

Rules Implicated by Companies Act, 2013 for Spending of Corporate Social Responsibility Activities

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Abstract

The concept of Corporate Social Responsibility (CSR) is not a new one in India. Previously, it was an optional matter for India which has turned into a compulsory activity for the corporate houses. This paper looks into different aspects of CSR as provisioned in the Companies Act 2013, including a list of activities defined by the law as CSR, penalties for violating the law in this regard, the responsibility of the board of directors of the concerned company, and the responsibility of CSR committee. The paper also focuses on the other important aspects of CSR like the principal process CSR spending that the companies follow in general, minimum mandatory CSR spending, evaluation of CSR spending trend, the response of the industries in this matter, etc.

Key Words: Corporate Social Responsibility, Companies Act, 2013

I. INTRODUCTION

The term Social Responsibility is not a new in India. The activity is linked to social responsibility is an inherent part of Indian culture. At different points of time, the nature and perspective of social responsibility have changed. Previously, it was a part of a religion where people were asked to perform some social welfare for the almighty's blessings, in modern time, social responsibility is a common term across the industries. It is now a tool for strategic management meant to enhance the goodwill of the company or brand in the market.

In a Vedic era, spiritual leaders or "Brahmanas" created rules and regulations that common people needed to follow in their everyday life. Social responsibility was spread as a part of paying respect to the religion or God. Post-Vedic phase, as the concept of kingdom and king grew all over the Indian sub-continent, social responsibility became the part of king's responsibility. A king, as a supreme leader of the state, propagated necessary "dos" and "don'ts" that the citizens need to follow in a society. During the medieval period, kings enforced rules and regulations in trade and business and mandatory fair practices from the part of traders and businessmen. Though throughout this extremely turmoiled period, the nature of social

responsibilities constantly changed with the change of rulers.

Some remarkable changes took place during post-independence era. Immediately after the independence, political leaders propagated their own concepts of social responsibilities. During that period, business houses were growing in volumes slowly which were increasing their influence on the political parties also on the societies across the country. The economic condition of the country also induced the political leaders and their respective parties to depend on the corporate houses immensely. It is then the corporate houses and business leaders started influencing common people too through their corporate social responsibility.

Today, India is one of the fastest growing economies of the world and the proponent of the most structured CSR. Very few countries in the world have been able to make CSR compulsory. Countries like Australia, Sweden, and Norway have made it mandatory to submit annual CSR report, whereas India is the only country where both CSR coverage and CSR spending have been made compulsory. The Companies Act 2013 has laid down a complete framework including the areas where the companies can spend in social perspectives, penalties for violating the law, etc.

II. THE LAW AND COMPANY RESPONSIBILITIES

A. The Law

With effect from 1st April 2014, Ministry of Company Affairs has rolled out the new version of the companies' act which is called the Companies Act 2013. This act is an amendment of the Companies Act 1956. The act has made it obligatory for certain public and private sector companies to spend a certain minimum percentage of their profit in social responsibility which is now known as compulsory social responsibility or CSR. As per the sec 135(1) of the Act companies who have a net worth of 500 Cr, or who has earned a profit minimum 5Cr or a who have a turnover of more than 1000Cr in the last financial year should undertake CSR program. As per the sec. 135(5), these companies should spend at least 2% of their annual net profit on CSR. Sec 192 has clearly

mentioned that depreciation on machinery or interest on loans and debentures can be deducted from the gross profit to find out the net profit, but the companies are not allowed to deduct the payable tax to obtain the net profit in this matter. Sec.2(42) of the Act made CSR compulsory for the holding companies and foreign companies whose branch established in India or any corporate activity is taking place in India.

B. Formation of CSR Committee

A public or private sector company that meets any of the above-mentioned criteria in form of net profit, net turnover, or net worth has to undertake CSR activities as per the Companies Act 2013. The foremost activity of such company is to form a CSR committee with at least three or more board members. Moreover, it is mandatory for a public limited company that one of the committee members is an independent director of the company. In the case of the private limited company, two directors can be appointed to the committee and an unlisted public limited company can form a three members' committee without an independent director. In the case of foreign companies, as per the sec. 380(d), one committee member must be an Indian national. If a company doesn't meet the criteria for three consecutive years, then the company is not bound to form a CSR committee.

