CORPORATE SOCIAL RESPONSIBILITY

COPYRIGHT & Disclaimer

Outline of the presentation

- Introduction to CSR
- Global scenario
- CSR vs donation
- Applicability of CSR
- CSR expenditure
- Calculation of net profits (with examples)
- Permissible activities under CSR (Schedule and circulars)
- Unspent amount and ongoing projects
- Carry forward of excess expenditure, surplus and capital assets
- Compliances pertaining to CSR
- CSR Committee
- CSR Policy
- Role of Board
- CSR Implementation
- Reporting and Disclosure
- Administrative Overheads
- Impact assessment
- Penal implications

CORPORATE SOCIAL RESPONSIBILITY

- India is arguably the only country that legislates CSR as a mandatory requirement.
- Why is CSR spending important? How is India's concept of CSR different from global outlook?

CSR in India

- India has legislated CSR spending as a mandatory requirement under law.
- CSR in India is two folded
  - Companies have to undertake business activities responsibly so that there is no harm to the society
  - Companies have to go out and spend funds annually for the welfare of the society
- There are penal provisions on non-spending
  - Untill 22-01-2021, it was "comply-or-explain"

CSR Globally

- Globally, business houses are expected to carry out its activities responsibility so that no harm is provided to the society at large
- There is no mandatory requirement of spending towards CSR activities.
- However, there are reporting requirements under various countries
- There is a difference between CSR and CSR spending. Whereas, most of the countries practice CSR and not spending

CSR - global scenario

USA	• CSR team in Bureau of Economic and Business Affairs (EB) leads businesses in promotion of ethical business • EB serves as source of guidance for companies for developing CSR policies
UK	• CSR is a part of corporate governance • Directors to consider community and environmental issues while conducting business • Disclosures to be made in business review
Europe	• CSR strategy built upon principles of United Global Compact i.e. voluntary initiative to implement universal sustainability principles • ISO 26000 Guidance Standard on Social Responsibility and OECD Guidelines for multinational enterprises adopted
Denmark	• Danish Financial Statement Act mandates companies of certain size to disclose CSR practices in Annual Report • Reporting on three topics required- CSR policies, plan of action and CSR achievements • Companies to account for human rights policy and climate impact
France, South Africa & China	• Similar mandatory reporting obligation as Denmark

ISO 26000- seven core subjects of social responsibility

Source: https://www.iso.org/files/live/sites/isoorg/files/store/en/PUB100258.pdf

CSR VS DONATION

CSR

- CSR is not donation
- It is targeted social spending
- For particular project/programme under Schedule VII
- Society at large should be served
- It is the responsibility of business houses and not kind heartedness
- Ex- Creating job opportunities for lower section of society shall be CSR as the same shall eradicate hunger as well as remove inequalities of income

Donation/Charity

- Donation is not CSR
- It is merely cheque issuing activity without any philosophy of serving the society
- Simple giving away of money is charity or philanthropy
- Ex- Distributing food packets to poor people during a festival is benevolence and not eradicating hunger.

PROVISIONS OF LAW

SECTION 135 OF CA, 2013 & COMPANIES (CORPORATE SOCIAL RESPONSIBILITY) RULES, 2014

Series of amendments in CSR provisions

Companies (Amendment) Act, 2017

3rd January, 2018

(Notified)

Companies (Amendment) Act, 2019

31st July, 2019

(notified on 22nd January, 2021)

Introduced s 135(7)

Shift from comply or explain to **comply or pay fine**

Companies (Amendment) Act, 2020

28th September, 2020

(notified on 22nd January, 2021)

Substituted section 135(7)

Shift from comply or pay fine to **comply or pay penalty**

Companies (CSR Policy) Amendment Rules, 2021

(notified on 22nd January, 2021

Companies (CSR Policy) Amendment Rules, 2022

(notified on 20th Sep, 22)

Applicability (1/2)

Turnover
Rs. 1000 crore or more

OR

Net worth
Rs. 500 crore or more

OR

Profit
Rs. 5 crore or more

As per the financials of immediately preceding financial year

Provision before Companies (Amendment) Act, 2017	Provision after Companies (Amendment) Act, 2017
Text of section 135: Networth/Turnover/Profit ***as per any financial year.*** MCA general circular dated 18th June, 2014: Clarified that term any financial year means "**any of the three preceding financial years**"	Networth/Turnover/Profit has to be evaluated as per the financials of '**immediately preceding financial year**'. Ex: To determine CSR applicability of FY 2021-22 we have to check trigger limits as per the financials of 2020-21

Whether net profits to be considered for CSR applicability should be before or after tax?

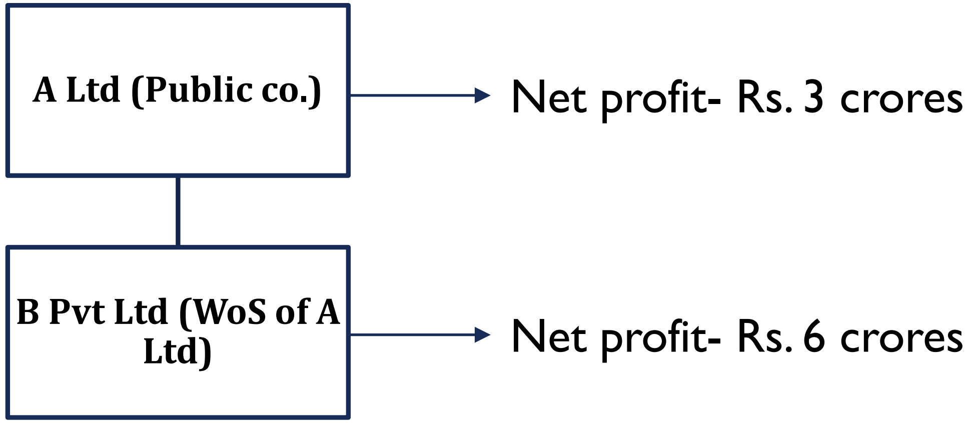
Net profit for the purpose of section 135 of CA, 2013 has to be considered before tax. **(MCA FAQ no. 3.1)**

Applicability (2/2)

- Applicability of CSR provisions on following companies:

Public co.	• Yes. Shall apply if limits are triggered
Private co.	• Yes. Shall apply if limits are triggered
Section 8 co.	• Yes. Shall apply if limits are triggered **(MCA FAQ 1.3)**
Deemed public company	• Shall apply only when limits are triggered
Foreign co.	• Shall apply to foreign companies defined under CA, 2013
Company under liquidation	• As the co. is under liquidation there are no profits hence no CSR expenditure required
Co. which has not yet completed three years	• Yes, shall apply if limits are triggered, average to be taken of preceding years **(MCA FAQ no. 1.4)**

