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Understanding Corporate Social Responsibility (CSR) Provisions

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What is CSR?

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- CSR is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders.

- CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line-Approach"), while at the same time addressing the expectations of shareholders and stakeholders.

- On April 1, 2014, India became the second country (after Mauritius) to legally mandate CSR.

- Sec.135 of India's Companies Act makes it mandatory for companies of a certain turnover and profitability to spend 2% of their average net profit for the past three years on CSR.

CSR as per Companies Act 2013 – Broad Overview

Applicability

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- Sec.135 is applicable to every company (including its holding or subsidiary, and a foreign company having branches/project office in India) which meets any of the following criteria during the immediately preceding financial year (FY) -
  - Net Worth of Rs. 500 Crore or more
  - Turnover of Rs. 1,000 Crore or more
  - Net Profit of Rs. 5 Crore or more.

  - Net Worth: Defined in Sec.2(57) – As per audited financial statement (FS)
  - Turnover: Defined in Sec.2(91) – As per audited FS
  - Net Profit: to be calculated under Sec.198 – Subject to adjustments under Sec.135 and Rule 2(h)

- Net Worth, Turnover and Net Profit of a foreign company should be computed as per the BS and PL prepared in accordance with the provisions of Sec.381(1)(a) and Sec.198 of the Act.

Definition of Net Profit

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For an Indian Company:

- Net profit as per the financial statements prepared in accordance with the applicable provisions of the Act, but will not include the following –
    - Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
    - Any dividend received from other companies in India, which are covered under and complying with the provisions of Sec.135 of the Act.
- Even Companies registered under Sec.8 (or Sec.25 of 1956 Act) are covered under CSR.

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CSR as per Companies Act 2013 – Calculations and Mechanics

Contribution

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The Board of Directors should ensure that in every FY, the company spends towards CSR, at least 2% of average net profits* of the company made –

- during 3 immediately preceding FYs, or
- where the company has not completed 3 FYs since its incorporation, during such immediately preceding FYs

The company is required to give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

* Net Profit: As computed under Sec.198 of the Act (similar to managerial remuneration).

What is not eligible as CSR?

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CSR means the activities undertaken by a Company in pursuance of its statutory obligation laid down in Sec.135 of the Act in accordance with the provisions contained in these Rules, but will not include the following –

- Activities undertaken in pursuance of normal course of business of the company.

  Provided that any company engaged in research and development (R&D) activity of new vaccine, drugs and medical devices in their normal course of business may undertake R & D activity of new vaccine, drugs and medical devices related to COVID-19 for financial years (FYs) 2020-21, 2021-22, 2022-23 subject to the conditions that –

  - such R & D activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act.
  - details of such activity shall be disclosed separately in the Annual Report on CSR included in the Board's Report.

What is not eligible as CSR?

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CSR activities will not include the following -

- Any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level.
- Contribution of any amount directly or indirectly to any political party.
- Activities benefitting employees of the company as defined in Sec.2(k) of the Code on Wages, 2019 (exception for Covid related support).
- Activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services.
- Activities carried out for fulfilment of any other statutory obligations under any law in force in India.

Administrative Overheads & Surplus

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- The Board of Directors should ensure that the administrative overheads* should not exceed 5% of total CSR expenditure for the FY.

  *Expenses incurred by the company for 'general management and administration' of CSR functions in the company but will not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or programme.

- Any surplus arising out of the CSR activities –
  - Should not form part of the business profit of a company and
  - Should be ploughed back into the same project or should be transferred to the Unspent CSR Account and
  - Spent in pursuance of CSR policy and annual action plan of the company or
  - Such surplus amount should be transferred to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the FY.

Excess Spent Set Off & Asset

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Any amount spent in excess of the CSR obligation in a FY can be set off against the CSR obligation up to immediate succeeding 3 FYs subject to the conditions that –

- Excess amount available for set off should not include the surplus arising out of the CSR activities
- Board of Directors of the company should pass a resolution to that effect

Can excess amounts of earlier years (FY 19-20 and before) be so carried forward?

The CSR amount may be spent by a company for creation or acquisition of a capital asset, which should be held by –

- A company established under Sec.8 of the Act, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number; or
- Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or
- A public authority.

Capital Assets created prior to CSR Amendment Rules

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- Capital asset created by a company prior to the commencement of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall be transferred to the specified charitable entities.

- Such transfer should be done within 180 days from the date when above Rules became effective.

