

CSR

UNDERSTANDING & IMPLEMENTATION

By CS Rupanjana De

CSR and sustainability

Concept of CSR arises from concerns for sustainability. The UN Brundtland Commission defined sustainability as :-

“development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

“Businesses cannot be successful when the society around them fails”

- CSR is an inter-disciplinary subject which combines social, ethical and moral responsibility by complying with legal and voluntary requirements. It is based on the management of corporate responsibility activities for producing a positive effect on society.
- Commission of the European Communities, 2003
“CSR is the concept that an enterprise is accountable for its impact on all relevant stakeholders. It is the continuing commitment by business to behave fairly and responsibly and contribute to economic development while improving the quality of life of the work force and their families as well as of the local community and society at large.”

The basic Premise

When corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial or social in nature.

- Businesses are integral part of society, with a critical role in sustenance and improvement of healthy ecosystems, fostering social inclusiveness and equity, and upholding essentials of ethical practices and good governance.
- As per Business for Social Responsibility (BSR)
“Corporate Social Responsibility is operating a business in a manner which meets or excels the ethical, legal, commercial and public expectations that a society has from the business.”

CSR in India

- ▶ The concept of CSR is not new in India.
- ▶ What is new is the mandate on CSR by companies meeting a specific criterion.
- ▶ Businesses have traditionally associated money-making with philanthropic activity.
- ▶ The idea was more embedded in trusteeship
- ▶ CSR even had its impact on institutions that actively participated in freedom movement.

Companies Act, 2013 & CSR

- ▶ Makes CSR mandatory for certain class of profitable undertakings
- ▶ There are grossly two points of view
- ▶ Social Development - A welcome step by MCA as an annual spending of over Rs. 15,000 - Rs. 20,000 crores is expected starting from FY 2014-15
- ▶ Business Houses - Generally mixed views. Some feel it is over-taxing and 'forced charity' as voluntary CSR is not being given recognition and CSR mandate still applies to companies already doing activity for social development.

Qualifying Criterion

As per section 135 of Companies Act 2013, mandatory CSR spending of 2% of net profit is required by the following companies:

- ▶ Net worth > Rs 500 crores, or
- ▶ Turnover > Rs 1000 crores, or
- ▶ Net profit > Rs 5 crores, or
- ▶ a foreign company defined u/s 2(42) having its branch office or project office in India which fulfills the criteria under pts. (i), (ii) or (iii)

Legal Framework

Companies Act, 2013

- ▶ Section 134(3)(o) - Disclosures in Board's Report
- ▶ Section 134(8) - Penalty
- ▶ Section 135(1) - Companies that are required to comply with mandatory CSR provisions
- ▶ Section 135(1) - Composition of CSR Committee
- ▶ Section 135(2) - Disclosures about CSR in Board's report
- ▶ Section 135(3) - Role of CSR Committee
- ▶ Section 135(4) - CSR Policy
- ▶ Section 135(5) - Mandatory CSR Spending
- ▶ Section 166(2) - Duties of directors
- ▶ Schedule VII - Activities in which CSR investment can be done

Legal Framework

Companies (Corporate Social Responsibility Policy) Rules, 2014

- ▶ Rule 2(1)(c) - Definition of Corporate Social Responsibility
- ▶ Rule 2(1)(e) - Definition of CSR Policy
- ▶ Rule 2(1)(f) - Definition of 'Net Profit'
- ▶ Rule 3 - Companies to which CSR applies
- ▶ Rule 4 - CSR activities
- ▶ Rule 5 - CSR Committees
- ▶ Rule 6 - CSR Policy
- ▶ Rule 7 - CSR Expenditures
- ▶ Rule 8 - CSR Reporting
- ▶ Rule 9 - Display of CSR activities on the website.
- ▶ Annexure - Format for Annual Report on CSR Activities to be included in Board's Report

Legal Framework

Companies (Accounts) Rules, 2014

- ▶ **Rule 9: Disclosures about CSR Policy.**

The disclosure of contents of Corporate Social Responsibility Policy in the Board's report and on the company's website, if any, shall be as per annexure attached to the Companies (Corporate Social Responsibility Policy) Rules, 2014.

- ▶ **DPE Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises**

Schedule VII - Specified activities

- ▶ CSR activities under the Companies Act, 2013 have to be undertaken in any of the areas mentioned in Schedule VII of the Act.
- ▶ While traditional CSR includes within its ambit activities directed towards Social and Environmental upliftment and upgradation, the Schedule VII of the Companies Act 2013 very specifically includes activities directed at overall national development also. This is in the right spirit for a developing country like India.

