

## Corporate Social Responsibility: Review of current policies, practices and disclosures

Among the various sections of the Companies Act 2013, Clause 135 has generated the most debate. The Clause 'mandates' spending on CSR to the extent of at least 2% of average net profits <sup>modified</sup> during every block of three years for companies above a certain financial threshold. ([Jump to Companies Act 2013](#))

Those supporting this clause, cite that India ranks amongst the poorest nations in the world. A [2010 World Bank report](#) says India had the second highest extreme poverty rates globally. It also ranked second amongst the world's extreme poor populations by region, only after Sub-Saharan Africa, with a mere average income of 87 cents/ day for developing countries.

*This updates our report published in November 2013.*

*The report includes the [notifications](#) issued by the MCA and Central Government on 27 February 2014*

Given that India faces bigger issues such as poverty, illiteracy, health and other social problems, they believe that the provisions of mandatory CSR are a welcome step – as this is expected to positively affect the community and the larger ecosystem as a whole, as well as the stakeholders involved in the business. Those on the other side of this divide believe that the business of business is business.

But even before this CSR spend was mandated, and contrary to the opposition from some quarters, the larger companies have been spending on social and environmental causes. These are disclosed as a part of the 'Business Responsibility' report, a part of the annual accounts.

Given the overlapping nature between these reports and the mandated reporting by the new Companies Act, IiAS studied the FY13 CSR initiatives and disclosures of 51 companies<sup>1</sup> to understand and evaluate the practices currently being followed.

Equally important, given that companies will be mandatorily spending on CSR, should investors blindly accept what is presented to them? IiAS engaged Samhita Social Ventures to develop a framework to evaluate companies CSR efforts. See '[Institutional EYE By Invitation](#)'. IiAS has used this broad framework to analyse the 51 companies.

### Summary of conclusions

- Larger companies are already spending on CSR programmes. During FY13, the 51 companies included in the Sensex or the Nifty50 indices spent Rs.26.6 bn towards CSR activities. This, at an average, accounts to 1% of average PBT<sup>2</sup> of the preceding three years of these companies, but overall outlay will still need to rise to meet the 2% norm laid out in the Companies Act 2013.

<sup>1</sup> These 51 companies form part of the BSE SNP Sensex ('Sensex') and CNX Nifty50 ('Nifty 50') indices (see annexure C).

<sup>2</sup> 'Profit Before Tax' calculated based on numbers available on Prowess database of Centre for Monitoring Indian Economy (CMIE). It includes profits arising from branches outside India

*Modified* As per the new rules notified by the MCA, 'Net profits' will be calculated in accordance with the provisions of section 198 for qualifying companies including foreign companies. In line with the notifications earlier, this will not include profits arising from branches outside India. Further it will not include any dividends received from companies that are covered under the section 135.

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Name of the company	CSR Spent (Rs. Mn)
ACC	255
Ambuja Cements	391
Asian Paints	10
Axis Bank	424
Bajaj Auto	NA
Bank of Baroda	70
BHEL	630
BPCL	179
Bharti Airtel	296
Cairn India	209
Cipla	77
Coal India <sup>a</sup>	237
DLF	68
Dr. Reddy's	168
GAIL	647
Grasim Industries	253
HCL Technologies	35
HDFC Bank	390
Hero MotoCorp	14
Hindalco Industries	298
Hindustan Unilever	520
HDFC	91
I T C	823
ICICI Bank	1,166
IDFC <sup>b</sup>	300
IndusInd Bank	91
Infosys	130
Jaiprakash Asso.	288
Jindal Steel & Power	991
Kotak Mahindra Bk	41
Larsen & Toubro	732
Lupin	94
Mahindra & Mahind	323
Maruti Suzuki India	189
NMDC	723

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- There is a need for significant improvement in the quality of disclosure on CSR activities – particularly with regard to quantum of spending. The format prescribed in the rules will help provide a lot more transparency on this and also provide a better sense of alignment with goals and ability to execute.
- It is encouraging to see that most of the larger companies have committees for oversight of CSR activities and undertake independent audits of these. However, with the Companies Act placing greater board level responsibility for CSR and mandating induction of at least one independent director on the CSR Committee, for some companies, the composition of the committee and the broader policy may need to undergo a revamp.
- It does appear that the frequency of review/monitoring will need to be increased, to ensure adequate tracking of CSR related activities by the board.
- Some companies could see significant change in the thrust of their CSR programs, given that the rules recognise only a limited number of activities and do not consider activities undertaken outside India or those exclusively for employees and their families as spending on CSR under Clause 135.
- Atleast two instances of State Governments <sup>Dropped</sup> trying to commandeer the CSR funds have been reported in the media. This defeats the purpose of mandating companies to carry out social projects. Such government over-reach needs to be addressed at this stage itself.