- This period may be extended by a further period of 90 days with the approval of the Board based on reasonable justification.

- Typically transfer would be at no consideration, else capital gains implications would have to be considered. Sec. 50C of the Income tax Act may also apply in case of transfer of immoveable property.

CSR as per Companies Act 2013 – Procedures & Penalties

Failure to contribute towards CSR

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If the company fails to spend CSR amount, the Directors' Report should specify the reasons for not spending the amount and –

- If the unspent amount does not relate to any ongoing project, then the unspent amount should be transferred to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the FY.

- If the unspent amount relates to any ongoing project, it should be transferred to a special account to be opened by the company in that behalf for that FY in any scheduled bank to be called the 'Unspent CSR Account' within a period of 30 days of the expiry of the FY.
- Such amount should be spent pursuant to its CSR obligations within a period of 3 FYs from the date of above transfer, failing which, the same should be transferred to a Fund specified in Schedule VII, within a period of 30 days from the date of completion of the 3rd FY.

About Ongoing Projects

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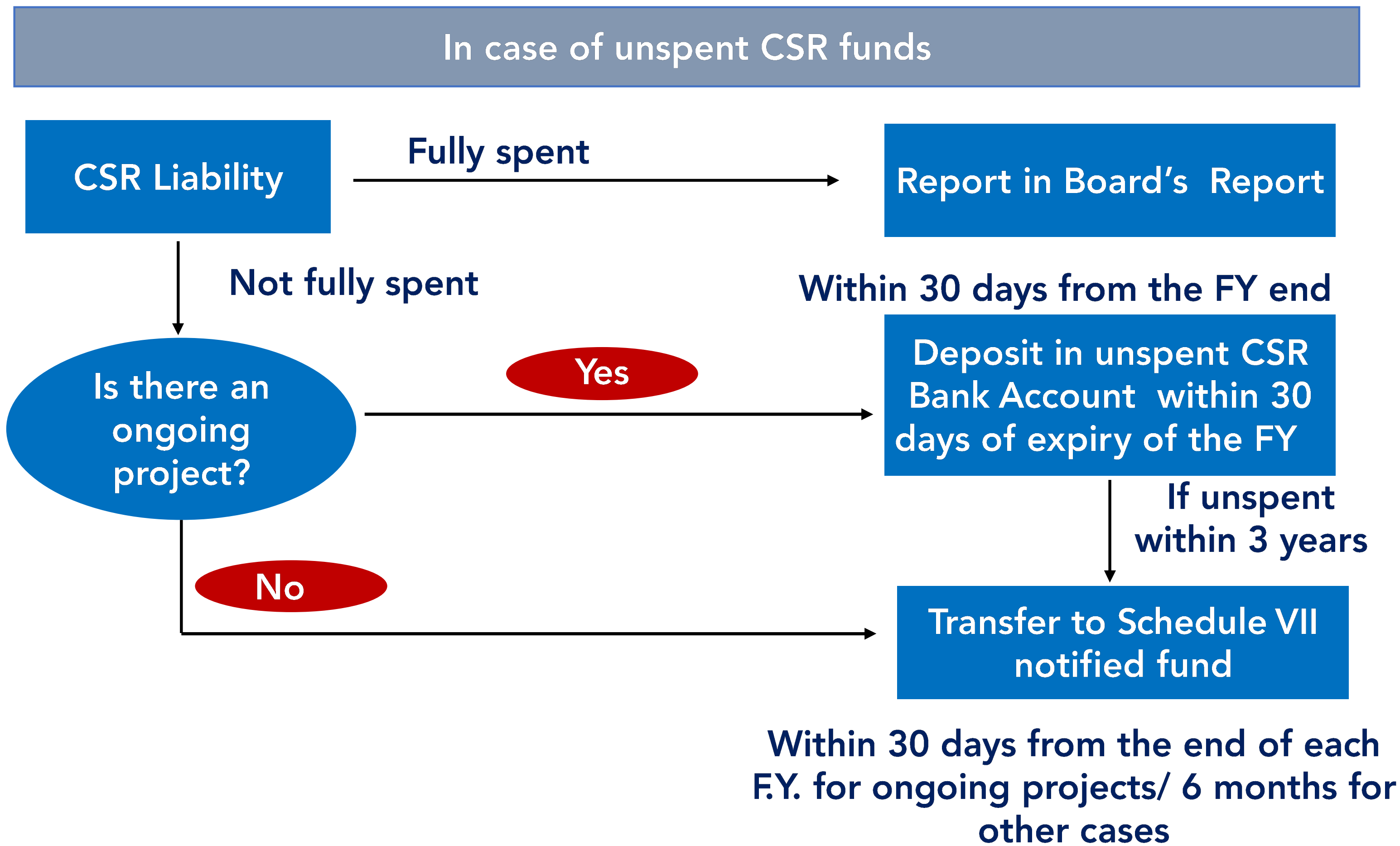
- Ongoing projects are defined as multi year projects but cannot exceed 3 years. Therefore, projects with duration exceeding 4 years (including year of commencement) are not contemplated.