Schedule VII - Social Projects under CSR

- ▶ Eradicating hunger, poverty & malnutrition promoting preventive health care and sanitation and making available safe drinking water;
- ▶ Promoting education, employment enhancing vocation skills among children, women, elderly, and the differently abled;
- ▶ Promoting gender equality, empowering women setting up homes and hostels for women, orphans or old age homes, day care centres etc. for the socially and economically backward classes
- ▶ Rural development projects.
- ▶ Setting up public libraries

Schedule VII - Environmental Projects under CSR

- ▶ Environmental sustainability,
- ▶ Ecological balance,
- ▶ Protection of flora and fauna, animal welfare, agro forestry,
- ▶ Conservation of natural resources and
- ▶ Maintaining quality of soil, air and water;
- ▶ Clean Ganga Fund
- ▶ Swachh Bharat Kosh

Schedule VII - Nationalistic Projects under CSR

- ▶ Protection of national heritage, art and culture,
- ▶ Restoration of buildings and sites of historical importance
- ▶ Promotion and development of traditional arts and handicrafts;
- ▶ Measures for the benefit of armed forces veterans, war widows and their dependents;
- ▶ Training to promote rural sports, nationally recognized sports, paralympic and Olympic sports;
- ▶ Contribution to PM National Relief Fund or any other fund set up by CG for socio-economic development, relief & welfare of SC, ST, OBC, other minorities and women;

Schedule VII - Technology Projects under CSR

- ▶ This is the darker side of CA 2013
- ▶ CSR in India speaks very less of technology.
- ▶ The only place in the Schedule VII where we see specific mention of technology is - Contributions to technology incubators within academic institutions;
- ▶ For overall development of a country technological development and incentives for carrying on Research and Development is very important. This is lacking. But we can hope that in the coming days we will see some inclusion in this regard.

Water Projects under CSR

- ▶ The largest focus of the govt. for CSR projects now appears to be **WATER PROJECTS**
- ▶ In a policy released earlier this year the govt. allowed CSR spending on water projects.
- ▶ The most important areas being the irrigation sector where water is grossly misutilised.
- ▶ Water saved through CSR initiatives will be used for ecological needs and ensuring 'environmental sustainability' and removal of disparity between water supply to rural and urban areas.

Water Projects under CSR ... contd

Companies can also spend under CSR in

- ▶ Construction of passes for wildlife over canals passing through sanctuaries
- ▶ Create awareness among farmers about conservation and minimizing water use
- ▶ Water saving irrigation techniques
- ▶ Renovation / modernization of old irrigation projects
- ▶ Lining of selective segments of canal reaches with excessive water losses
- ▶ Installing flow measuring devices
- ▶ Sponsoring research activities in irrigated agriculture
- ▶ Desilting of small water bodies

Spendings that do not qualify

- ▶ In project not related to activity in Schedule VII
- ▶ Spending in the ordinary course of business
- ▶ Spending outside the local area of operation of the company (this is marked as 'preferable')
- ▶ Spending outside India by a Foreign company to which this section applies (spending 'locally' here means in India)
- ▶ Spending that benefits only employees & their families
- ▶ Contribution given to any political party with objective of carrying out any such specified activity
- ▶ Any spending which a company is statutorily required to do under any other Act
- ▶ Spending in violation of any Act
- ▶ Spending beyond limit specified in CSR Policy
- ▶ Spending on One-off Events
- ▶ Spending on projects not specified in CSR Policy

Responsibility of the BOD

- ▶ To compose a CSR Committee
- ▶ To disclose composition of CSR Committee in its reports.
- ▶ To ensure that CSR committee meetings are held properly
- ▶ To ensure at least 2% of average net profit of the preceding 3 years is spent on CSR activities every year.
- ▶ To approve the CSR Policy after considering recommendations of the CSR Committee.
- ▶ To ensure that activities laid down in CSR policy are actually undertaken as per the intent of the committee.
- ▶ To disclose CSR policy and initiatives towards implementation in its report and in the website.
- ▶ If spending up to 2% of net profits, as required, is not done, to report the reasons for failure in its report.

CSR Committee

- ▶ Board to constitute a CSR committee
- ▶ To consist of at least 3 directors of the company one of whom shall be an independent director.
- ▶ For companies that are not mandatorily required to appoint IDs, or companies that do not require three directors under the Companies Act 2013 but qualify for CSR spending the following applies:
- ▶ Private Company having only 2 directors may have only 2 directors in CSR committee
- ▶ Companies not required to have an independent directors (ID) may have CSR Committee without an ID
- ▶ In case of Foreign company, the authorized representative of the company in India and another person nominated by such company in this regard

Duties & Functions of CSR Committee

- ▶ Review past and current CSR activities of the company, examine their alignment with Schedule VII
- ▶ Researching on national and local development priorities and setting up relevant CSR activities for the company.
- ▶ Studying the CSR practices of other companies and learning from their experiences.
- ▶ Formulate and recommend to BOD, a CSR Policy listing the activities to be undertaken by the company and to lay down what those policies would imply in terms of the company's vision, mission and its core business area.
- ▶ Recommend the amount of expenditure to be incurred
- ▶ Determine the mechanism for implementation
- ▶ Monitor and supervise the implementation of the CSR projects recommended
- ▶ Monitor the CSR Policy of the company from time to time.