C. Responsibilities of CSR Committee

The CSR committee so constituted out of the directors of the company needs to develop a clear CSR policy on behalf of the company abiding the underlying rules laid down in the Companies Act 2013. The policy so developed is to be conveyed to the company's board of directors. The policy should contain the necessary activities to be undertaken along with the expenses to be incurred in each of such activities as per Schedule VII of the Act. The CSR committee is also responsible for developing a suitable mechanism including a necessary monitoring system that would help to implement CSR smoothly.

D. Mandatory Reporting by the Board

The Companies Act 2013 has imposed certain responsibilities on the board of directors regarding the representation of comprehensive CSR report along with the annual report of the company. The report should contain the composition of the CSR committee, issues related to the CSR activities, the disclosure of activities and mechanisms, etc. The report will also reveal the implementations of those activities already undertaken throughout the year. Companies are to follow the reporting format as per the Companies (Corporate Social Responsibility Policy) Rules, 2014. Details of the report are to be displayed on the official website of the company including the total expenses incurred for CSR.

If for any reason, whatsoever, minimum 2% expense is not made during the preceding year, the annual report placed in the general meeting should also narrate the reason.

E. Responsibilities of the Board

As per sections 135(4b) and 135(5), the board of directors should confirm that the CSR Committee is sincerely implementing the CSR activities as laid in the CSR policy, and minimum 2% of net profit is set aside for the expenses in this matter. The same sections also mention that the CSR committee should concentrate on the local areas where the company mainly operates or having their manufacturing units. Sec 8 of the Companies Act 2013 narrates that the CSR activities are to be undertaken through any of the following legal entity: a registered Trust, a registered society, a subsidiary of the company, a holding company of the concerned company, a company newly established to perform CSR activities along with any other purpose. In the case, the CSR activities are performed by any other company not belong to any of the above-mentioned categories, but a completely different entity, then this entity should have a proven record and experience of accomplishing similar projects or programs during the last 3 financial years. This company, through which the concerned company is willing to materialize their CSR policy, needs to submit to the CSR committee of the concerned company regarding their modalities, reporting process, and mechanism of working in this matter.

Moreover, a company can collaborate with other companies to render their CSR activities jointly on any common purpose. But, in any case, these companies should have their respective CSR committee and reporting process as per the Companies Act, 2013.

III. THE CSR ACTIVITIES AND NON-COMPLIANCE

A. Eligible Activities

Schedule VII of the Companies Act 2013 has clearly mentioned the channels for undertaking CSR activities, it includes, issues related to extreme hunger and poverty, education, health, gender inequality, child mortality, eradication of endemic diseases like AIDS, HIV, malaria, dengue, tuberculosis, cancer, etc. Companies can also undertake different developmental projects in environmental matters, social business activities, and enhancement of vocational skills among youths. Their contributions to the Prime Minister's National Relief Fund (PMNRF) or any other funds of similar categories are also considered as a CSR activity. At the same time, MCA has also published a general circular (MCA, 2014b) whereby any contribution as a donation to an academic institution for a specific

developmental purpose will also be considered as a CSR activity of a company.

B. Restricted Activities

The Schedule VII of the Companies Act 2013 has also laid down some restriction on CSR activities. A company can make an expenditure of 5% of total fund CSR fund the company board has allocated on the training and development of the company's selected staffs for building CSR capacities in them. CSR activities for the benefits of internal staffs or their family members only will not be considered as CSR activity. Sec. 182 of the act has clearly mentioned that any donation to any political party cannot be considered as a CSR activity. Moreover, the company can't use the surplus of CSR fund for any other purpose or consider it as their profit.

C. Penalties for Non-Compliance

Section 134(8) of the Companies Act, 2013 has laid down certain penalties for not complying with the provisions of CSR as per the schedule VII of the act. The companies should produce the comprehensive report as per the schedule, if not followed in ditto; the companies violating the rules will be penalized with an amount anything in between Rs. 50,000 to Rs.2.5 lakhs. At the same time, the officers who are responsible for non-disclosure of the comprehensive CSR report will be punished as per the law which may be an imprisonment for a maximum term of 3 years or with a fine within the range of Rs.50, 000 to Rs.500, 000 or both with imprisonment and fine. Again, if for any reason a company fails to spend at 2% of their net profit in CSR, they need to mention the reason for not spending the stipulated amount, otherwise, the responsible officers may be punished.

IV. PERCEIVED RESPONSE AND SPENDING MAGNITUDE

A. Societal Response

Drafting of the new CSR policy and amendment of the Companies Act was undertaken by the union government in 2009. Since then various aspects related to CSR was in much discussion and debate in various forums. Finally, the bill on Companies Act, 2013 was passed by the President of India on 29th August 2013 along with the amended of the CSR policy.