- Would it cover a project of 3 months started in the end of one year and concluding in the beginning of next year?

- Treatment of the CSR expenditure transferred to implementing agencies but not entirely spent by such agencies within the relevant FY?

- Compulsion of completing projects in such inflexible time bound manner is harsh. CSR projects of longer gestation capable of creating significant impact will not be planned.

Expenditure on CSR - Spending Chart



Penalties

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If a company fails to transfer the unspent amount to the Fund specified in Schedule VII or Unspent CSR Account, following penalty will be imposed –

- On the company - twice the amount required to be transferred or Rs. 1 crore whichever is less; and
- On every officer of the company who is in default - 1/10th of the amount required to be transferred or Rs. 2 lakh, whichever is less.

For other defaults under Sec.135 and CSR Rules, penalties can be levied under the general penalty provisions of the Act (Sec.450).

Payment of penalties does not extinguish the company's obligation to transfer CSR amounts to the Fund.

The above penalty provisions now make the CSR provisions mandatory.

CSR as per Companies Act 2013 – Implementation & Reporting

CSR Committee of the Board

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- Companies should constitute CSR Committee of the Board consisting of 3 or more Directors, out of which at least 1 director should be an Independent Director subject to following criteria –
    - Companies which are not required to appoint an independent director as per the Act - CSR Committee should be formed without such Director.
    - A private company having only 2 directors on its Board - CSR Committee should have 2 such Directors. What about one person Company?
    - A foreign company covered under these Rules - CSR Committee should comprise of at least 2 persons of which one person should be as specified under Sec.380 (1) (d) of the Act (i.e., person resident in India) and another person should be nominated by the foreign company.
- Where the amount to be spent by a company towards CSR does not exceed Rs. 50 lakhs, exemption from formation of CSR Committee – functions to be discharged by the Board of Directors of such company.

CSR Committee of the Board

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Every Company which does not cross the eligibility threshold for 3 consecutive FYs is not required to –

- Constitute a CSR Committee; and
- Comply with provisions of the Sec.135 of the Act

till such time it meets the criteria mentioned above.

The Central Government may give general or special directions to a company or class of companies as it considers necessary to ensure compliance with provisions of this section.

Detailed Rules and Responsibilities of CSR Committee laid down in the Act (incl CSR Policy).

Role of the CSR Committee

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- Formulate and recommend to the Board of Directors a CSR Policy indicating the activities to be undertaken by the company in areas or subjects specified in Schedule VII.
- Recommend the amount of expenditure to be incurred on the above activities.
- Monitor the CSR Policy of the company from time to time.
- <u>Formulate and recommend to the Board of Directors an Annual Action Plan in pursuance of its CSR Policy</u>, which should include -
  - List of CSR projects or programs that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act.
  - Manner of execution of such projects as specified in the Rules.
  - Modalities of utilisation of funds and implementation schedules for the projects or programmes.
  - Monitoring and reporting mechanism for the projects; and
  - Details of need and impact assessment, for the projects undertaken.

Role of the Board in respect of CSR

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- After taking into account the recommendations made by the CSR Committee, approve the CSR 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.

- Ensure that the activities as are included in CSR Policy of the company are undertaken by the company.

- Mandatorily disclose the composition of the CSR Committee, and CSR Policy and projects approved by the Board of Directors on the company website, if any, for public access.

Implementation Agencies for CSR

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Board of Directors should ensure that the CSR activities are undertaken by the company itself or through –

- A company established under Sec.8 of the Act, or a registered public trust / society, registered under Sec.12A, Sec.80G of the Income Tax Act, 1961, established by the company or along with its holding / subsidiary / associate company; or
- A company established under Sec.8 of the Act or a registered Trust / Society, established by the Central Government or State Government; or
- Any entity established under Act of Parliament or a State legislature; or
- Company established under Sec.8 of the Act, or a registered public trust / society, registered under Sec.12A and Sec.80G of the Income Tax Act, 1961, and having an established track record of at least 3 years in undertaking similar activities.