Since the rules are relatively broad and do not provide guidance on many issues relating to implementation, in the initial period, this gives flexibility to companies to innovate, but it also increases the risks of this spend getting frittered in non-serious initiatives.

Investors should engage company managements to understand the rationale and apply their judgement to assess if there is indeed a risk of non-compliance or whether this would lie within the spirit of the law (and possibly get captured in subsequent revisions to the rules).

The key findings are:

- As mentioned during FY13, the 51 companies included in the Sensex or the Nifty50 Indices spent Rs.26.6 bn towards CSR activities. This, at an average, accounts to 1% of average profits before taxes of the preceding three years of these companies.

Five companies spent at least 2% towards CSR activities, considering CSR spends as a percentage of the immediately preceding three years' profit before tax. These companies are Ambuja Cements, Cairn India, Jindal Steel and Power, Tata Motors, and Tata Steel.

This indicates that most of these companies will have to step up spending towards CSR activities by FY15. Based on FY13 numbers i.e., considering average PBT of preceding three years, the 51 companies will have to increase CSR spends by Rs.24.9 bn to meet the 2% threshold.

<sup>Dropped</sup> Schedule VII notified by the Central Government is silent on the contributions made to State Governments for CSR. It is likely that contributions to such funds will no longer be considered as CSR.

Name of the company (Rs. Mn)	CSR Spent
NTPC	795
ONGC	2,616
Power Grid Corp.	218
Punjab National Bk	32
Ranbaxy Lab.	43
Reliance Industries	3,571
Reliance Infra	64
Sesa Goa Ltd.	226
State Bank of India	1,230
Sun Pharma	46
TCS	716
Tata Motors	554
Tata Power	79
Tata Steel	4,708
UltraTech Cement	433
Wipro	160

**Note:**

Based on data available on company's Business Responsibility Reports.

<sup>a</sup> As disclosed in Coal India's notes to standalone accounts

<sup>b</sup> Assuming IDFC's FY13 standalone PAT

- For most companies, current CSR disclosure levels are poor. There is a need for significant improvement in the quality of disclosure on CSR activities – particularly with regard to quantum of spending. For instance, Bajaj Auto did not disclose the amount spent on CSR activities for FY13.

IIAS believes such disclosures will be useful for shareholders going forward.

- FY13 data indicates that 12 (or 23%) of the 51 companies studied conduct CSR initiatives outside India.

The draft rules do not consider programmes conducted solely for the benefit of employees and those conducted outside India as CSR activity. It's unclear whether these programmes will continue.

- More than 75% of the companies confirmed that they conform to national/international standards of reporting.
- During FY13, 37 (or 73%) of the 51 companies had a committee to overlook the functions of CSR activities.
  - Of these 37 companies having committees overseeing the CSR function, only 18 consisted of at least one independent director, as per IIAS classification.
- The CSR policies of 68% of the 51 companies underwent independent audits/evaluation by internal or external agencies

To ensure that CSR efforts meet the desired objectives, it is important that companies formalise and set out an effective framework to oversee implementation and monitoring of its CSR activities. Shareholders too need to evaluate this spend. Going forward IIAS will use these to assess CSR.

While the provisions of the Act 2013 and the draft rules address some of these issues, several grey areas still exist that should engage shareholders. These are discussed later in the report.

## CSR Evaluation Methodology:

As highlighted above, IiAS evaluated the CSR efforts of 51 companies through 16 evaluation parameters. The parameters are categorized under four heads: integrity, transparency, strategic orientation, and efficiency.

This report helps understand how companies performed on their CSR initiatives for FY13. While the new rules of the Companies Act and the provisions of the Companies Bill did not apply during this period, the analysis discusses FY13 disclosure levels, implementation methods, and the initiatives undertaken by companies assuming they did.



*Evaluation  
methodology  
developed with  
Samhita Social  
Ventures*

### Integrity and Transparency:

Integrity and transparency are perhaps the most critical aspects that shareholders need to consider while evaluating the CSR performance of companies. Given the close relationship between the two, we have clubbed these for the purpose of our discussion.

IiAS considered seven evaluation parameters that help understand the (i) disclosure levels on CSR, (ii) conformance to social and environmental standards, (ii) composition of committee overseeing CSR function, and (iv) Audit/ evaluation of the working of the CSR policies during FY13.

