aspect of ambiguity in the new law that was expected to be corrected through the rules was the ‘local area preference’. The Act provides that a company should give preference to the local area in which it operates for CSR spending. However it fails to specify how would this work if a company has more than one operational office, should location of a factory or the corporate office be the target of preference?
- The CSR provisions have excluded contributions made to a political party from the scope of CSR activity. But, it does not specify about contributions made to institutions that are affiliated or are run under the office of a politician or political party. Moreover, voices have been raised ever since the introduction of mandatory guidelines that it can be dangerous rather than effective. Milton Friedman viewed that social responsibility of a business is to increase profits and thus forcing businesses towards social welfare rather than profit making will be ineffective. Rather the companies should create profits, jobs and pay taxes. Fears have been raised that the 2% mandatory rule can lead to forced philanthropy and even corruption in case of failed monitoring in terms of how well the funds are utilized and thus should not be imposed.

### Conclusion

The introduction of mandatory CSR provision in the new companies act is an honest attempt to Meet India’s social and sustainable development goals. Businesses have failed to take care of external costs of their operations and it is time when they should seriously contemplate social responsibilities towards their employees, customers, stakeholders and society at large. There is urgent need for more inclusive management of CSR activities where businesses should not view CSR as a hindrance of carrying business in India. Rather it should be considered as an opportunity to make a positive impact on the community. CSR presents an opportunity by which India can achieve a

balance of social, environmental and economic imperatives and at the same time protecting the interest of various stakeholders and reducing administrative burdens.

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