Partnering & Collaborating

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- A company may engage international organisations for designing, monitoring and evaluation of the CSR projects or programs as per its CSR Policy as well as for capacity building of their own personnel for CSR.

- A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programmes in accordance with these Rules.

Monitoring Disbursement & Implementation

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- The Board shall satisfy itself that the funds disbursed for CSR activities have been utilised for the purposes and in the manner as approved by it and the CFO or the person responsible for financial management shall certify to the effect.

- In case of ongoing project, the Board of Directors should monitor the implementation of the project with reference to the approved timelines and year-wise allocation and shall be competent to make modifications, if any, for smooth implementation of the project within the overall permissible time period.

Registration of Implementation Agencies

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- Every entity which intends to undertake any CSR activity, should register itself with the Central Government by filing the form CSR-1 electronically with the Registrar, with effect from 01/04/21.

- Above requirement is not there for CSR projects or programs approved by the Board prior to 01/04/21.

- Form CSR-1 should be signed and submitted electronically by the entity and should be verified digitally by a Chartered Accountant /Company Secretary/ Cost Accountant in practice.

- On the submission of the e-form CSR-1 on the portal, a unique CSR Registration Number will be generated by the system automatically.

CSR Reporting

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- The Directors' Report should include an Annual Report on CSR activities. Reporting has been made much more detailed for FY commencing on or after 01/04/20.
- In case of a foreign company, the BS filed under Sec.381(1)(b) should contain an Annual Report on CSR activities containing particulars specified.
- Every company having average CSR obligation of Rs. 10 crore or more in the 3 immediately preceding FYs, should undertake impact assessment, through an independent agency.
- The impact assessment should be of their CSR projects having outlays of Rs. 1 crore or more, and which have been completed not less than 1 year before undertaking the impact study.
- The study should be placed before the Board of Directors and annexed to the Annual Report.
- Company may book the impact assessment expenditure as CSR but the same should not exceed 5% of total CSR expenditure for that FY or Rs. 50 lakh, whichever is less.

Impact Assessment

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- Impact assessments help funders, grant-makers and companies to understand and evaluate the impact of their expenditure on their target beneficiaries or society.
- The findings can also help companies to make evidence-based decisions in implementation and identify hurdles, allowing for programme continuity, scale, sustainability, efficiency, etc.
- To be done at least one year after programme implementation.
- If companies have multi-year programs (say 3 years), impact assessment needs to be conducted after completion of three years of the programme.
- Companies cannot conduct self-assessments – An independent agency must be engaged for the assessment.

Annual Report of the Board on CSR Activities

- Brief outline on CSR Policy
- Composition of CSR Committee
- Web link for above on website of company
- Impact assessment of CSR projects (as applicable) *(added from FY 21-22)*
- Amounts available for set-off
- Average Net Profit, 2 % to be spent, total obligation, etc.
- Details of spending (incl surplus arising), amount spent / unspent on ongoing projects, unspent amount for last 3 years, etc.
- Details of capital asset created or acquired, name under which created, etc. *(added from FY 21-22)*
- For unspent amounts, reason why amounts not spent *(added from FY 21-22)*

CSR as per Companies Act 2013 – Recent Circulars

Schedule VII Amendment

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Date	Particulars / Amendment
24/08/20	**Amendment to Schedule VII**
	Item (ix) of Schedule VII has been amended. <u>Companies may also contribute the CSR amount towards the following</u> – • Contribution to incubators or R & D projects in the field of Science, Technology, Engineering and Medicine funded by the Central Government / State Government or any agency or Public Sector Undertaking of the Central Government / State Government; and • Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and Autonomous Bodies established by the Department of Pharmaceuticals, Ministry of AYUSH etc. engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

COVID-19 FAQs on CSR by MCA

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Circular	Particulars
No. 15/2020 10/04/20	Following spending **will qualify** as CSR expenditure: • Contribution made to "PM CARES Fund" under item no (viii) of Schedule VII of the Companies Act, 2013. • Contribution made to "State Disaster Management Authority" to combat COVID-19 under item no (xii) of Schedule VII of the 2013. • Spending CSR funds for COVID-19 related activities under items nos. (i) and (xii) of Schedule VII relating to promotion of health care including preventive health care and sanitation, and disaster management. • Any ex-gratia payment made to temporary/ casual workers/ daily wage workers over and above the disbursement of wages, specifically for the purpose of fighting COVID 19. This will be treated as CSR expenditure provided there is an explicit declaration to that effect by the Board and the same is duly certified by the statutory auditor.