### Disclosures:

Currently, the quality of disclosures of CSR programmes/ initiatives undertaken by companies do not provide adequate insight to shareholders to evaluate CSR efforts. Our analysis of the FY13 data of the 51 companies indices indicate that:

- 96% of the companies disclosed the broad areas of CSR undertaken.

The major areas of CSR activity are in healthcare and sanitation, education and literacy - academic, vocational training, scholarships etc., women's empowerment, sustainable livelihoods and employment, environment protection, infrastructure, rural development, employee welfare, and other forms of community development.

- However, only 22% (11 of the companies) disclosed the amount spent under each of these major categories of CSR for FY13.
- About 50% or 26 companies disclosed the number of beneficiaries for a majority<sup>3</sup> of their CSR programmes/ initiatives in FY13
- However, less than 20% of the companies in these indices disclosed the amount spent in majority<sup>2</sup> of their CSR programmes/ initiatives in FY13.
- The companies did not disclose whether the amounts reserved for CSR not spent completely in a given financial year were carried forward to the next year.

<sup>3</sup> For the purpose of our analysis, we have evaluated whether companies have disclosed FY13 numbers for 50% or more of the CSR initiatives/ programmes.

To some extent, the draft rules address these issues as they require companies to provide such disclosures in a prescribed format.

These are:

- i. The amount spent to be spent for the year
- ii. The amount to be carried forward from earlier years
- iii. The amount spent during the year ( in a certain format)
- iv. The amount carried forward for the year

However, the rules do not clarify whether companies can carry forward such amounts, for say three or five years, or for an indefinite amount of time. If companies are permitted to do so, can they account the interest/ dividend incomes arising from such CSR amounts, aggregated over several years, as business profits? Or should the amount be added to the CSR corpus?

The rules specify that companies shall not account the surplus arising from CSR programmes as profits. Would this also apply to the above? In addition, the provisions encourage companies 'to integrate business models with social and environmental priorities and process in order to create shared value'. The rationale, then, for not permitting companies to account these as business profits is less apparent.

### **Checks and Balances:**

Given the above, and to assess the state of current checks and balances in implementing CSR activities, IiAS examined whether the CSR policies of the 51 companies conform to national or international standards of reporting. These include:

- National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business- issued by the Ministry of Corporate Affairs
- GRI Framework (Global Reporting Initiative)
- Standards such as SA2000 (Social Accountability System)
- Undergo independent audit/ evaluation by internal or external agencies.

Evaluating companies on the above parameters, the FY13 CSR data should bring some comfort to shareholders:

- Eighty percent or 41 of the 51 companies satisfied the above criteria.
- Seventy percent or 35 of these companies disclosed that their CSR policies underwent independent audits/ evaluations.

In addition to these checks and balances, IiAS also assessed whether the committees that overlook the CSR function of companies have at least one independent director, based on IiAS policy (see box 1).

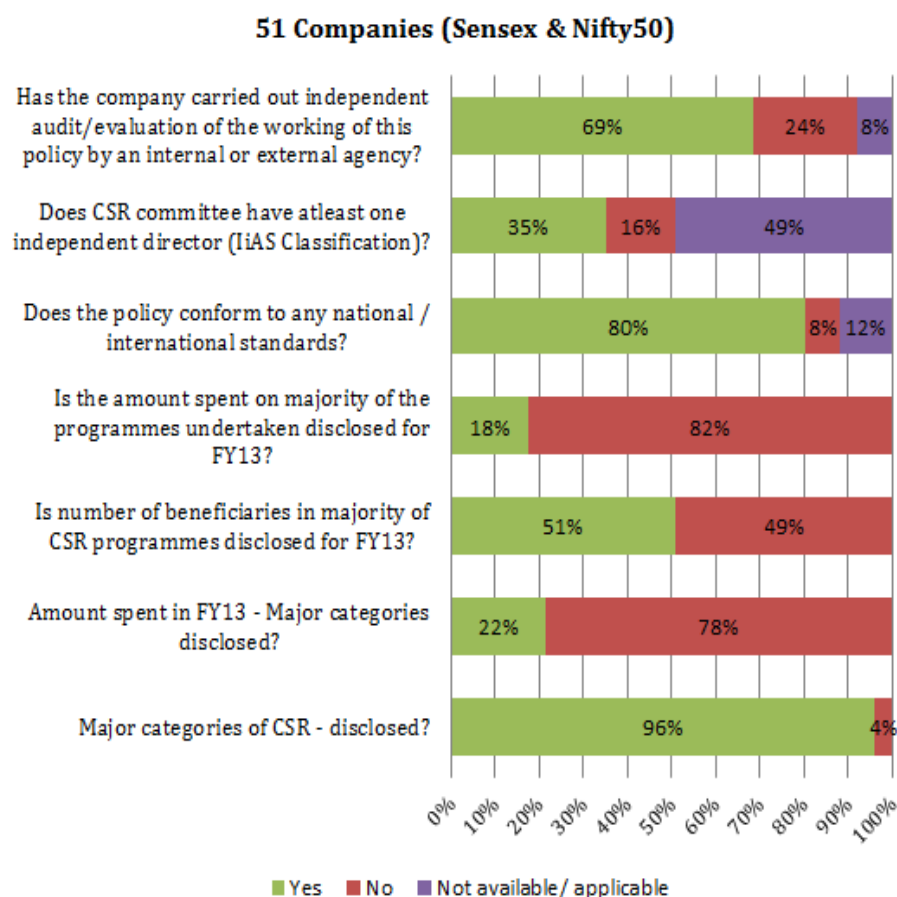
IiAS is indifferent whether companies conduct CSR initiatives through related entities or external agencies. However, given the underlying risks inherent in related party transactions, IiAS is of the opinion that, ensuring these committees include an independent director will provide some comfort to shareholders.