Contents of CSR Policy

- ▶ Motto / vision of the company w.r.t. CSR
- ▶ Local area identification
- ▶ List of projects and programmes proposed to be undertaken by the company under CSR initiative.
- ▶ Details of the modalities of execution of the projects - via NGO etc.
- ▶ Funds allocated under each activity, and
- ▶ The implementation schedules for them.

CSR Corpus

CSR corpus would include the following funds:

- ▶ 2% of the average net profits (calculated on the basis of profits of past 3 years),
- ▶ Any income / profit arising therefrom
- ▶ Surplus funds arising out of CSR activities of previous year.
- ▶ Interest earned on funds unutilised in previous years

NOTE:

- ▶ In calculating net profit, PBT would be taken
- ▶ Does not include profit of foreign branch
- ▶ For company that has not completed 3 yrs, the period of its existence will apply

Implementation mechanism

- ▶ On its own, through an in-house department
- ▶ Through its own non-profit foundation set-up to facilitate the CSR initiative
- ▶ By partnering with registered NGOs working independently and having experience in implementing similar activities for not less than three years
- ▶ Through joint collaboration with other companies which also qualify for CSR spending

Tax treatment

- ▶ CSR spending is generally not tax deductible unless specifically stated
- ▶ By making it tax deductible govt. would contribute 30%
- ▶ Lot of debate still going on in the topic
- ▶ No tax deductability u/s 37(1) of Income Tax Act, 1961
- ▶ CBDT Circular has stated that a company can get deduction u/s 30 to 36 if relevant conditions are fulfilled
- ▶ Only clearly deductible option is investment in PM National relief Fund with 100% (50%) deduction u/s 80G of the Income Tax Act, 1961
- ▶ Finance Budget 2015: Investment in the following funds under CSR would not be tax deductible although an individual gets 100% tax deduction for investment in
 1. Clean Ganga Fund and
 2. Swachh Bharat Kosh

Word of caution

- ▶ For companies investing the CSR amount through an NGO, just handing over the amount does not complete the responsibility of the company.
- ▶ Responsibility of company extends till the time of actual utilisation and reporting thereon

Salary vs. Employee Benefit

- ▶ Salary to employees of the CSR Department may be paid out of the CSR Fund, but
- ▶ The fund cannot be utilised for the objective of activities beneficial only to employees

Penalty for non-compliance

- ▶ As per section 134(8), penalty for non-compliance may range from Rs. 50,000 to Rs. 25,00,000
- ▶ CSR activity reporting forms part of the Board's Report and hence the same penalty applies

Illustrations

Illustration 1 - ABC Ltd. has provided the following relevant financial data for ascertaining its CSR obligation. Is it liable to spend any amount on CSR in FY 2014-15; if so, what amount?

Particulars	FY	2011-12	2012-13	2013-14
	Rs. In crores			
Turnover		300	310	350
Net worth		250	256	260
Net profit		3	5	4

Solution

Based on the clarification of the terms 'any financial year' in section 135(1) of the Act read with Rule 3(2) of the Companies (CSR Policy) Rule, 2014 provided by the MCA on by its General Circular No. 21/2014 dt 18th June 2014, the term indicates 'any of the preceding 3 FYs'. This implies that the eligibility criteria do not necessarily be hit on the current FY to make it applicable. Since ABC Ltd's net profit was Rs. 5 crores in 2012-13, although none of the criteria were met in 2013-14, yet the company is covered by the provisions of section 135(1) and will have to make CSR investment in 2014-15. And the amount of investment would be 2% of the average of (Rs. 3 Cr + Rs. 5 Cr + Rs. 4 Cr) which comes to Rs. 8 lakhs.

Illustrations

Illustration 2 - The Company Secretary of XYZ Ltd. has drawn the following chart of relevant financial data of the company and is required to brief the management about the applicability of section 135(1) of the Companies Act 2013 to it. Advice him as to whether the said section is applicable to it. If not, why?

FY	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Particulars	Rs. In Crores						
Turnover	300	310	350	400	422	430	510
Net worth	250	256	260	261	265	268	270
Net profit	3	4	5	4.5	4.8	4.9	5
CSR investment				0.8	0.9	0.95	?