COVID-19 FAQs on CSR by MCA

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Circular	Particulars
No. 15/2020 10/04/20	Following spending will not qualify as CSR expenditure – • Contribution to "Chief Minister's Relief Fund" or "State Relief Fund for COVID-19". • Payment of salary/ wages to employees and workers during the lockdown period (including imposition of other social distancing requirements). • Payment of wages to temporary or casual or daily wage workers during the lockdown period.

Clarifications on Spending CSR Funds

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For awareness and public outreach on COVID-19 Vaccination Program

Circular	Particulars
No. 1/2021 13/01/21	Spending of CSR funds for carrying out awareness campaigns / programs or public outreach campaigns on COVID-19 Vaccination program is an eligible CSR activity under Schedule VII of the Act.

For setting up makeshift hospitals and temporary COVID Care Facilities

Circular	Particulars
No. 5/2021 22/04/21	Spending of CSR funds for setting up makeshift hospitals and temporary COVID Care facilities is an eligible CSR activity under Schedule VII of the Act.

Clarifications on spending CSR Funds

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For 'creating health infrastructure for COVID care', 'establishment of medical oxygen generation and storage plants' etc.

Circular	Particulars
No. 9/2021 05/05/21	Spending of CSR funds for: • 'creating health infrastructure for COVID care', • 'establishment of medical oxygen generation and storage plants', • 'manufacturing and supply of oxygen concentrators, ventilators, cylinders and other medical equipment for countering COVID-19' or • similar such activities are eligible CSR activities under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and disaster management, respectively.

Clarifications on offsetting excess CSR spent

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Excess CSR spent for FY 2019-20 to offset against the requirement to spend under Sec.135(5) for FY 2020-21

Circular	Particulars

20/05/21	• An appeal dated 30/03/20 was made to MDs/CEOs of top 1000 companies in terms of market capitalization, to contribute generously to PM CARES Fund
	• Some companies have contributed CSR funds to PM CARES over and above their prescribed CSR amount for FY 2019-20
	• Such excess amount or part thereof can be set off against the requirement to spend CSR funds for FY 2020-21
	• Conditions –
	  • the amount offset as such shall have factored the unspent CSR amount for previous financial years, if any;
	  • the CFO and statutory auditor of the company shall certify that the contribution to "PM CARES Fund" was indeed made on 31/03/20 in pursuance of the appeal; and
	  • the details shall be disclosed separately in the Annual Report on CSR as well as in the Board's Report for FY 2020-21.

Some Accounting Aspects
&
Disclosures under Companies Act

Accounting for Expenditure on CSR Activities
Technical Guidance by ICAI & MCA Notification

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- Provides detailed guidance on the accounting aspects of CSR spends and its presentation in the FS. Objective is to provide guidance on recognition, measurement, accounting, presentation and disclosure of expenditure on activities relating to CSR.
- Guidance issued both to the Company covered by CSR and the implementing agencies.
- Schedule III to the Companies Act, 2013 amended to substantially enhance the disclosures required to be made by the company in its FS.

FAQs on Accounting for amounts to be incurred towards CSR *(ASB of ICAI)*

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Published in May 2021

- CSR expenditure would be recognised as expense in the statement of P&L as and when such expenditure is incurred on the CSR activities undertaken as per the Board approved CSR Policy and CSR projects during the financial year.

- For the "unspent amount", a legal obligation arises to transfer to specified accounts depending upon the fact whether such unspent amount relates to ongoing projects or not. Therefore, liability needs to be recognised for such "unspent amount" as at the end of the financial year as per para 17(a) of Ind AS 37.

- Surplus arising from CSR activities activities shall be recognised in the P&L and since it cannot be a part of business profits, the same should immediately be recognised as liability for CSR expenditure in the BS and recognised as a charge to the statement of P&L.

- Further as per Ind AS 34, Interim Financial Statements, CSR obligation will be recognised based on the principles for recognition of the same in annual financial statements.