Data indicates that the committees overseeing the CSR function of only 18 companies (or 35%) included at least one independent director.



It is to be noted that though the rules require that CSR committees include at least one independent director, sub-section 10 and 11<sup>4</sup> of the Act may not apply to companies for some time while CSR is in effect (reporting on CSR starts from FY15)

### Snapshot of Indicators: Integrity and Transparency:



Source: Business Responsibility Reports, IiAS Research

#### **Box 1: IiAS Policy – Independent Directors:**

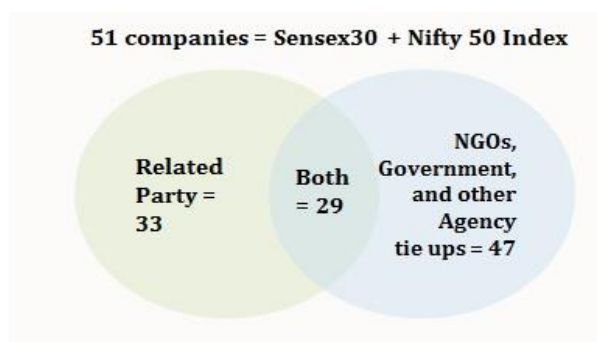
The IiAS policy on eligibility of independent directors is broadly in line with the provisions of the Companies Bill. In addition to this, the policy does not consider following directors as independent:

- Any director who has had any pecuniary/ material relationship with the company or its affiliated entities, in the preceding three years (new Companies Bill specifies only a two year cooling-off period)
- Past executives who have worked with the company in management roles for more than five years
- Directors who are simultaneously on the board of a large number/ percentage of group companies unless these are subsidiaries, in which case the board membership could be on account of regulatory requirement.

<sup>4</sup> The sub-section 10 and 11 of Clause 149 restrict independent directors from serving on the board of companies for more than two terms of five years each.

## Strategic Orientation:

Data indicates that, of the 51 companies, 33 companies carry out CSR initiatives through trusts, foundations or entities they have set up or through related parties. On the other hand, 47 companies of these companies make contributions towards CSR through NGOs, government and other agency tie-ups.



IiAS notes that most companies prefer conducting CSR through external agency tie-ups. However, over 50% of the companies in our analysis implement CSR programmes through both related parties and external agencies. As highlighted earlier, the rules of the Act are neutral on this.

However, the provisions require companies that are routing CSR activities through related parties, to provide:

- Disclosures of projects/ programmes to be undertaken by such parties
- A monitoring mechanism

The provisions allow companies to conduct CSR programmes through entities not set up by them. The rules require that such spends are contributed to organizations having a track record of atleast three years in carrying activities in such areas.

IiAS is of the opinion that if companies conduct programmes through its own entities, it provides them the opportunity to align the CSR initiative along the lines of its core business activity. This may help companies to directly interact with various stakeholders in its area of business.

For example, as part of its CSR activity, Bharti Airtel runs a 'mobile sustainability program'. Through this initiative the company has partnered with Nokia to provide broadband connectivity to 100 rural schools across Nigeria.

Bharti also partnered with another agency to provide telecommunication to villages in six African countries. IiAS, therefore, believes that aligning CSR activities along the lines of the company's business may create new revenue sources for corporates through new clients.

It is to be noted that the provisions of the Act 2013 do not consider the CSR initiatives implemented by companies outside India.