But, the CSR amendments as made in the Companies Act 2013 had some negative impacts on the political parties as also criticized by many business leaders at that time. They viewed it as a forceful induction and avoidance of the basic responsibilities from the part of central government. Industry leaders opined that the government could have imposed 2%

corporate tax than asking the corporate houses to spend 2% on CSR. Some experts also viewed it as an extra burden on the corporate houses that are already bearing 33% corporate tax. It is also argued that the companies which have just included within the purview of CSR would feel the pressure more than the other companies. In a study on food industry (Mehta and Deodhar 2014) it was seen the amendment in CSR in the new Companies Act neither had nor affected the stock prices of the food companies. It indicates that the stock market was not against the mandatory CSR rules.

B. Estimates of CSR Spending

Creating a minimum mandatory spending on CSR has created a new issue which is a matter of interesting debate these days. In a study, Desai, Piungali, and Tripathy (2014) raised a new debate on the expenditure habit on CSR of many companies. They opined that there remains a chance of lowering of overall CSR expenditure as many companies who were accustomed to spend more than 2% in this matter may now reside on the minimum slab only. But, there are many new companies that would come under the purview of CSR and they will be bound to spend 2% on CSR. Again, there are some companies who were spending less than 2% on CSR will be compelled to spend at least 2% on CSR. So, it is tough to say what will happen unless a complete data on CSR spending in India is generated.

As Rai and Bansal (2014) showed in their research paper, the estimated CSR spending at the time of the publication of their research paper was around Rs. 25000 crore. However, they marked two important issues:

Firstly, the spending was based on 2% of the net profits after the deduction of income tax which was a clear violation of the sec.198 of the Companies Act, 2013. Secondly, the estimate was based on the available data of 2012-13 which they expected to be much higher in reality as the net worth, turnover, or net profit of many new companies would come under the purview of CSR.

V. CHANNELS OF CSR SPENDING

Section 2 and 3 of the act mentions the mechanism of fulfilling obligations under CSR and list of activities where the companies may undertake. However, the regulatory body doesn't provide any guidelines on the channels of CSR practices.

Ragan, Chase, and Karim (2015) narrated that any kinds of CSR activities can be categorized into three channels: Investment in philanthropic activities, transforming or upgrading any business model, and enhancing the operational efficiency.

Among these three categories, investment in philanthropic activities is an obvious part of many specified activities mentioned in the Companies Act 2013. The company, Persistent Systems, received the best HR practices in CSR activities award in 2012-13. Their CSR activities were focused on many aspects of social welfare like regular health checkup camps for the poor, providing Jaipur foot, initiating different environment conservation activities, providing financial help to the employees for participating in social welfare activities, etc. Needless to say, these activities are solely philanthropic in nature, so they fall in the channel as mentioned before. Any contribution to PMNRF is also categorized as a philanthropic activity which is a recognized CSR activity as also 100% tax-free investment comes under the purview of section 80G of Income Tax Act, 1961.

The activities under the second channel, i.e. transforming or upgrading the business model, in quite different in nature and can't be directly related to the other types of CSR activities. Here, a company invests in their existing business model with an intention to upgrade or transfer the operation they follow keeping in view the social and environmental values. In the same research paper, Rangan, Chase, and Karim (2015) narrated the example of Jain Irrigation. This company is involved in the manufacturing of drip irrigation equipment for the farmers.

The company markets a drip irrigation machine that works wonderfully on the limited water supply. Thus, the agricultural yields are just as much as with the surplus water. In this way, the company lowered the expenses of water for irrigation. At the same time, the company provides technical support to the farmers, and micro-credits for buying necessary equipment. Thus, the company, actively supporting social and environmental causes through transforming or upgrading their own business model. It is a channel through which the company, as also external stakeholders benefited through the companies CSR policy. Working on this channel is a difficult task so also convincing the concerned authority that such initiative is not a part of the business and it could be considered as a CSR activity as per the Companies Act, 2013.

The other major challenge in following this channel for CSR activity is measuring the degree of value creation and representing effects of such activity in financial terms. The researchers opined that the CSR norms would be expanded and amended with the passage of time as newer avenues would be opened for meeting CSR. However, the companies that have confidence on mutual benefits and prefer to link their

organizational interest with that of the CSR activities will continue to explore new aspects that will make the world a better place for living in for economically and socially weaker sections of the society. But, these companies also need to ensure that they pass the 2% expenditure criteria as per the prevailing act.