Accounting for Expenditure on CSR Activities *by Implementing Agency (IA)*

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- IA may receive corpus donation which may be CSR in the hands of donor company.
- Accounts will have to be maintained project-wise as funds could come from different companies.
- The unspent project amount should be carried forward in the BS or returned to the company.
- Formalities of carrying forward the amount like filing Form 10 (under the Income tax Act) would have to be complied with.
- The CSR Policy of the company must specify monitoring and reporting mechanism for effective utilization of CSR funds.
- ICAI has recommended that the companies should obtain CA / Auditor's Report on the utilization of funds when CSR is done through IA.

Expenditure on CSR – Up to FY 19-20

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- CSR spending was 'voluntary' till January 2021-
  - Since no penalties prescribed,
  - Only disclosures and reasons for non-spending in Directors' Report.
- Since voluntary, no provisioning to be made (as no obligation created).
- For Public Sector Enterprises (PSEs) however, DPE guidelines mandate spending on CSR (and hence creates an obligation) and hence PSEs needed to create provision for unspent CSR.
- Since there were no penalties, several companies accumulated large unspent amounts.
- MCA (through RoC) also issued notices to several companies for non-spending.
- For listed entities, from FY 2020-21 expenses recognized as and when spent and balance provision at year-end? (View as per ICAI FAQ)

Expenditure on CSR – From FY 20-21

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- Expenditure on CSR has now moved from ‘voluntary’ to “MANDATORY’ and penalties for non-compliance.
- Provisioning now mandatory (as obligation arises).
- All spending, including excess spending would be charged as expenses of the year in which the same is incurred. Where such excess is carried forward pursuant to Board resolution, asset would be created for excess spending.
- What about excess spending prior to 31/03/21?

Income Tax Implications

Income Tax Implications

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- Sec. 37 provides that for the purpose of the section, any expense incurred on CSR activities shall not be deemed to be expenditure incurred by assessee for the purpose of business or profession.
- By implication CSR expenses, allowable under other sections like Sec. 35, 35AC, etc. would be deductible also in computing the taxable income.
- CSR expenses would generally not be allowable under other sections (Sec 28 to 36) as it would be difficult to treat CSR expenses as incurred for the purpose of business.
- Specific provision that donation to Swatch Bharat Kosh and Clean Ganga Fund eligible for CSR will not qualify for Sec. 80G benefit.
- Hence other permissible donations to say, PM Cares Fund or PM National Relief Fund would be eligible for both CSR and 80G?

CSR as per Companies Act 2013 – What can Chartered Accountants do?

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Chartered Accountants' Contribution

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- Assist in setting up the CSR Framework
- Support incorporation of a Sec.8 company or trust or society and obtain relevant registrations
- Assist in selection of the proposed partner organizations and the proposed projects
- Develop a monitoring mechanism for project milestones
- Draft related documents and agreements
- Governance, Risk & Compliance (GRC) Services
- Audit the project to confirm spend, allocation and milestone achievement
- Monitor the operational efficiencies

Chartered Accountants’ Contribution

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- In-depth Project Reviews and Impact Assessment
- Monitor unspent amount, excess spend and set off, transfer to special bank account, Schedule VII fund, reasons for inability to spend as per statutory requirements, etc.
- Identify the gaps between project planning and implementation
- Design, build, manage and restructure MIS
- Assist in CSR reporting
- Analyse tax laws and ensure compliance with the latest developments in the tax regime

Is CSR Corporate Greenwashing?

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- Primary purpose of the company is to maximise shareholder return without compromising on ethics or the regulatory framework.
- Citizens are more concerned about corporations treating their workers well and obeying laws than about engaging in philanthropic activities.
- CSR may allow corporations to distract consumers and legislators from their core activity and the need to regulate corporations.
- Corporations spend on advertising to exaggerate or misstate the impact of their environmental actions or promote products as being “eco-friendly” when in fact they are not.
- Many companies claiming to do CSR are in industries - such as fossil fuels or automobiles - that produce the most greenhouse gases to begin with.

Some Closing Remarks..

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- There is a need to draw a distinction between CSR, which can be a strategic business management concept, and CSR as charity, sponsorships or philanthropy.
- CSR should be about how companies manage their business processes to produce an overall positive impact on society.
- CSR covers sustainability, social impact and ethics, and done correctly should be about core business - how companies make their money - not just add-on extras such as philanthropy.

Key CSR issues:
environmental management, eco-efficiency, responsible sourcing, stakeholder engagement, labour standards and working conditions, employee and community relations, social equity, gender balance, human rights, good governance, and anti-corruption measures.

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THANK YOU