Applicability of CSR provisions on WoS

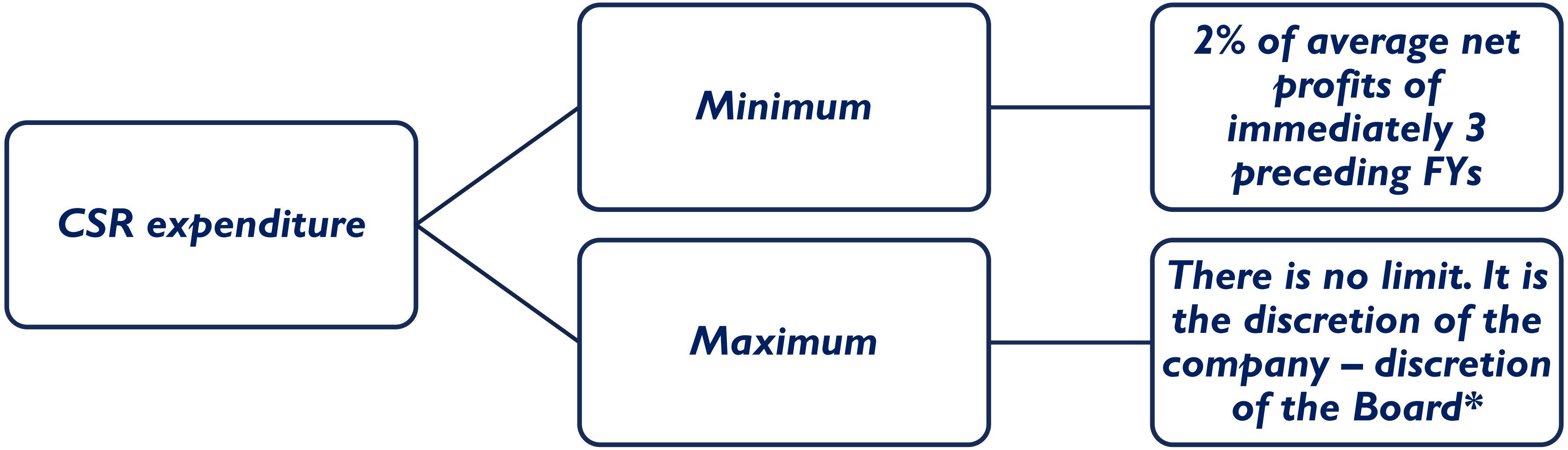


- Applicability of CSR provisions is to be seen company wise **(Refer MCA FAQs on CSR 1.2)**
- It is not necessary that if CSR provisions are applicable on holding company it will automatically be applicable on WoS
  - By virtue of being subsidiary of the company
- The limits of CSR are to be checked for each company on individual basis
- In the instant case
  - CSR is applicable on WoS but not applicable on holding company

CSR EXPENDITURE

SPENDING REQUIREMENT

CSR Expenditure



*The **Board of every company** referred to in sub-section (1), shall ensure that the company spends, in every FY at least 2%....

Ex: The CSR policy of the co. mandates spending of minimum 5% of average net profits of immediately 3 preceding FYs towards CSR. What will be the minimum expenditure requirement for this co.?

Since the policy provides a stricter limit of 5%. The minimum expenditure for the Company shall be 5% and not 2%.

Scope of CSR Expenditure, and exclusions

- Definition of CSR in Rule 2 (1) (d) seeks to exclude several items from CSR spending
- Earlier definition defined what CSR includes, viz., by reference to Schedule VII, but revised definition has a list of exclusions.
- Further, the expression **"statutory obligation"** is notable
- 6 exclusions specified in Rules
- However, in any case, Schedule VII still remains the list of activities/subjects

- Exclusions:
  - Activities undertaken in pursuance of normal business of the company
  - Activities outside India, except training of sports personnel
  - Contribution, direct or indirect, to a political party
  - Activities benefiting employees
    - Erstwhile provisions explicitly excluded families of employees as well
  - Sponsorship for deriving marketing benefits for products/services
    - However, brand building as a collateral benefit does not vitiate spirit of CSR ***(MCA FAQ no. 4.3)***
  - Activities for statutory obligations

Concept of ‘normal course of business’ in CSR

- Black Law’s Dictionary defines the term “ordinary course of business” as “normal routine in managing trade or business.
- Generally, normal course of business refers to something that company does **ordinarily** to conduct its business activities.
- Rule 2(1)(e) of CSR Rules, 2014 defines CSR Policy as document which provides list of activities to be undertaken by the company but excludes activities undertaken by the company in the normal course of business
- Rule 4 of CSR Rules, 2014 provides that:
  - *CSR activities shall be undertaken by the company as per its policy but excluding activities undertaken in normal course of business*
- Rule 6(1)(b) also provided similar reference
- Since inception, CSR in India has always focused on differentiating CSR objectives and business objectives of the company.
- On the contrary, MCA on 28th March, 2014 vide an affidavit clarified that CSR activities which is core part of its business also can be undertaken if it is not done with profit motive.

  “*pharmaceutical company donating medicines/drugs within section 135 read with Schedule VII to the Act is a CSR Activity, as the same is not an activity undertaken in pursuance of its normal course of business which is relatable to health care or any other entry in Schedule VII*”

Quoted in the Mohd. Ahmed (Minor) vs Union of India & Ors dated 17th April, 2014

Activities benefiting Employees

- Should employees be completed ousted as beneficiaries?
- If the activities are intended for larger good, and there is neither a distinctive reservation for employees, nor a distinctive exclusion, does it offend the intent?
- For example, if a Company runs a medical aid program in a hospital, does it mean the hospital should oust the employees?
- The intent is that **employer's obligation** to employees, or employee welfare activities are not taken as CSR
- Idea cannot be to deprive employees completely from social benefit programs
- The erstwhile Rules had put specific bar on the activities benefitting families of employees as well, the amended rules are silent about the families of employees
  - Will the families of employees also be excluded?
- Hence, if employees are not targeted specifically, or have any special status, the spirit of CSR is not breached
- Any activity which is not designed to benefit employees **solely**, but the public at large, and if the employees and their family members are **incidental beneficiaries**, then, such activity would not be considered as "activity benefitting employees" and will qualify as eligible CSR activity

Sponsorships etc for deriving marketing benefit

- What is excluded is activities supported by companies "on sponsorship basis for deriving marketing benefits
- Sponsorship basis implies company being a sponsor of an event
- The event is intended for **marketing benefit**
- The idea is not to rule out marketing benefit from other CSR spending
- For example, Covid-related awareness is specifically permitted as CSR activity
  - Jan 13 2021 circular
  - There may be marketing advantage from that too
- Companies should not use CSR as a marketing or brand building tool
- CSR purely as a marketing or brand building tool for their business, but brand building as a collateral benefit does not vitiate the spirit of CSR *(MCA FAQ no. 4.3)*
- However, the best strategic use of CSR is to align with the company's business model – hence, some brand assets are likely to be created by CSR spending