The third channel of activities, enhancing the operational efficiency can be designed to improve the competence of which in turn improve the social and economic condition of people at large. If a company adopts some steps for sustainability, it may drastically reduce the wastage, greenhouse emissions, and use of resources. IT Company, Infosys has designed smart buildings where the company has reduced the energy consumption by 15%. The company is converting the food waste into biogas in their Pune office whereas in Bangalore they are using CFL crusher to separate the mercury present in the bulbs for recycling (Bhatt, 2015).

Undoubtedly, these initiatives are a bit different in nature but they are directly linked with CSR. It is difficult to prove before the authority their effectiveness as CSR. The companies need to engage an auditor for an impartial evaluation of their activities and their long-term value for the society. They have to show the authority that they are doing all these activities not as a part of their business activities but solely for the purpose of CSR activities as mentioned in section 135, Schedule VII of the Companies Act, 2013.

The channel that is created for enhancing the operational efficiency also includes training and development measures taken by a company for the improvement the productivity, proper utilization of new technologies meant for reducing greenhouse emission or company resources, and reduction of operational cost. However, the act doesn't consider expenditure incurred on employee benefits as a part of CSR activity.

VI. CONCLUDING COMMENTS

The newly enacted Companies Act, 2013 has introduced the mandatory social responsibility of certain corporate houses in public and private sectors. The companies which come under the purview of mandatory CSR policy of MCA needs to form CSR committee to execute their essential obligations under this act. The CSR committee should comprise of at least three board members and essentially one independent director of the company with some clearly mentioned exceptions for unlisted public limited companies, holding companies, and foreign companies. He purposes of the CSR committee are to plan, implement, monitor, and report the initiatives and programs of the company in this respect.

The Act has made it mandatory for the companies under the purview of mandatory CSR activity to provide a complete report on their CSR activities along with the annual report, failing to which leads to a penalty in lump sum or imprisonment to the concerned officers or both. Initially, it was thought that enactment of compulsory CSR may be taken negatively by the shareholders and corporate houses. However, the stock markets showed no sign of disagreement which proved its universal acceptance across the industries in India. There is another point of concern for the union government that some companies may decrease their spending to 2% in this matter when they were actually spending more than 2% on an average. But on a positive note, it is also realized that many companies who used to spend less than 2% have now begun to spend more and many new companies have come under the purview of the CSR policy with the introduction of compulsory CSR activities in the Companies Act, 2013. Until the actual data is available, it is hard to evaluate the effects of mandatory CSR. In a study, it is found that the corporate houses as a whole have spent almost Rs.25000 crore till the end of the study in 2014. However, this data was not cent percent true because the figure was underestimated with a wrongful calculation of minimum spending slab in this matter. Under the new norm, the calculation of 2% profit is to be done before deducting the income tax. At the same time, the estimate was made on the basis of the data available for the financial year 2012-13, which would have been much higher for the financial period 2014-15.

The Companies Act 2013 has clearly narrated the activities the companies can undertake but the act has not mentioned any specific channels through which they need to comply with CSR activities. There are three commonly used channels for accomplishing this mandatory task.

The companies can follow the path of philanthropic activity. The companies can follow the channel of transforming or upgrading their business model whereby the external stakeholders as also the company are benefited through the CSR activities. The activities will be such that the production will be more environment-friendly, recyclable, or more efficient. Thus, through the changing business model, the company can provide a sustainable economic and social growth to the society at large. The third channel is enhancing operational efficiency.

The activities in this category provide better waste management, as also reduces the application of resources, greenhouse emissions, and also cost of production. This channel makes the working

environment less hazardous and keeps the environment free from harmful gasses and particles. Spending in this channel through different activities can be linked to the scheduled list of activities under the Act. Moreover, financial support provided to the staff members for training and development, healthcare, higher education with an intention to enhance their efficiency can also be linked with one or more of the CSR activities mentioned in the Schedule VII, if those are meant for the betterment of operational activities that will then resolve any economic, social or environmental issues. In any case, it is the sole responsibility of the company to prove that they are taking the right initiative to discharge their CSR activities. Their task is to show that the CSR fund is invested in the best possible way and activities are directed as per the listed activities in the Act. But in many instances, it will be difficult for the management to make any direct connection with the scheduled activities. With the passage of time, hopefully, many new CSR activities will be added when the companies will be able to align their business interest with one or more CSR activities as per the schedule VII of Section 135 of the Companies Act, 2013. Till then, they must spend the 2% of net profit as per the schedule.

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