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Law and Interpretations related to Corporate Social Responsibility under Companies Act, 2013

The concept of Corporate Social Responsibility has been introduced by Companies Act, 2013. Section 135 of the Companies Act, 2013 deals with provisions related to Corporate Social Responsibility. Ministry of Corporate Affairs (MCA) has, vide its notification dated February 27, 2014 notify the provisions of Corporate Social Responsibility to be applicable w.e.f. April 01, 2014.

Through this brief write up we shall discuss the provisions and technicalities related to Corporate Social Responsibility along with its effect on Indian Corporate Sector.

GOVERNING PROVISION UNDER COMPANIES ACT 2013

The topic of Corporate Social Responsibility has been regulated by Section 135 of the Companies Act, 2013 read with Companies (Corporate Social Responsibility Policy) Rules, 2014. These rules were also notified by MCA w.e.f. April 01, 2014 vide its notification dated February 27, 2014.

Text of Section 135 is reproduced below for ready reference:

135. (1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall,—

- (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the Company as specified in Schedule VII;
- (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- (c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-section (1) shall,—

- (a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
- (b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

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Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (a) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation.—For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198.

Analysis of the provisions related to CSR

1. **Criteria for applicability of CSR provisions:** As per section 135(1), every company having:

- a. net worth of rupees five hundred crore or more, or
- b. turnover of rupees one thousand crore or more or
- c. a net profit of rupees five crore or more.

during any financial year shall constitute a Corporate Social Responsibility Committee of the Board of Directors. So there are basically 3 trigger points and all 3 are independent from each other. Accordingly provisions related to CSR shall become applicable whenever a Company satisfies any of the condition mentioned in section 135(1).

2. **Companies Covered under CSR:** The word used in section 135(1), is "every Company". Hence provisions related to CSR shall apply to all companies Public, Private, Foreign, Holding, Subsidiary or even Government Company. Another interpretation would be – Section 135(1) will be applicable only if company in question satisfying the criteria by itself. For example in case holding Company 'XYZ' satisfying the criteria, then section 135(1) will be applicable only on Company 'XYZ' and would not automatically becomes applicable on subsidiary companies of Company 'XYZ' or *visa versa*. Kindly refer rule 3(1) of Companies (Corporate Social Responsibility Policy) Rules, 2014.

3. **Monetary Figures of which year should be considered to decide the applicability of CSR:** Section 135(1) talks about Net Worth, Turnover and Net Profit to decide the applicability of CSR. Now a genuine question arise which year's Net Worth, Turnover and Net Profit shall be taken for this purpose. Section 135(1) says Net Worth, Turnover and Net Profit "during any financial year". But according to me it is a faulty language as "during any financial year" cannot be taken as any historic financial year. So as per the view of various learned law experts reference should be made to most recent available and audited balance sheet i.e. March 31, 2013. In other words audited financial figures for the FY 2012-13 should be considered for the purpose of Net Worth, Turnover and Net Profit keeping in view the applicability date of April 01, 2014 for CSR provisions.

4. **Constitution of Corporate Social Responsibility Committee:** Companies Covered by CSR Rules are required to Constitution a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. Refer rule 5.

Notable points and Interpretations about CSR committee:

- a. As per section 135(2), the Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

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- b. Composition of CSR committee should be three or more directors, out of which at least one director shall be an independent director. However, in case of a Private Company if there is no independent director, then any 3 directors may be members of CSR committee. This is expressly allowed in CSR rules.
- c. A Private company having only 2 Directors on its Board shall constitute its CSR Committee with 2 such directors. Refer Rule 5(1)(ii).
- d. **CSR Committee Meeting:** Law is silent w.r.t. number of CSR Committee meetings in a year. So it is dependent on the requirement of the Company. However there is no restriction if CSR Committee meeting conduct business by circulation.
- e. For CSR Committee Quorum Law is silent again. It is recommended to apply same quorum provisions as are applicable to board meetings under section 174 of the Companies Act, 2013.
- f. No time limit prescribed for constitution of CSR Committee. However keeping in view the fact that CSR Section and rules become effective w.e.f. April 01, 2014, it is advisable to do it in the first board meeting after April 01, 2014.