Calculation of net profits as per Section 198

Calculation of Net Profit as per Section 198 of the Companies Act, 2013		Amount
Profit Before Tax (PBT)		
Add/ Less items specified below:		
Credit to be given to items specified under sub-section (2)	[A]	
Credit not to be given to items specified under sub-section (3)	[B]	
Deduct items specified under sub-section (4)	[C]	
Non-deductible items specified under sub-section (5)	[D]	
Net Profit as per section 198 + [A] - [B]- [C] + [D]		

Note: 1) *If computation of PBT includes income as specified in **[A]**, then no further additions are required to be made.*

Note: 2) *If computation of PBT includes income as specified in **[B]**, then such amounts are required to be deducted from PBT.*

Note: 3) *If computation of PBT has taken into consideration expenses provided in **[C]**, then no further deductions are required to be made.*

Note: 4) *If in computation of PBT, expenses provided in **[D]** are taken into consideration then such expenses are required to be added back to the profit in order to compute normal profits.*

Calculation of net profits as per Section 198

- Profits calculated as per section 198 will ***also exclude*** the following: (Rule 2(1)(h) of CSR Rules)
  - profit from any overseas branch or branches of the company; and
  - dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act

Items under (A)

Bounties and subsidies from Govt or public authority

Items under (B)

a) Profits by way sale of shares at premium

b) Profits of capital nature

c) Profits on sale of immovable property

d) Profits on sale of forfeited shares

e) Unrealised gains, notional gains etc.

Items under (C)

a) Usual working charges

b) directors' remuneration

c) Bonus or commission paid

d) Interest on unsecured loan and advances

e) Depreciation etc.

(Includes similar specific expenses deductible)

Items under (D)

a) Income tax and super tax

b) Loss of capital nature

c) Any compensation, damages or payments made voluntarily

Example-1 : Calculation of profit as per section 198

- Vision Limited, a listed NBNC has provided the following data for the purpose of calculating profits under section 198 of the CA, 13:
  - PAT- INR 3000000
  - Tax- INR 1000000
  - Premium of issue of debentures- INR 150000
  - Profit on sale of machinery- INR 40000
  - Net gain on fair value changes- INR 80000
  - Directors' remuneration- INR 300000
  - Interest on debentures & unsecured loan- INR 100000
  - Bad debt- INR 55000
  - Loss of sale of undertaking- INR 80000
  - Unrealised gain of forex fluctuation- INR 10000
  - Govt. subsidy INTR 10000

Particulars	clause	Amt.
Profit before Tax		4000000
Credit shall be given to the following: (1)		
bounties and subsidies received from any Government, or any authorised public authority	198(2)	0
where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value.	198(3)(d)	0
Credit shall not be given to the following: (2)		0
profits, by way of premium on shares or debentures of the company, issued or sold	198(3)(a)	0
profits on sales by the company of forfeited shares	198(3)(b)	0
profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof (assuming it is forming part of PBT)	198(3)(c)	(40000)
profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company	198(3)(d)	0
any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value (assuming it is forming part of PBT)	198(3)(e)	(80000)
any amount representing unrealised gains, notional gains or revaluation of assets (assuming it is forming part of PBT)	198(3)(f)	(10000)
The following items will be deducted: (3)		
all the usual working charges		0
directors' remuneration (impact is already given in profits before tax, so no impact required)		300000
bonus or commission paid or payable to any person employed or engaged by the company, whether on a whole-time or on a part-time basis		0
any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits		0
any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf		0
interest on debentures issued by the company		0

Particulars	clause	Amt.
interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets	198(4)(g)	0
interest on unsecured loans and advances	198(4)(h)	0
expenses on repairs, whether to immovable or to movable property	198(4)(i)	0
Outgoings inclusive of contributions made to bonafide charitable and other funds	198(4)(j)	0
depreciation to the extent specified in Schedule II	198(4)(k)	0
The excess of expenditure over income, arisen in computing the net profits in accordance with this section in any year in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained	198(4)(l)	0
any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract	198(4)(m)	0
Any sum paid by way of insurance against the risk of meeting any legal liability	198(4)(n)	0
debts considered bad and written off or adjusted during the year of account		0
The following items will be not be deducted : (4)		0
Income-tax and super-tax payable by the Company under the Income-tax Act, 1961, or any other tax on the income of the Company	198(5)(a)	0
any compensation, damages or payments made voluntarily that is to say otherwise than in virtue of a legal liability	198(5)(b)	0
loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value	198(5)(c)	85000
Any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.		0
Net Profit as per 198		3955000

Example-2 : Calculation of profit as per section 198

- Mission Limited, a unlisted public company has provided the following data for the purpose of calculating profits under section 198 of the CA, 13:
  - PAT- INR 2000000 (Managerial remuneration already included in computation)
  - Tax- INR 1000000
  - Dividend income- 520000
  - Loss of sale of residential flat- 12,00,000
  - Managerial remuneration- IND 300000

Particulars	clause	Amt.
Profit before Tax		3000000
Credit shall be given to the following: (1)		
bounties and subsidies received from any Government, or any authorised public authority	198(2)	0
where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value.	198(3)(d)	0
Credit shall not be given to the following: (2)		0
profits, by way of premium on shares or debentures of the company, issued or sold	198(3)(a)	0
profits on sales by the company of forfeited shares	198(3)(b)	0
profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof	198(3)(c)	0
profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company	198(3)(d)	0
any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value	198(3)(e)	0
any amount representing unrealised gains, notional gains or revaluation of assets	198(3)(f)	0
The following items will be deducted: (3)		
all the usual working charges		0
directors' remuneration		300000
bonus or commission paid or payable to any person employed or engaged by the company, whether on a whole-time or on a part-time basis		0
any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits		0
any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf		0
interest on debentures issued by the company		0

Particulars	clause	Amt.
interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets	198(4)(g)	0
interest on unsecured loans and advances	198(4)(h)	0
expenses on repairs, whether to immovable or to movable property	198(4)(i)	0
Outgoings inclusive of contributions made to bonafide charitable and other funds	198(4)(j)	0
depreciation to the extent specified in Schedule II	198(4)(k)	0
The excess of expenditure over income, arisen in computing the net profits in accordance with this section in any year in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained	198(4)(l)	0
any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract	198(4)(m)	0
Any sum paid by way of insurance against the risk of meeting any legal liability	198(4)(n)	0
debts considered bad and written off or adjusted during the year of account		0
The following items will be not be deducted : (4)		0
Income-tax and super-tax payable by the Company under the Income-tax Act, 1961, or any other tax on the income of the Company	198(5)(a)	0
any compensation, damages or payments made voluntarily that is to say otherwise than in virtue of a legal liability	198(5)(b)	0
loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value	198(5)(c)	1200000
Any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.		0
Net Profit as per 198		4200000

Calculation of **Average** Net Profits

Profit for FY1

Loss for FY 2

Profit for FY 3

How to calculate average net profit?

