

CNK & Associates LLP

Corporate Social Responsibility (CSR) – An Overview

In Brief

India is the first country in the world to introduce statutory CSR through the Companies Act, 2013. Since then the provisions of CSR have undergone several modifications. Summary of provisions of CSR also incorporating amendments introduced by the Companies (Amendment) Act, 2020 and Companies (CSR Policy) Amendment Rules, 2021 are given herewith. These amendments are applicable from 22nd January 2021.

Introduction

As per the Companies Act, 2013 (**the Act**), CSR is mandatory in India. The Ministry of Corporate Affairs (MCA) had notified 1st April 2014 as the date on which the provisions of Section 135 and Schedule VII of the Act came into force.

Synopsis of Section 135 read with Companies (CSR Policy) Rules, 2014

Meaning

CSR means the activities undertaken by a Company in pursuance of its statutory obligation laid down in Section 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
- ▲ 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 under Section 182 of the Act
- ▲ activities benefitting employees of the company as defined in Section 2 (k) of the Code on Wages, 2019
- ▲ 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

Applicability

Section 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 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, Turnover and Net Profit of a foreign company should be computed in accordance with the Balance Sheet Profit and Loss Account prepared in accordance with the provisions of Section 381(1)(a) and Section 198 of the Act. (It may be noted that the computation of Net Profit is similar to the computation for managerial remuneration – subject to certain further adjustments for Net Profit as mentioned hereunder)

Every Company which **does not meet** the above-mentioned criteria for **3 consecutive FYs** is not required to –

- ▲ Constitute a CSR Committee; and
- ▲ Comply with provisions of the Section 135 of the Act

till such time it meets the criteria mentioned above.

The Central Government (**CG**) may give such general or special directions to a company or class of companies as it considers necessary to ensure compliance of provisions of this section and such company or class of companies shall comply with such directions.

Definition of Net Profit

For an Indian Company

Net profit as per the financial statement (**FS**) 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 Section 135 of the Act.

For Foreign Company

Net profit as per the Profit and Loss Account prepared in terms of Section 381(1) (a) read with Section 198 of the Act.

Contribution

The Board should ensure that in every FY, the company spends, 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

towards CSR

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.

CSR Expenditure

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

- ▲ Any surplus arising out of the CSR activities **will 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 transfer such surplus amount to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the FY.
- ▲ Any amount spent in excess of the CSR obligation can be set off against the CSR obligation up to immediate succeeding 3 FYs subject to the conditions that –
 - the excess amount available for set off should not include the surplus arising out of the CSR activities
 - the BoD of the company should pass a resolution to that effect.
- ▲ 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 section 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:

Any capital asset created by a company prior to the commencement of the Companies (CSR Policy) Amendment Rules, 2021 (*i.e.*, 22nd January 2021), should within 180 days from such commencement (*i.e.*, 20th July 2021) comply with the requirement of this Rule, which may be extended by a further period of not more than 90 days with the approval of the BoD based on reasonable justification.

**Administrative overheads mean the 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.*

§ CSR Policy means a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan

Failure to contribute towards CSR

If the company fails to spend CSR amount, the BoD’s 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 within a period of 3 FYs from the date of 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.

@ “Ongoing Project” means a multi-year project undertaken by a company in fulfilment of its CSR obligation having timelines not exceeding 3 years excluding the FY in which it was commenced and should include such project that was initially not approved as a multi-year project but whose duration has been extended beyond 1 year by the BoD based on reasonable justification.

Until a fund is specified in Schedule VII, the unspent CSR amount, if any, should be transferred by the company to any fund included in schedule VII of the Act.

Penalties

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-

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

CSR Committee of Board

- ▲ The 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 the 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;
 - a foreign company covered under these Rules- the CSR Committee should comprise of at least 2 persons of which one person should be as specified under Section 380(1)(d) of the Act (*i.e., person resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company*) 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 is granted from constitution of the CSR Committee and functions of such Committee will be discharged by the BoD of such company
- ▲ The BoD Report should disclose the composition of the CSR Committee.