FY13 data indicates that about 25% of the 51 companies in our analysis conduct CSR initiatives outside India. Understandably, as these companies have businesses in different geographies, setting up foundations/ trusts in these countries for CSR

activities can help them create goodwill from stakeholders in these locations.

While we understand that the provisions, for computing net profits under Clause 135, do not include profits arising from companies' branches outside India, it is not clear why the provisions exclude such initiatives from a company's on-going CSR activity.

Rather than disqualifying the activities conducted abroad completely, the provisions should permit companies to account these as CSR for meeting the minimum 2% threshold (including the profits arising, in these locations, outside India). Rules may however encourage companies to start new initiatives, if any, locally or to focus more on CSR efforts within India.

The rules lay down the list of activities that would be considered as CSR. However, it is unclear if these are exhaustive or the provision 'X' of Schedule VII stating 'such other matters as may be prescribed' will provide flexibility. For instance:

- Maruti Suzuki conducts a 'Road Safety' programme that provides training on driving skill and behaviour. For the initiative, the company has partnered with (i) State governments to set up Institutes of driving and traffic research and (ii) Its dealers to set up Maruti Driving Schools.
- In order to make its products affordable, Cipla reduced the prices of medicines treating cancers in kidney, lung, and brain and other generic anti-cancer drugs, by over 60%.
- As part of its contribution towards 'Environment Sustainability', ITC implemented several measures to improve energy, water, emissions and effluent management in its hotels, plants and manufacturing units. As per the company, renewable sources and carbon neutral fuels currently provide nearly 40% of its total energy consumption.

In case of ITC, the company's efforts toward environment sustainability reduce the dependency level on carbon fuels. In the longer run, renewable sources of energy may also reduce the operating costs of the company.

Given the alignment of these initiatives with the company's broader area of activity and strategy, would these be considered under 'social business projects' (- Maruti Suzuki), combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases (- Cipla) or ensuring environmental sustainability (- ITC) or under provision 'X' as highlighted above?

Further, should the provisions accommodate the above, how would companies account for the expenditures towards such activities? For instance, can Cipla account for the price discounted (60%+) on sales of cancer drugs as CSR spends for a given financial year?

These are a few grey areas and there is less clarity if the above programmes will be considered as CSR. Given that these programmes complement the company's operations/ strategy, in one way or the other, IiAS believes that these should be taken as CSR efforts.

Given the importance of CSR, it is essential that the Board evaluates and approves the CSR policy of the company - formulated and recommended by its CSR committee. The draft rules of the Act highlight this as part of the Board's responsibilities. Disclosures in



the 'Business Responsibility' reports indicate that 45 companies (about 90%) already comply with these rules.

### **Efficiency:**

As highlighted earlier, CSR initiatives need to be driven and reviewed by the Board on a periodic basis. The disclosures provided by companies in accordance to the SEBI circular, indicate that during FY13 or as per company's policy:

- 36 companies disclosed that the board, a committee of the board, or CEO, review the Business Responsibility (BR) performance of the company – on annual, half yearly or quarterly basis. Of these, only 12 companies disclosed that they review the BR performance atleast on a quarterly basis.

Given the amount of effort and money involved in CSR activities IiAS believes that it is essential that companies form (i) Committees to overlook the functions of CSR activities/ initiatives (ii) In-house teams to implement these activities in a timely and efficient manner. FY13 data indicates that:

- 10 companies did not have a committee to overlook the functions of CSR activities while the information was not available for four companies.
- About 85% of the companies have an in-house structure to implement the CSR policy/ policies. A few companies such as State Bank of India disclosed the reporting structure of such teams.

Shareholders should note that the Act mandates qualifying companies to form CSR committees comprising of three or more directors with atleast one being independent.

However, both the draft rules and the Act do not require (i) Companies to form an in-house structure (ii) CSR committee to meet at minimum specified intervals to review of BR/CSR performance.

## **Government Interpretations of CSR <sup>Dropped</sup>**

Recent developments indicate that state governments may commandeer the CSR corpus of companies.

As per a recent newspaper article, the Chhattisgarh government has set up a 'Chief Minister Community Development Fund'. While the policy not only 'mandates' that companies contribute to the CM's fund, it has also laid down its own interpretation of the provisions of CSR, as opposed to the one described by the Act.