FY1+(FY2)+FY3/3= Average net profits for the purpose of CSR (A)

CSR expenditure for current FY **=** **2% of A**

FAQs on CSR expenditure (1/2)

- **Whether CSR expenditure can be of revenue or capital nature?**
  - CSR expenditure can be both revenue or capital in nature
    - Expenditure which does not give rise to 'asset' may be treated as revenue expenditure.
    - Expenditure incurred by the company in the nature of 'asset' is recognized in the balance sheet as capital expenditure.
    - Economic benefits arising from CSR assets cannot be treated as a part of business profits.
- **Whether CSR expenditure can be treated as an appropriation or charge on P&L?**
  - Amount spent towards CSR needs to be appropriated unless otherwise it is incurred by the company as a part of its normal business activity.
- **Whether contribution to corpus of trust amounts to CSR spending?**
  - **Corpus is akin to the capital of trust. Since the obligation is to "spend", whereas the capital is permanent in nature, no immediate spending can be possible and hence, in our view, the same should not be considered as a CSR spending unless the context is otherwise.**
- **Whether a CSR spending exclusively for benefit for employees or their families will qualify?**
  - No. CSR spending focussed for benefit for employees and their families is not a social spending. If employees are a small part of larger audience of people in CSR spending, the same can be seen liberally.

FAQs on CSR expenditure (2/2)

- **Can CSR spending be in kind? (MCA FAQs no. 3.12)**
- The requirement comes from Section 135(5) that states that *"The Board of every company shall ensure that* ***it spends****…"* Therefore, it can be understood that the obligation is to spend. The contribution made in kind cannot be considered as CSR. *(Refer ICSI FAQs Q.55 and General Circular No. 1/2016 dated 12th January, 2016)*
- The view has been reiterated by MCA in the FAQs released by it (*FAQ No. 3.12*).

Schedule VII of CA, 2013- prescriptive list of CSR activities

i. Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

ii. promoting 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, 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 faced by socially and economically backward group.

iv. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund setup by the Central Government for rejuvenation of river Ganga.

v. protection of National Heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts.

vi. measure for the benefit of armed force veterans, war widows and their dependent, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans and their dependents including widows.

vii. training to promote rural sports, nationally recognized sports, Paralympic sports and Olympics sport.

viii. contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Schedule Tribes, other backward classes, minorities and women.

ix. Contributions to incubators or research and development projects in the field of science, technology, engineering and medicine funded by CG or SG or PSU or any agency of the CG or SG

x. Contributions to public funded universities, IITs, National laboratories and autonomous bodies established under DAE, DBT, DST, Department of Pharmaceuticals, AYUSH, DRDO, ICAR, ICMR, CSIR,

xi. Rural Development projects.

xii. Slum area development.

xiii. Disaster management including relief, rehabilitation and reconstruction.

Recent amendments in Schedule VII

Notification dated 23rd May, 2020

- PM CARES Fund has been inserted in item no. (viii) of Schedule
- Shall be effective from retrospective date i.e. 28th March, 2020

Notification dated 26th May, 2020

- Benefit to Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans and their dependents
- Inserted in item no. (vi) of the Schedule.

  Shall be applicable from 26th May, 2020

Notification dated 24th August, 2020

- Bifurcation of activities mentioned under clause (ix) of Schedule
- a) Contribution to incubators or R & D in various fields of science, technology, medicine etc

  b) Types of Ministry/Departments for collaboration with new addition of Ministry of Ayush and Department of Pharmaceuticals

Corpus contributions – whether CSR?

- Contributions to general corpus of public charitable trust, society etc
  - Not eligible as CSR expenditure
- CSR expenditure should be for a specific activity/ project/ programme
- Corpus are permanent funds of a trust
  - Not generally used to spend until dissolution of trust

- Erstwhile Rule 7 allowed contribution to the corpus of implementing agencies to be included in the CSR expenditure.
  - Pursuant to certain conditions specified in MCA Circular
- However , ***MCA FAQ 3.5*** clarifies that corpus contributions are not eligible CSR expenditure
- Further ***MCA FAQ 3.16*** clarifies that contribution to any fund in line with Schedule VII activity shall not qualify as CSR expenditure.

Limited exemption for pharmaceutical companies

- Due to COVID-19 pandemic, the Ministry has issued special exemption to pharmaceutical companies from the requirement of complying with Rule 2(1)(e)
- These companies can undertake 'normal course of activities' as its CSR activities
- The exemption is dependent on fulfilment of following conditions:

1. Should be for R & D activities for new vaccine, drugs and medical devices
2. Must be carried out in collaboration with institutions mentioned under clause (ix) of Schedule VII mostly includes incubators and R & D projects funded by Government, IITs, AYUSH, ICMR etc.
3. Applicable only till FY 2022-23
4. Must be disclosed in the Annual Report of the Company

UNSPENT AMOUNTS AND CARRY BACKWARD

Analysis of Unspent amount and Ongoing Projects 1/2

- "Ongoing Project" is defined in CSR Policy Rules [Rule 2 (1) (i)]
  - Multi-year project, stretching over more than one financial year.
  - However, not for longer than 3 years excluding the year of commencement
  - Should have commenced within the financial year to call it "ongoing"
  - 'Year' refers to financial year as defined in section 2(41) of the Act. (MCA FAQ no. 6.1)
  - Idea is to include a project which has an identifiable commencement and completion; recurring expenses which are segregatable by nature should not be included
  - For example, if Company contributes to the annual running exps of a Cancer Hospital, the spending for the next year cannot be regarded as an "ongoing project"
  - But, for example, installation of a new facility at the same Hospital, if already undertaken during the year, should be regarded as "ongoing"

- To regard it as an "ongoing project", is it necessary that some spending must have been during the financial year?
  - If there is a binding commitment on the part of the company during the financial year, the fact that nothing has been spent during the year should not preclude it from "ongoing" status
  - The idea of retention of money is for something which would need to be spent based on committed funds
  - The essence of the retention is - Rolling the expense to the next year, and claim it to be expense of this year.

An ongoing project will have 'commenced' when the company has either issued the work order pertaining to the project or awarded the contract for execution of the project ***(MCA FAQ no. 6.2)***

Analysis of Unspent amount and Ongoing Projects 2/2

- So, what is the Company expected to do end-of-year:
  - The CSR Target is based on average of 3 preceding years – hence, that is unimpacted by the current year's accounts
  - However, aggregation of all that is spent (Spending) during the FY needs to be done
  - Total Shortfall = Target – Spending by end of FY
  - Identification of "Ongoing Projects"
  - Identification of further outlay required for Ongoing Projects upto the expected completion date (Ongoing Project Outlay)
  - Transferable Shortfall = Total Shortfall – Ongoing Project Outlay
  - Transfer Transferable Shortfall within 6 months of EoY

- Whose responsibility is it to identify Ongoing Project and Ongoing Project Outlay?
  - Going by Rule 4 (6), the identification of Ongoing Project, Ongoing Project implementation schedule, as well as Ongoing Project Outlay are **Board** responsibilities
  - Non-compliance of sec. 135 (5) and (6) attract the penal provisions of sec. 135 (7)
- What happens to money retained for Ongoing Projects, but not spent there?
  - Transfer to Unspent Fund within 30 days from the end of third financial year
  - Assuming that the implementation schedule stretches only to the next financial year, can the Company still retain unspent funds for 3 years?
    - Does not seem logical