Role of CSR Committee

The CSR Committee should –

- ▲ formulate and recommend to the BoD, a CSR Policy indicating the activities to be undertaken by the company in areas or subject, specified in Schedule VII;
- ▲ recommend the amount of expenditure to be incurred on the activities referred above; and
- ▲ monitor the CSR Policy of the company from time to time
- ▲ formulate and recommend to the BoD an annual action plan in pursuance of its CSR policy, which should include the following -
 - the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;
 - the manner of execution of such projects or programmes as specified in the Rules;
 - the modalities of utilisation of funds and implementation schedules for the projects or programmes;
 - monitoring and reporting mechanism for the projects or programmes; and
 - details of need and impact assessment, if any, for the projects undertaken by the company:The BoD may alter such plan at any time during the FY as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Role of BoD in respect to CSR

- ▲ After taking into account the recommendations made by 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; and

- ▲ 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 BoD on their website, if any, for public access.

CSR Implementation

- ▲ The BoD should ensure that the CSR activities are undertaken by the company itself or through -
 - a company established under section 8 of the Act, or a registered public trust or a registered society, registered under Section 12A and 80 G of the Income Tax Act, 1961, established by the company, either singly or along with any other company, or
 - a company established under Section 8 of the Act or a registered trust or a registered society, established by the CG or State Government; or
 - any entity established under an Act of Parliament or a State legislature; or
 - a company established under Section 8 of the Act, or a registered public trust or a registered society, registered under Section 12A and 80G of the Income Tax Act, 1961, and having an established track record of at least 3 years in undertaking similar activities.
- ▲ Every entity who intends to undertake any CSR activity, should register itself with the CG by filing the form CSR-1 electronically with the Registrar, with effect from 1st April 2021. However, the provisions of this sub-rule will not affect the CSR projects or programmes approved prior to 1st April 2021. 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 Form CSR-1 on the portal, a unique CSR Registration Number will be generated by the system automatically.
- ▲ A company may engage international organisations for designing, monitoring and evaluation of the CSR projects or programmes 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 programmes 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.
- ▲ The BoD of a company will satisfy itself that the funds so disbursed have been utilised for the purposes and in the manner as approved by it and the Chief Financial Officer or the person responsible for financial management shall certify to the effect.
- ▲ In case of ongoing project, the BoD 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.

CSR Reporting

- ▲ The BoD's Report should include an Annual Report on CSR activities for FY commencing on or after 1st April 2020
- ▲ In case of a foreign company, the Balance Sheet filed under Section 381(1)(b) should contain an Annual Report on CSR activities containing particulars specified in Annexure I or Annexure II, as applicable.
- ▲ 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, 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 impact assessment reports should be placed before the BoD and annexed to the Annual Report on CSR.

A company undertaking impact assessment may book the expenditure towards CSR for that FY, which should not exceed 5% of the total CSR expenditure for that FY or Rs. 50 lakh, whichever is less.

CNK Comments:

- ▲ *The provision for adjustment of excess spending in one FY against spending in subsequent FY and non-constitution of CSR Committee where spending is less than 50 lakhs is welcome:*
- ▲ *Though provisions regarding prosecution for non-compliance of CSR, have been dropped, penalties introduced for unspent CSR on the company and its officers are stringent and would require companies to be more vigilant in ensuring that amount on CSR is spent within time;*
- ▲ *The Rules mandate companies to register their entities conducting CSR, perform impact assessment of large projects and offer more flexibility in the utilization of CSR funds and promote ease-of-doing business;*
- ▲ *Changes like making it mandatory for companies to transfer capital assets created from CSR funds to public trust, society or Section 8 Company (non-profit organisation) will ensure transparency in compliances;*
- ▲ *Companies will now have to closely monitor compliance with CSR Rules, CSR spending and the reporting thereon. Many companies may even consider appointing an external agency to independently certify the compliance with these provisions.*

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