5. **Role and Responsibility of Corporate Social Responsibility Committee**

As per section 135(3), Corporate Social Responsibility Committee shall,—

- a. Formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the Company as specified in Schedule VII, as amended from time to time;
- b. Recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- c. Monitor the Corporate Social Responsibility Policy of the company from time to time.
- d. The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the Company.

6. **Responsibility of Board regarding CSR Committee and Policy**

As per section 135(4), the Board of every company on which CSR provisions are applicable shall—

- a. After taking into account the recommendations made by the Corporate Social Responsibility Committee, **approve** the Corporate Social Responsibility Policy for the company, and;
- b. Disclose contents of such CSR Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
- c. Ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

7. **Notable points and Interpretations about CSR Policy**

- a. CSR Policy will be formulated and recommended by CSR Committee to the Board for its approval.
- b. CSR Policy shall indicate the activities to be undertaken by the Company as specified in Schedule VII, as amended from time to time;
- c. It shall be duty of the Board to approve CSR Policy and ensure that the activities as given in CSR Policy are undertaken by the company. Rule 9 also casts such duty on the Board of Directors.

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- d. No time limit prescribed within which CSR Committee frame and recommend CSR Policy to the Board. However it is advisable to do it as early as possible keeping in view the spending target for the Financial Year.

8. Contents of CSR Policy: As per Rule 6, CSR Policy of the Company must include the following:

- a. A good CSR policy elaborates the approach and philosophy of the company towards its social responsibility. How company wants to help needy sections of the public at large through its CSR initiatives within a given time frame.
- b. A list of CSR projects or programs that the company plans to undertake falling within the purview of Schedule VII of the Act, specifying the process of execution of such project or project and the implementation schedule of the same.
- c. Monitoring process for projects or programs undertaken under CSR initiatives of the Company.
- d. CSR Policy shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profits of the Company.

9. CSR Spending

As per section 135(5), the Board of every company covered under CSR provisions, shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities. Further if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation—

- a. For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198.
- b. As per rule 7 CSR expenditure shall include all expenditure including contribution to corpus for projects or programs relating to CSR activities as approved by the Board on the recommendation of CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the preview of schedule VII of Companies Act, 2013.

10. CSR Reporting and Display of CSR Activities on Company website:

As per section 135(2) read with Rule 8, the Board's report of a company covered under CSR rules shall disclose the composition of the Corporate Social Responsibility Committee under sub-section (3) of section 134. As per Rule 9 company shall place its CSR Policy on its website, if any.

Sample Board Resolution for Constitution of CSR Committee:

"RESOLVED THAT pursuant to the provisions of Section 135 of the Companies Act, 2013, a Corporate Social Responsibility (CSR) Committee of the Board of Directors of the Company be and is hereby constituted comprising of the following members of the Board of Directors of the Company as members of CSR Committee:

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1. Mr. Raman Joshi, Chairman
2. Mr. Uday Singh, Member
3. Mr. Ravi Kumar, Member

RESOLVED FURTHER THAT the terms of reference of CSR Committee shall, inter-alia, include the following:

- a. To formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken by the Company as per the Companies Act, 2013;
- b. To review and recommend the amount of expenditure to be incurred on the activities to be undertaken by the company;
- c. To monitor the CSR policy of the Company from time to time;
- d. Any other matter as the CSR Committee may deem appropriate after approval of the Board of Directors or as may be directed by the Board of Directors from time to time.

RESOLVED FURTHER THAT the quorum for the CSR Committee Meeting shall be one-third of its total strength (any fraction contained in that one-third be rounded off as one) or two members, whichever is higher.

RESOLVED FURTHER THAT Company Secretary to the Company shall act as Secretary to the CSR Committee.”

Disclaimer:

This write up is intended to start academic discussion on few significant interpretations under Companies Act, 2013. It is not intended to be a professional advice and should not be relied upon for real time professional facts. Readers are advised to refer relevant provision of law before applying or accepting any of the point mentioned above. Author accepts no responsibility whatsoever and will not be liable for any losses, claims or damages which may arise because of the contents of this write up.

I am hopeful that this write up would be of some help w.r.t. your professional working and endeavors under Companies Act, 2013. Kindly share your opinion.

Thanks

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