Characteristics of Unspent money on Ongoing Projects

- It must be a "project", and not merely a spending
- The project should have been a part of the CSR plan for FY 20-21
  - The idea of unspent money on ongoing project is that there was something which was expected to be completed in the financial year, but could not be completed
- The project should have been commenced, and it not yet completed
- If a project was originally a multi-year project, and the cash outlay was originally scheduled to be spent in subsequent years, can it be called unspent money for FY 20-21?
  - Does not seem logical

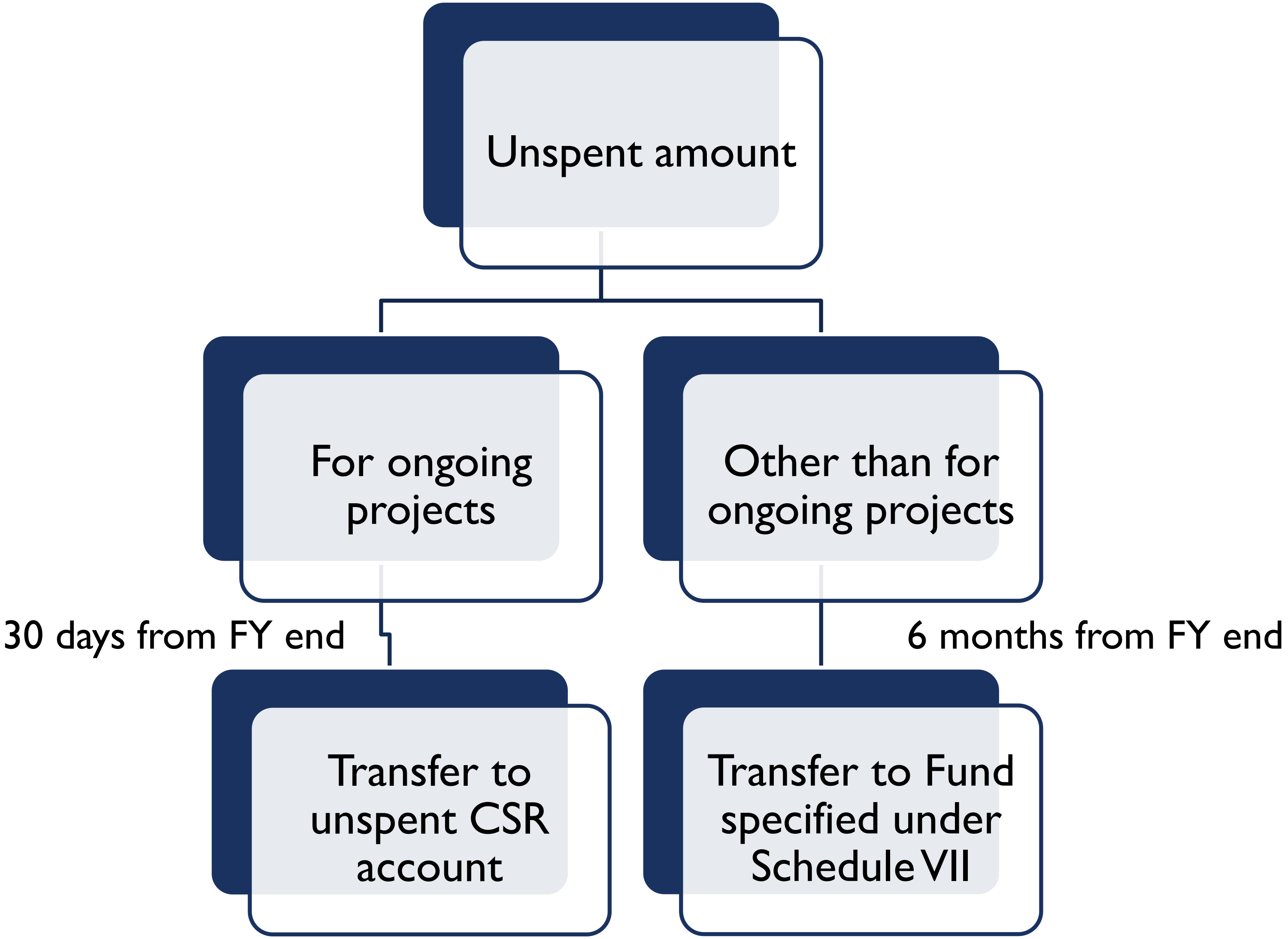
- Does the project have to be completed within 3 years?
  - The idea is not to rule out long-term projects. Several developmental projects may, by definition, be long-term projects
  - The idea is to limit the dragging of unspent money to a time-bound frame

As per the definition, the maximum permissible time period shall be 3 FYs excluding the FY in which it is commenced i.e., (1+3) FYs. Under no circumstances shall the time period of an ongoing project be extended beyond its permissible limit. ***(MCA FAQ no. 6.3)***

Leading Unspent Funds for Ongoing Projects

- Unspent Funds that go to National Unspent CSR Fund go irretrievably
- Hence, there may be a strong motivation on the part of companies to retain the Funds for Ongoing Projects
  - Timely identification of Ongoing Projects
  - Do Ongoing Projects have to be part of a pre-approved CSR "Action Plan"?
    - In reality, in most companies, it is not possible to identify all CSR projects at the start of the year. Spending opportunities keep arising through the year and the CSR Committee continues to approve the same
- Presumably, a Company may retain Unspent Funds, within 3 years of retention
- However, given the penal implications of sec. 135 (7), it should not be a good idea to have an ambitious retention plan
- Board disclosures in case of retention:
  - If funds have been retained for Ongoing Projects, is that itself an explanation for Unspent Funds?
    - Target Spending pertains to the financial year, and therefore, should have been expected to be spent during the year
    - Not spending during the year, and spilling over for Ongoing Project, itself should require explanation
- Comprehensive disclosure requirements for Ongoing Projects

Treatment of unspent amounts



Carry backward of CSR shortfall

- Concept of carry backward:
  - Shortfall of CSR spending in any year can be adjusted against excess spending in any previous year
- 3rd proviso to sec 135 (5) provides
  - if the company spends an amount in excess of the requirements provided under this sub-section, such company may set off such excess amount against the requirement to spend under this sub-section for such number of succeeding financial years and in such manner, as may be prescribed
- Rule 7 (3) provides for a time frame of 3 immediately succeeding years for adjusting that excess spending
  - The set off need not be spaced out – it may be in any of the 3 years
- However, puts conditions:
  - The excess shall not include surplus arising from CSR activities
  - The Board shall pass a resolution to this effect
- Board resolution to what effect? And in which year?
  - In author's view, excess spending in any year is a **matter of fact – that is not something that requires a decision**
  - However, the decision to adjust the surplus is a decision, and that should require a board resolution – for set-off