The policy published in the Gazette of Chhattisgarh 'mandates' that companies:

- With net profits (in the previous year) of less than Rs.5 bn will contribute 3% of their annual profits towards CSR
- With net profits above Rs.5 bn will have to pay 2% of their annual profits towards CSR with a minimum threshold of Rs.150 mn

*Dropped Schedule VII notified by the Central Government is silent on the contributions made to State Governments for CSR. It is likely that contributions to such funds will no longer be considered as CSR.*

It should be noted that the provisions of the Act allow companies to follow the 'comply or explain' philosophy on CSR. The company and its officers are liable to be fined only in case of non-disclosures of CSR. However, the Chhattisgarh Government has put forth the implications for non-compliance with its policy:

*'those industrial units which are obtaining facilities/grant from various departments of State of Chhattisgarh or according to the industrial policy prevailing at that time will have to compulsorily deposit the amount in Chief Minister Community Development Fund, otherwise the grant/facilities being provided by the administration can be taken back. However, they will be given an opportunity to hearing before taking the above action'.*

It is important to highlight that the Act allows and provides the necessary flexibility to companies:

- i. Whether to spend the required 2% of profits
- ii. To choose the medium of spending these funds (whether through related parties or external agencies),
- iii. Evaluate and adopt the CSR activities and the area of operations.

While Schedule VII of the draft rules considers contribution to 'any fund set up by the State Government for socio-economic development', these are one of the 10 areas which companies can 'choose' to take up as their CSR responsibility.

Another newspaper reported that the 'Andhra Pradesh State Housing Corporation' recently floated tenders for the supply of one million metric tonnes of cement for its weaker section housing programme from cement manufacturers. As per the reports this was under their 'corporate social responsibility' obligations.

IiAS believes that such instances will very quickly lead to the whole CSR initiative being reduced to a charade, and should be checked at this stage itself.

**Schedule VII notified by the Central Government on 27 February - Point (Viii):** contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; modified and replaced

Modified and replaced

**Schedule VII notified by the Central Government on 27 February - Point (Viii):** contribution to the Prime Minister's 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;

## Comments:

- Given that CSR activities will lead to participation from the larger ecosystem and communities, IiAS believes that the initiative may bring significant goodwill to companies and enhance its brand value in the long term. But for this to happen companies must:
  - i. Formulate robust CSR policies including identifying key improvement areas of CSR
  - ii. Form a strong and adequately staffed CSR team with sufficient board and CSR committee oversight
  - iii. Ensure proper implementation of funds towards CSR activities
  - iv. Make adequate and timely disclosures of CSR activities undertaken in their annual reports and websites.
  - v. Align CSR programmes/initiatives along the lines of its core activity of business
- Several companies conduct corporate social responsibility programmes outside India. In our opinion the rules should allow companies to continue such on-going initiatives and account these as part of CSR. They may include the profits of branches made by these companies outside India.
- IiAS welcomes the 'comply or explain' philosophy as it provides the necessary flexibility to companies in exercising discretion in CSR initiatives.
- It is not clear whether certain programmes and initiatives undertaken by companies currently fall under the CSR activities as prescribed in Schedule VII of the rules.
 

IiAS is of the opinion that the provisions should provide the flexibility to companies to align the CSR initiatives around its core business activity. This would help companies build on their existing business platform.
- The rationale for not including the surplus arising from CSR initiatives as business profits of the company is unclear. IiAS believes that companies should be permitted to account for such surpluses:
  - As these programmes and initiatives are the results of contribution from the company's profits.
  - As the provisions allow companies to integrate their business models with such initiatives.
  - Self –sustaining programs
- Rules do not stipulate the period for which companies can carry forward the amount committed towards CSR. In case of carry forwards, companies should be allowed to account the interest/ dividend incomes from such accumulated amounts as business profits.
- IiAS believes that the onus and method of CSR spending should be left to the companies. This will build relations with the relevant stakeholders and enable companies to grow their CSR initiatives organically, as well as align it around their business activities to make it sustainable over the long term. Since deleted

## Annexure A: Regulations

### Recent MCA/ Central Government notifications:

Earlier this month the Ministry of Corporate Affairs confirmed that the provisions of Corporate Social Responsibility (section 135) of the Companies Act 2013 and Schedule VII shall come into force from 1 April 2014 for companies above a certain threshold.

The additions/ changes that were made in the MCA notification on the CSR rules, amongst others, include:

- 'Net profits' will be calculated in accordance with the provisions of section 198 for qualifying companies including foreign companies.
- The CSR rules apply to companies, including the holding or subsidiary companies and foreign companies provided that it has its branch or project office in India.
- Net profits for the calculation of CSR will not include dividends received from other companies in India that qualify spend on CSR, under the section 135 of the Act. In line with earlier CSR rules, profits arising from overseas branches of the company will not be included for calculating net profits.
- Expenditure on company personnel hired or through implementing agencies for undertaking CSR with institutions with atleast three year track record, will be capped at 5% of the total CSR spend each year.
- Any contributions made directly or indirectly to political parties will not be regarded as CSR.
- A qualifying unlisted/ private company, under sub section 4 of section 149, which not required to appoint an independent director, may constitute a CSR committee without an independent director.