Solution

In none of the 7 FYs the company came under applicability of section 135(1) under the Turnover or Net worth criteria. As for Net profit criteria, it hit the applicability provisions only in FY 2013-14. So it has duly complied with Section 135 by making necessary CSR investment. It is not satisfying any of the 3 criteria for the next 3 FYs, 2014-15, 2015-16 and 2016-17. Rule 3(2) of the Companies (CSR Policy) Rules, 2014 provides that a company which is covered u/s 135(1), will continue to attract the provision for a maximum of 3 years even if none of the criteria are hit during the period. On completion of 3 years since it ceases to be covered u/s 135 it shall be out of purview of the provisions. The company has rightly complied with the section by doing CSR investment in FY 2014-15, 2015-16 and 2016-17, but since during all these 3 years it has already ceased to fall u/s 135(1), it will not be required to make any investment in 2017-18. But we can see that XYZ Ltd. has again hit the Net profit criteria in 2017-18. So from FY 2018-19 onwards it will again be required to comply with the provisions of section 135. This means the company is getting a relief from CSR expenditure only during the year 2017-18.

Net Worth, S. 2(57)

It is the aggregate of

- ▶ paid-up share capital;
- ▶ all reserves created out of the profits; and
- ▶ Securities Premium Account.

The following are the implied inclusions:

- ▶ any reserve created out of profits,
- ▶ (including statutory reserves); and
- ▶ does not matter whether or not dividend can be paid out of it;

Deductions therefrom

- ▶ accumulated losses;
- ▶ deferred expenditure;
- ▶ miscellaneous expenditure not written off.

The following shall be excluded in calculation on net worth

- ▶ reserves created out of revaluation of assets;
- ▶ reserves created out of write-back of depreciation; and
- ▶ reserves created out of amalgamation.

Turnover, S. 2(91)

Turnover is the aggregate value of realization made by the company during a financial year from:

- ▶ the sale, supply or distribution of goods or
- ▶ on account of services rendered or
- ▶ both of the above

The definition looks very simple but practical difficulties arise for which ICAI has issued some guidelines

Net profit, R. 2(1)(f)

Rule 2(1)(f) “Net profit” means the net profit of a company as per its FS prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :—

- ▶ profit arising from any overseas branch or branches whether operated as a separate company or otherwise; and
- ▶ dividend received from other companies in India, which are covered under and complying with the provisions of sec 135
- ▶ The net profit in respect of a FY for which the relevant FS were prepared in accordance with the provisions of the Companies Act, 1956 shall not be required to be re-calculated in accordance with the provisions of the Act:
- ▶ In case of a foreign company net profit means the net profit of such company as per P & L A/c prepared in terms of Section 381(1)(a) read with section 198 of the Act.

A Critique

“The Social Responsibility of Business is to increase its profits”.

- Milton Friedman, New York Times,
September 1970

A Critique

But in an underdeveloped country like India the CSR mandate is a welcome step to make business houses responsible corporate citizens

A Critique – the points of review

1. Spending should be done in the local area of operation

How about
Automobile companies?
Software companies?

A Critique – the points of review

2. No cause and effect linkage.

Why not directly mandate
correcting the wrong done?
e.g. Automobile companies again

A Critique – the points of review

3. Comply or Explain !?!?

Lock your door properly and
give the key to the thief!

A Critique – the points of review

4. Direct linking of turnover / profit with CSR spending

What if

The company has already taken care of Schedule VII activities in earning profit ... e.g. Hospitals, Rural Development organisations, etc.

A Critique – the points of review

5. 2% - on what basis? How do you quantify liability? 2% may be very less for big companies but a huge amount for SMEs.

Isn't it discouraging entrepreneurship?

A Critique – the points of review

6. No monitoring agency.
Directors in CSR Committee
may not be sufficiently
qualified to judge the social
impact of companies

CSR policy may end up becoming a
money usurping mechanism in the
hands of those in power

A Critique – the points of review

7. No time limit for compliance. CSR implementation of a single year can go on perpetually

Result?

Increase in paperwork

Less implementation

A Critique – the points of review

8. Voluntary Charitable work not recognised. Too much focus on Schedule VII

This is myopic vision. Those who willingly do charitable work will get discouraged. There should be a system of CG approval of existing charitable activities under mandatory CSR

Conclusion

For a country like India, mandatory CSR seems to be a step in the right direction. But the codification is definitely poor.

We are in a Trial and Error phase with not much of specific guidelines to follow. The coming years will see a lot more stringency and clarity of provisions.

Until then we can 'Wait and Watch'

THANK YOU