Capital assets, surplus, etc

- Surplus from CSR to be ploughed back
- Rule 7 (2) Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year
- Capital assets can be held by
  - a company established under section 8 of the Act, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number under sub-rule (2) of rule 4; or
  - beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or
  - a public authority:
  - For existing capital assets - this has to be complied within 180 days i.e by 21st July, 2020 or additional period of 90 days with the approval of Board

COMPLIANCES TO BE ENSURED UNDER CSR

IMPLEMENTATION, REPORTING AND OTHER ROLES AND RESPONSIBILITIES

Compliances to be ensured

Limits of section135(1) of CA, 2013 triggered, following compliances to be ensured:

CSR COMMITTEE

CONSTITUTION AND ROLE

Constitution of committee

- It should be a committee of Board
- With minimum 3 directors
- Atleast one should be ID out of the 3 directors (in cases where co. is req to appoint an ID)

Listed cos	Unlisted Public cos	Private debt listed cos	Unlisted Pvt cos	Deemed Public cos
3 or more directors with min 1 ID	3 or more directors with min 1 ID (if req)	3 or more directors	3 or more directors if co. has 3 directors. Can be limited to 2 members also	Structure remains unchanged of a deemed public co. Same as pvt cos’

Ambiguity on requirement of constitution of committee

- Committee is not constituted or reconstituted every year
- Applicability of CSR has to been seen on yearly basis
  - Based on the figures of immediately preceding FY
- Ex- Company has a CSR committee, but the applicability of CSR provisions keeps fluctuating. Whether company is required to have a CSR committee even when the CSR provisions are not applicable during any FY
- Applicability of constitution of CSR committee comes along with CSR provisions
  - Pursuant to section 135(1)
- If in any FY, CSR spending not required or the spending obligations is upto Rs. 50 lacs, constitution of committee is also not mandatory [Sec 135(9)]
  - Practically, the company does not have to constitute or reconstitute the committee every year
  - In the year where CSR is not applicable, the committee can remain dormant
    - This again depends if the Company is predicting future applicability of CSR provisions

- CSR Amendment Rules, 2022 resolves the ambiguity created by Rule 3(2) of CSR Policy Rules

*Every company which **ceases to be a company covered under subsection (1) of section 135 of the Act for <u>three consecutive financial years</u> <u>shall not be required</u>** to -*

(a) constitute a CSR Committee

  - Same has ben omitted to align with sec 135(1)
- New proviso inserted that requires any company having any amount in its Unspent CSR account
  - To constitute a CSR Committee and comply with section 135

Role of CSR committee

- Formulate and recommend CSR policy to Board
- Identify activities mentioned in Schedule VII as priority projects to be undertaken by the Company as CSR i.e. CSR philosophy
- Recommend the amount of expenditure to be incurred on CSR every year
- Review the status of expenditure incurred on CSR activities last year
- Monitor implementation of CSR activities including modalities of utilisation of CSR funds
- Appoint any implementing agency or trust for carrying out CSR activities includes review and monitoring
- Approve and recommend CSR report to be annexed to Annual Report

FAQs on CSR committee

- **How often does the CSR committee have to meet in a year?**
  - No prescribed time. Considering the ToR of the committee, meeting atleast once in a year seems to be required.
- **Whether CSR committee has to be constituted every year?**
  - Committee is required to be constituted when conditions are met.
  - However, if company ceases to fulfil conditions in any financial year, the company may either decide to dissolve or reconstitute on subsequent fulfilment of conditions. [Rule 3(2)]
- **Whether CSR committee can approve budget for CSR activities?**
  - CSR committee only recommends CSR budget to the Board. The Board of Directors is the ultimate authority for approving CSR budget.
- **Whether a company can approve to delegate the powers and duties of CSR committee to Board?**
  - Once the conditions are met, CSR committee has to be constituted. Further, the separate constitution of a Board committee for CSR is to achieve targeted focus on CSR. Accordingly, delegating its duties is not a correct approach. However, where the spending obligation of the company does not exceed Rs. 50 lakhs, the powers of the Committee can be exercised by the Board.

CSR POLICY

REQUIREMENT & CONTENTS OF POLICY

Requirement & contents of CSR Policy

CSR Committee → CSR Policy → BoD → Approves √

Formulates and recommend CSR Policy to BoD

List of activities to be undertaken by the company which are related to activities mentioned in Schedule VII of the Act.

CONTENTS OF CSR POLICY

- *Company's philosophy on CSR spending*
- *Targeted approach- List of priority projects as per Schedule VII*
- *Process of implementation*
- *Modalities of execution*
- *Guiding principles for formulation of annual action plan*
- *Process of monitoring and reviewing of projects or programs*
- *Surplus arising out of CSR projects shall not form part of business profits*

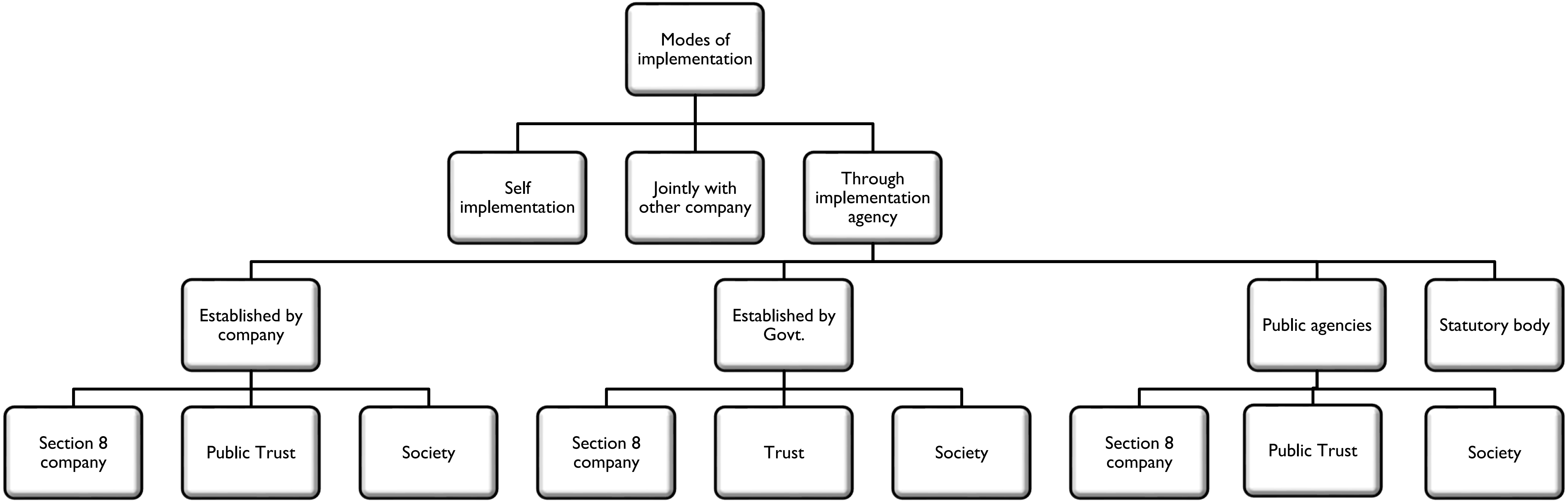
Formulation of Annual Action Plan

Role of Board of Directors

- Constitute a CSR committee
- Approve CSR policy and priority projects
- Approve annual report on CSR
- Monitor minimum spending for the purpose of CSR
- Satisfy itself regarding utilisation of funds disbursed
- Approve disclosure of reasons of unspent CSR expenditure, if any