The Central Government altered Schedule VII of the Companies Act, 2013. This specifies the activities to be undertaken by the company for undertaking CSR activities.

The funds contributed to Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development will be considered as CSR. However, this note is silent on contributions made to State Governments for CSR.

Few additions include:

- Promoting preventive healthcare, sanitation and safe drinking water.
- Protection of national heritage, art, culture or restoring buildings of historical importance, setting up of libraries, etc.
- Measures for the benefit of armed forces veterans, war widows etc.

The complete Schedule VII is given in Annexure B

## Companies Act 2013:

As highlighted above, Clause 135 of the Companies Act 2013 requires that qualifying companies contribute atleast 2% of their average net profits<sup>5</sup> of the immediately three preceding years towards CSR. This is applicable to all companies <sup>clarified</sup> with:

- Networth of atleast Rs.5 bn or
- Turnover of atleast Rs.10 bn or
- Net profit of atleast Rs.50 mn in any financial year

According to a [recent media article](#), the provisions of CSR would apply to about 8,000 companies. While this number seems high, we believe that a large chunk of companies will qualify for CSR given the low profitability threshold of Rs.50 mn. These companies will be required to report their first CSR from 2014-15.

The Act further requires that these companies constitute a Corporate Social Responsibility committee. As indicated earlier, the committee of the board is required to have atleast three directors of which atleast one should be an independent director.

The CSR committee will be responsible for:

- Formulating and recommending the CSR policy to the Board of activities as listed under Schedule VII (- see annexure B). The policy is required to disclose:
  - The names of the CSR projects and programme
  - The projects and programmes the company intends to carry out during the implementation year, the method of implementation, as well as implementation schedules
  - Any surplus funds or income generated due the CSR activity. The surplus funds are not to be considered as part of the profits of the company
- Establishing a transparent monitoring mechanism for ensuring implementation of the company's CSR projects, programmes and activities.
- Recommending the amount the company will spend on CSR activities as indicated above
- Monitoring the company's CSR policy on a periodic basis

The Board in turn is expected to:

- Consider the recommendations made by the CSR committee and approve the CSR policy
- Disclose the contents of the policy in its report and company website
- Ensure that the activities prescribed in the CSR policy are undertaken by the company
- Spend atleast 2% of its average net profits, during every block of three years towards the activities as highlighted in its CSR policy

*<sup>5</sup>'Net Profit' for the purpose of CSR shall mean, net profit before tax as per books of accounts and shall not include profits arising from branches outside India.*

<sup>Clarified</sup> As per the new rules notified by the MCA, networth, turnover or net profits of a foreign company shall be computed in accordance with the section 381(1) and 198 of the Companies Act 2013



In a given financial year, should a company not be able to spend 2% of its average profits towards CSR, the Board is required to disclose the reasons for not doing so. The guidelines, however, do not explain what constitutes a valid reason for not carrying out CSR activities in a given financial year. For instance, can a company state that it could not spend the required 2% of average net profits because it needs to capitalize on business opportunities or wants to invest in new product development, infrastructure expansion etc.

While companies are not mandated to spend 2% of average profits, lack or inadequate disclosures about CSR policy or its implementation during a financial year is punishable under the new Act. Companies are liable to be fined between Rs.50,000 and Rs.2.5 million and officers in default may be punishable by imprisonment upto three years and/or fined between Rs.50,000 to Rs.0.5 million.

The 'comply or explain' principle of the law brings in a certain level of flexibility to companies and puts the onus on the board. IiAS welcomes such flexibility.

The draft rules allow companies to conduct CSR through related parties or external agencies. However, the rules expect additional disclosures for CSR activities routed through related parties – whether it is a trust, section-8 company, society or foundation or any other entity set up by the contributing company:

- Disclosures of projects/ programmes to be undertaken by such entity
- Establishment of a monitoring mechanism

Companies can contribute to CSR activities through external agencies (i.e. entities not setup by themselves) provided that these entities have a track record of atleast three years in such activities.

Readers should note that the following activities are not considered as part of CSR initiatives:

- Programmes/ initiatives that are conducted solely for the benefit of employees or their family members.
- Programmes/ initiatives that are conducted outside India (the Act requires that the Board gives preference to the local area for CSR activities).

