

Corporate Social Responsibility (Sec 135) Part-1

1. Legislative Background

The notes on clauses to the Companies Bill, 2011 read as follows:

“Clause 135.—This new clause seeks to provide that every company having specified net worth or turnover or net profit during any financial year shall constitute the Corporate Social Responsibility Committee of the Board. The composition of the committee shall be included in the Board’s Report. The Committee shall formulate policy including the activities specified in Schedule VII. The Board shall disclose the content of policy in its report and place on website, if any of the company. The clause further provides that the Board shall endeavour to ensure that atleast two per cent of average net profits of the company made during three immediately preceding financial years shall be spent on such policy every year. If the company fails to spend such amount the Board shall give in its report the reasons for not spending.”

2. Meaning of Corporate Social Responsibility

As stated in rule 2(1) (c) of the Companies (Corporate Social Responsibility) Rules, 2014, “Corporate Social Responsibility (CSR)” ‘means and includes but is not limited to:

- (i) Projects or programs relating to activities specified in Schedule VII to the Act; or
- (ii) Projects or programs relating to activities undertaken by the 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.’

The above definition is not exhaustive. It merely draws reference to such activities enumerated in Schedule VII. The said schedule covers 11 headings. General circular no. 21/2014 dated 18.06.2014 provides that the entries are to be interpreted liberally to capture the essence of the subjects in the schedule. Hence, any activity which relates to the categories mentioned in Schedule VII can qualify as CSR.

3. CSR in India

The concept of Corporate Social Responsibility is not new to the corporates in India. The concept can be traced back to times immemorial, our Vedas say - man can live individually but can survive only collectively. Vedas suggest that peace, order, security and justice were regarded as the fundamental aims of the state. Welfare of the public was clearly regarded as the chief aim of the state. Hence the challenge is to form a progressive community by balancing the interests of individuals and that

of the society. Modern corporations are not treated as merely economic entities functioning with an objective to maximize profits of shareholders. The changing facets of a modern corporation along with all its newly given attributes was traced in the Supreme Court judgement of *National Textile Workers Union v. P.R. Ramakrishnan and others* [1983 SCR (1) 9]. It seeks to establish company as an entity accountable to all its stakeholders including society at large. It also casts a duty on Directors to take care of interests of the stakeholders and not merely shareholders. It was held that “The traditional view of a company was that it was a convenient mechanical device for carrying on trade and industry..... With this change in socio-economic thinking, the developing role of companies in modern economy and their increasing impact on individuals and groups, through the ramifications of their activities, began to be increasingly recognised. It began to be realised that the company is a species of social organisation, with a life and dynamics of its own and exercising a significant power in contemporary society. The new concept of corporate responsibility transcending the limited traditional views about the relationship between management and shareholders and embracing within its scope much wider groups affected by the trading activities and other connected operations of companies, emerged as an important feature of contemporary thought on the role of the corporation in modern society. The adoption of the socialistic pattern of society as the ultimate goal of the country’s economic and social policies hastened the emergence of this new concept of the corporation. The socio-economic objectives set out in Part IV of the Constitution have since guided and shaped this new corporate philosophy.

It is now accepted on all hands, even in predominantly capitalist countries, that a company is not property. The traditional view that the company is the property of the shareholders is now an exploded myth. There was a time when a group controlling the majority of shares in a company used to say: “This is our concern. We can do what we like with it.” The ownership of the concern was identified with those who brought in capital. That was the outcome of the property-minded capitalistic society in which the concept of company originated. But this view can no longer be regarded as valid in the light of the changing socio-economic concepts and values. Today social scientists and thinkers regard a company as a living, vital and dynamic, social organism with firm and deep rooted affiliations with the rest of the community in which it functions. It would be wrong to look upon it as something belonging to the shareholders. It is true that the shareholders bring capital, but capital is not enough. It is only one of the factors which contributes to the production of national wealth.”