IMPLEMENTING *through* AGENCIES

MODES OF IMPLEMENTATION



Implementing agencies

- Rule 4 provides of carrying of CSR activities either by the company itself, or through the specified implementing agencies
- CSR activities have 2 ends:
  - The Company as the principal
  - The end beneficiary(ies) as the destination
- Implementing agencies are the intermediaries, typically carrying the following functions:
  - Aggregation of spending by several group companies
  - Identification of CSR opportunities
  - Coordination with the end beneficiaries
  - Monitoring of CSR implementation
- Implementing agencies essentially save the company from the drudgery and let the company focus on strategizing, deciding and spending

- 4 types of agencies – Rule 4 (1)
  - Captives – sec 8 company, public trust, society
  - Govt agencies – sec 8 company, trust or society
  - Statutory bodies – entity under Act of Parliament or state legislature
  - Public agencies – sec 8 company, public trust or society
- These implementing agencies will need 2 registrations
  - MCA registration – in all cases
  - Income-tax registration u/s 80G – in case of 1, and 4
- Further, exemption u/s 10(23C) or regd. u/s 12A
- Trusts have to be registered with Registrar of Assurances

Implementing agencies vs beneficiary

- Implementing agencies is not defined anywhere in the Act or Rules
- Where the "mode of implementation" is not direct, CSR is said to be undertaken through implementing agency
- Indicia of principal-agent relationship
  - Bound to exercise his authority in accordance with all lawful instructions given by his principal
  - Relationship depends largely on terms of contract
  - No independent rights of agent
  - Agent needs to be instrumentality of the Company in undertaking CSR

- Beneficiary has also not been defined anywhere.
- Entity that derives benefits from CSR activities of Company, construed as beneficiary
- Independent existence and rights
- Not bound by the instructions of principal
- Direct implementation of CSR activities by the Company in its personal capacity

Whether disbursal to implementing agencies constitute "spending"?

- No, it is mere parking of funds to agency of the company ***(Refer MCA FAQ No. 7.4)***
- Agency acts on behalf of company and not independently
- Therefore, such disbursal of funds cannot be treated as spending
- Treatment of funds lying unspent with implementing agency at the end of the year
  - Same treatment as that of money lying with company

Monitoring and Implementation

Company undertakes CSR activities on its own. For ex: construction of a school

- Company may monitor the expenditure by way of obtaining regular updates from the internal CSR execution team (if any).

Company undertakes CSR activities through its own established trust or foundation

- The company may obtain quarterly or half year report from trust or foundation as to the utilisation of funds

Company undertakes CSR activities through implementing agencies

- Company should obtain utilisation certificates from such agencies and track disposal of funds

Further, the CFO or any other person responsible for the financial management shall certify the utilisation of CSR funds

REPORTING AND DISCLOSURE

Amended Annual Report on CSR

- CSR Amendment Rules, 2022
  - Prescribes amended format of Annual Report on CSR
  - w.e.f. 20.09.2022
  - Applicable for FY 22-23 onwards:
- Brief outline on CSR Policy
- Composition of CSR committee and details of Committee meetings
- Web links where CSR Committee, CSR policy and projects are disclosed
- Executive summary along with web-link(s) of Impact Assessment of CSR Projects carried out in pursuance of sub-rule (3) of rule 8, if applicable.
- (a) Average net profit of the company as per sub-section (5) of section 135

  (b) Two percent of average net profit of the company as per sub-section (5) of section 135

  (c) Surplus arising out of the CSR Projects or programmes or activities of the previous financial years.

  (d) Amount required to be set-off for the financial year, if any.

  (e) Total CSR obligation for the financial year [(b)+(c)-(d)]
- (a) Amount spent on CSR Projects (both Ongoing Project and other than Ongoing Project)

  (b) Amount spent in Administrative Overheads.

  (c) Amount spent on Impact Assessment, if applicable

  (d) Total amount spent for the Financial Year [(a)+(b)+(c)].

  (e) CSR amount spent or unspent for the Financial Year:
  - Total amount spent
  - Amount transferred to Unspent CSR
  - Amount transferred to a fund under Schedule VII

Amended Annual Report on CSR

(f) Excess amount for set off, if any:

(i) Two percent of average net profit of the company as per section 135(5)

(ii) Total amount spent for the Financial Year

(iii) Excess amount spent for the financial year [(ii)-(i)]

(iv) Surplus arising out of the CSR projects or programmes or activities of the previous financial years, if any

(v) Amount available for set off in succeeding financial years [(iii)-(iv)]

- Details of Unspent CSR amount for the preceding three financial years:

(i) Preceding Financial Year.

(ii) Amount transferred to Unspent CSR Account under section 135 (6) (in Rs.)

(iii) Balance Amount in Unspent CSR Account under section 135(6) (in Rs.)

(iv) Amount spent in the reporting Financial Year (in Rs.)

(v) Amount transferred to any fund specified under Schedule VII as per section 135(6), if any.

(vi) Deficiency, if any

- Whether any capital assets have been created or acquired through CSR amount spent in the financial year? If yes, the number of capital assets created/ acquired and the details relating to such asset(s) so acquired/ created through CSR amount spent in the financial year
- Specify the reason(s), if the company has failed to spent two per cent of the average net profit as per section 135(5)

Responsibility statement of CSR committee

- The CSR committee has to report in the annual report of CSR, which forms part of the Board's Report that implementation and monitoring of CSR policy is in compliance with CSR objectives and Policy of the Company.
- For providing this statement, the CSR committee may rely on the utilisation certificate and monitoring reports, if any obtained for the purpose of implementation.

Responsibility statement of the CSR committee

The implementation and monitoring of [*] CSR Policy is in compliance with CSR objectives and Policy of the Company

Sd/-
Chairman, CSR Committee

Enhanced website disclosures

- The following are on the website
- The Board of Directors of the Company shall mandatorily disclose
  - the composition of the CSR Committee,
  - and CSR Policy
  - and Projects approved by the Board on their website, if any, for public access.
    - CSR projects are approved on ongoing basis
    - Some of them are fairly minor in terms of expense
    - It will be reasonable for the board to make a policy and disclose only material projects

Overhead expenses- capacity building

- "Administrative overheads" means
  - the expenses incurred by the company
  - for 'general management and administration' of Corporate Social Responsibility functions in the company
  - but shall not include
    - the expenses directly incurred
    - for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project or programme;
- Administrative overheads shall not exceed 5% of the total CSR expenditure of the Company in one FY.