Parts of the CSR provisions and its applicability, based on our observations on the FY13 data of Sensex and Nifty50 companies, are discussed in other sections of the report.

## **SEBI Circular – Business Responsibility Reports: Current disclosures**

In August 2012, Securities and Exchange Board of India (SEBI) released a circular mandating the top 100 listed companies (based on market capitalization on 31 March 2012) to include Business Responsibility (BR) Reports as part of their annual filings. Accordingly, 'Clause 55 of the Listing Agreement' was amended and the BR reporting framework was included.

While the reporting framework suggested by SEBI, requires additional disclosures, it is broadly in line with the guidelines laid down by the Ministry of Corporate Affairs (MCA) on 'Social, Environmental and Economic Responsibilities of Business'. This includes the nine principles emphasized by MCA:

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle

Principle 3: Businesses should promote the wellbeing of all employees

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

Principle 5: Businesses should respect and promote human rights

Principle 6: Business should respect, protect, and make efforts to restore the environment

Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

Principle 8: Businesses should support inclusive growth and equitable development

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

It is to be noted that the SEBI circular does not mandate companies to conduct programmes in the environmental, social, governance domains. It only lays down the framework for disclosures in a certain format for the top100 companies effective 31 December 2012.

## **Annexure B: SCHEDULE VII of CSR Rules (As notified by Central Government on 27 February 2014)**

Activities which may be included by companies in their Corporate Social Responsibility Policies

Activities relating to:

- (i) Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water
- (ii) Promotion of education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects
- (iii) Promoting gender equality and empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities for socially and economically backward groups;
- (iv) Ensuring environment sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of air, soil and water
- (v) Protection of natural heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up libraries; promotion and development of traditional arts and handicrafts;
- (vi) Measures for the benefit of armed forces veterans, war windows and their dependents;
- (vii) Training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports
- (viii) Contribution to the Prime Minister's 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;
- (ix) Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government
- (x) Rural Development Projects

## Annexure C: List of 51 Companies:

Sr. No	Company Name	Sensex30	Nifty50
1	ACC Ltd.		✓
2	Ambuja Cements Ltd.		✓
3	Asian Paints Ltd.		✓
4	Axis Bank Ltd.		✓
5	Bajaj Auto Ltd.	✓	✓
6	Bank of Baroda		✓
7	Bharat Heavy Electricals Ltd.	✓	✓
8	Bharat Petroleum Corporation Ltd.		✓
9	Bharti Airtel Ltd.	✓	✓
10	Cairn India Ltd.		✓
11	Cipla Ltd.	✓	✓
12	Coal India Ltd.	✓	✓
13	DLF Ltd.		✓
14	Dr. Reddy's Laboratories Ltd.	✓	✓
15	GAIL (India) Ltd.	✓	✓
16	Grasim Industries Ltd.		✓
17	HCL Technologies Ltd.		✓
18	HDFC Bank Ltd.	✓	✓
19	Hero MotoCorp Ltd.	✓	✓
20	Hindalco Industries Ltd.	✓	✓
21	Hindustan Unilever Ltd.	✓	✓
22	Housing Development Finance Corporation Ltd.	✓	✓
23	I T C Ltd.	✓	✓
24	ICICI Bank Ltd.	✓	✓
25	IDFC Ltd.		✓
26	IndusInd Bank Ltd.		✓
27	Infosys Ltd.	✓	✓
28	Jaiprakash Associates Ltd.		✓
29	Jindal Steel & Power Ltd.	✓	✓
30	Kotak Mahindra Bank Ltd.		✓
31	Larsen & Toubro Ltd.	✓	✓
32	Lupin Ltd.		✓
33	Mahindra & Mahindra Ltd.	✓	✓
34	Maruti Suzuki India Ltd.	✓	✓
35	NMDC Ltd.		✓
36	NTPC Ltd.	✓	✓
37	Oil & Natural Gas Corporation Ltd.	✓	✓
38	Power Grid Corporation of India Ltd.		✓
39	Punjab National Bank		✓
40	Ranbaxy Laboratories Ltd.		✓
41	Reliance Industries Ltd.	✓	✓
42	Reliance Infrastructure Ltd.		✓
43	Sesa Goa Ltd.	✓	✓
44	State Bank of India	✓	✓
45	Sun Pharmaceutical Industries Ltd.	✓	✓
46	Tata Consultancy Services Ltd.	✓	✓
47	Tata Motors Ltd.	✓	✓
48	Tata Power Co. Ltd.	✓	✓
49	Tata Steel Ltd.	✓	✓
50	UltraTech Cement Ltd.		✓
51	Wipro	✓	

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