Keeping in mind the need for development, the Ministry of Corporate Affairs, Govt. of India had notified the Corporate Social Responsibility Voluntary Guidelines 2009 on 21st November 2009 to be followed by the corporates. The companies were required therein to formulate a CSR Policy according to Voluntary Guidelines 2009 as an integral part of the overall business policy in order to provide a road map for the CSR initiatives and efforts and guide to its strategic planning. Accordingly, the CSR Policy was expected to cover the following four core elements:

i. Care for all Stakeholders

The companies should respect the interests of, and be responsive towards all stakeholders, including shareholders, employees, customers, suppliers, project affected people, society at large etc. and create value for all of them. They should develop mechanism to actively engage with all stakeholders, inform them of inherent risks and mitigate them where they occur.

ii. Ethical functioning

Their governance systems should be underpinned by Ethics, Transparency and Accountability. They should not engage in business practices that are abusive, unfair, corrupt or anti-competitive.

iii. Respect for Workers' Rights and Welfare

Companies should provide a workplace environment that is safe, hygienic and humane and which upholds the dignity of employees. They should provide all employees with access to training and development of necessary skills for career advancement, on an equal and non-discriminatory basis. They should uphold the freedom of association and the effective recognition of the right to collective bargaining of labour, have an effective grievance redressal system, should not employ child or forced labour and provide and maintain equality of opportunities without any discrimination on any grounds in recruitment and during employment.

iv. Respect for Human Rights

Companies should respect human rights for all and avoid complicity with human rights abuses by them or by third party.

v. Respect for Environment

Companies should take measures to check and prevent pollution; recycle, manage and reduce waste, should manage natural resources in a sustainable manner and ensure optimal use of resources like land and water, should proactively respond to the challenges of climate change by adopting cleaner production methods, promoting efficient use of energy and environment friendly technologies.

vi. Activities for Social and Inclusive Development

Depending upon their core competency and business interest, companies should undertake activities for economic and social development of communities and geographical areas, particularly in the vicinity of their operations. These could include: education, skill building for livelihood of

people, health, cultural and social welfare etc., particularly targeting at disadvantaged sections of society.

In the last few years, several leading Indian corporates have set aside separate budget and scaled up the CSR spending. In the above background, the Act has introduced a new section on Corporate Social Responsibility, wherein broad guidelines & disclosure requirements / compliances are specified.

4. Applicability of CSR provisions

Every company meeting any one or more of the following conditions during any financial year shall constitute a committee of its Board called “Corporate Social Responsibility Committee”:

- i. Net worth of Rs. 500 crore or more
- ii. Turnover of Rs. 1000 crore or more
- iii. Net profit of Rs. 5 crore or more

This section is applicable to all companies, whether public company or private company including companies registered under section 8 and foreign companies having its branch office or project office in India. The net worth is required to be calculated latest audited financial statements of the company (as provided in the definition under clause (57) of section 2) while the definition of ‘turnover’ [as provided in clause (91) of section 2] is applicable for a financial year. The definition of “net profit” is provided rule 2 (1) (f) which provides that the same is as calculated in the financial statements prepared as per the Act excluding profit arising from overseas branches and dividend received from companies complying with the provisions of section 135. The rule further clarifies that restatement of profits for the years in which the statements are prepared as per the provisions of the Companies Act, 1956 is not necessary. It should be noted that for the dividend income to be excluded from the net profit, the payer company shall comply with the provisions of section 135 i.e. actually spend the amount prescribed under the section. In case, the said company fails to spend the amount, such dividend income shall not be excluded while calculating the net profit as per rule 2(1)(f). In case of a foreign company, net profit of such company is the net profit as per profit and loss account prepared as per clause (a) of sub-section (1) of section 381 read with section 198.

Further, a question arose as to the interpretation of ‘any Financial Year’ and the Ministry has clarified vide general circular no. 21/2014 dated 18.06.2014 that ‘any financial year’ referred under sub-section (1) of section 135 of the Act read with rule 3(2) of Companies CSR Rule, 2014, implies ‘any of the three preceding financial years’. Hence, the previous three financial years are to be considered for deciding the applicability of the CSR provisions. The Companies (Amendment) Bill, 2016 proposes to change the criteria by substituting the words “the immediately preceding financial year” for the words “any financial year”.

5. Constitution of CSR Committee

The committee shall consist of three or more directors, out of which at least one director shall be an independent director. Rule 5 provides that an unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee without any independent director. Further, a private company having only two directors on its Board shall constitute its CSR Committee with two such directors. CSR Committee of the foreign companies shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company. Clause (d) of sub-section (1) of section 380 requires foreign companies to notify to the Registrar, one or more persons resident in India authorised to accept on behalf of the company, any notices etc. required to be served on the company.

The Companies (Amendment) Bill, 2016 proposes to insert the following proviso to the same effect:

“Provided that where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee with two or more directors.”

The CSR Committee shall be constituted once the criteria prescribed in sub-section (1) of section 135 are fulfilled. No specific time limit has been prescribed in the Act. Hence, keeping in mind the obligations cast upon the Committee, it may be constituted any time after the provisions become applicable but before the end of the financial year.

(To be continued...)

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.