MCA FAQ 3.18 – Involvement of employees cannot be monetised to claim CSR expenditure

MCA FAQ 3.2 – Training of employees involved in CSR can be claimed as administrative overheads

Example to understand overhead expenses vs project implementation cost

- X Ltd has a tree plantation programme
- Expenditure is incurred in
  - training the employees to plant trees
  - Seeds, fertilisers and other necessary materials
  - Salary of employees planting such trees

- Administrative overheads
- Project implementation costs
- Cannot be monetised as CSR expenditure

Impact assessment

- Rule 8 (3) brings in the requirement of impact assessment
  - If the CSR target of the company, in each of the 3 preceding financial years, is Rs 10 crores or more
  - The activity or the project has an outlay of Rs 1 crore or more
  - Since the requirement applies immediately, the CSR target for FY 2017-18, 18-19 and 19-20 will be relevant, to see the impact assessment requirement for FY 20-21
  - Applies to projects completed on/after 22nd January, 2021
- Impact assessment to be carried by an independent agency
  - Who is the independent impact assessment agency?
    - Eligibility criteria left upon Board's discretion (***MCA FAQ 9.4)***
  - What exactly will be the scope and the format of the impact assessment
- By what time is the impact assessment to be done?
- To whom is the impact assessment report addressed?
  - This has to be placed before the Board [Rule 8(3)(b)]
  - This has to form part of CSR Annual Report
- Will impact assessment has to be done for projects completed by 2019-20
  - Not mandatory
  - However, companies can do as a matter of good practice (also refer ***MCA FAQ No. 9.2***)
- Impact assessment costs shall not exceed
  - 2% of the total CSR expenditure for that financial year or
  - Rs. 50 lacs, whichever is lower
    - Prior to amendment, limits were higher of 5% of total CSR expenditure or Rs. 50 lacs

Meaning of impact assessment

- The purpose of impact assessment is to assess social impact, and hence, it is called "social impact assessment"
- Impact assessment may also include "social return on investment"
- Social impact assessment and "social audit" are closed related
- International Association for Impact Assessment has several publications on the topic, mostly in context of environmental projects:
- https://www.iaia.org/reference-and-guidance-documents.php
- Several PSUs have carried out impact assessment of their various CSR projects
  - Examples
    - https://www.nmdc.co.in/CSR/NMDC_Kirandul.pdf

Time frame, scope and approach of impact assessment

- Social impact assessment takes a retro view on the CSR projects of the company – hence, it travels to concluded programs
- Rule 8 (3) seems to say that impact assessment will include CSR projects concluded at least 1 year before the study
- Hence, if done in FY 20-21, it will include projects which were concluded earlier on in FY 19-20 or before that

- Who does it:
  - Mostly academic or research entities with capabilities of field surveys, understanding the objectives of the CSR interventions
- Who is it reported to
  - Board of directors
- Is it a regular feature:
  - If the same project or similar activity is recurring in nature, it seems that impact assessment may be carried once
  - Hence, ideally impact assessment may be carried out on rotational basis, so as to cover all material projects, say, once in 3 years

Synopsis of process of CSR spending

- CSR committee shall review expenditure of prev year and note if there is any unspent amount to be reported
- Committee shall discuss and determine the focus area for CSR spending for the current FY as per the CSR policy
- Committee shall determine whether CSR projects shall be undertaken by the co. or any trust or implementing agency
- Board shall take note of minutes of CSR committee and discuss if any unspent amount is to be disclosed in the Board’s Report
- The CSR team shall initiate the activities
- The amount remaining unspent as at the end of the year shall be transferred within the specified timelines
- The CSR committee shall obtain utilisation certificates from implementing agency
- Company shall undertake impact assessment and monitoring of activities undertaken

Penal implications under CSR provisions

- Sec 135 (7) specifically relates to 135 (5) and (6)
- Which means the penalty mentioned in sec. 135 (7) is payable only for failure to spend the target CSR amount, or failure to transfer the money to Unspent CSR Account
- Penal provisions include:
  - Penalty on company
    - Upto twice the amount required to be transferred to fund specified in Schedule VII or Unspent CSR a/c
    - Rs. 1 crore, whichever is lower
  - Penalty on officers in default
    - 1/10 of amount required to be transferred to fund specified in Schedule VII or Unspent CSR a/c
    - Rs. 2 lakhs, whichever is lower

- For the other mandatory provisions of Sec. 135, or the CSR Policy Rules, there is no specific penalty provisions
  - Sec. 450 applies where there is no specific penalty
  - Rs 10000 plus Rs 1000 Per day subject to maximum of
    - Rs. 2 lacs on the company
    - Rs. 50,000 on officers-in-default

Some queries on CSR

Queries (1/2)

Q. Will CSR spend be an appropriation or a charge on P&L?

The amount spent on CSR needs to be appropriated unless otherwise it is incurred by the company as part of its normal business activity which also qualifies for CSR activity, in which case, it will continue to be charged to P&L in the normal course.

Q. Whether contribution to corpus of the trust made by the company amounts to spending?

No, clarified vide MCA FAQs on CSR

Q. Can a medicine company distribute medicines during the pandemic as a CSR expenditure?

Considering the intent of law, this may not qualify unless otherwise specifically stated.

Q. Can a company undertake CSR activity by using some its fixed assets, say those assets which are not in use?

Will qualify as CSR expenditure is these assets are not manufactured by the Company in the normal course of business.

Q. If the total cash outflow by the Company for the long term CSR projects is spread over a long period, say 3 years, will it be in compliance with the provisions of the Act, 2013, if the proposed budget is lying unspent as on Financial Year end?

The unspent amount is required to be transferred to unspent CSR account within 30 days of the end of the FY.

Queries (2/2)

Q. Whether expenses incurred by implementing agencies also qualify as administrative overheads?

Expenses incurred by implementing agencies for general management and administration of the CSR activities should be treated akin to the expenses incurred by the company. Therefore, the same should also qualify as administrative overheads.

However , ***MCA FAQs (refer Q 3.3)*** holds a different view on this.

Q. Can the funds lying unutilized in the unspent CSR account be used for making investment such as Fixed Deposit? If yes, whether the income/interest generated from such investment be used for any other business use?

In our view, the parking of money needed for ongoing CSR projects serves two purposes – first, it gets insulated from the rest of the operating funds of the company, and two, it indicates a firm commitment to spend the money. If the scheduled spend of a particular year went to the next year, it does not mean there will be cost overrun. If there was a cost overrun, it would amount to CSR spending of the next year. However, interest on the parked money is the company's money. Merely segregation of the money into a separate account does not render the money as a third party or social fund, on which interest also belongs to the beneficiary of that money.

However, The ICSI FAQs on CSR says that the interest on the temporarily parked funds will also be construed as surplus arising out of CSR and therefore, rule 7 (2) pertaining to surplus arising out of CSR activities will apply. (Refer Q No. 46)

Thank You!