Draft CSR Rules Make CSR More Prescriptive

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Background

While the Indian corporate houses are busy decoding the various aspects of the amended CSR provisions brought in by the Companies Amendment Act, 2019 (yet to be notified), the much awaited changes to the existing CSR Rules ('Rules') have been rolled out by the Ministry of Corporate Affairs ('MCA') in its draft avatar ('Draft CSR Rules[1]').

As we know that the transition under the CSR provisions has been in the direction of 'COREX' to 'Comply or Pay Penalty' (COPP), various provisions under the amendment are still in a nascent stage in terms of the manner of implementation. Many interesting changes have been set to roll out for carrying our CSR activities including changes with respect to detailed annual report on CSR, CFO certification, impact assessment for certain companies, National Unspent CSR Fund in addition to clarifying or defining 'ongoing projects', 'unspent CSR account', 'transfer to Fund specified under Schedule VII' which have been extensively and granularly discussed and stated under the draft set of rules.

This note is an attempt to critically cover the Draft CSR Rules and discuss the issues that may crop up with the notification of the said rules in its current form.

Tentative timeline for implementation

The financial year for which the amended CSR provisions will be effective is still not clear since neither the amended provisions under section 135 is notified nor the Draft CSR Rules contain the effective date of its application.

Having said that one may take clue from the Draft CSR Rules where under Rule 7 (4) it mentions the following:

> *"**Unspent balance, if any, towards fulfilment of CSR obligation at the time of commencement of these Rules shall be transferred within a period of thirty days from the end of Financial Year 2020-21 to special account** viz., 'Unspent Corporate Social Responsibility Account' opened by the company and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year."*

On reading the aforesaid and in the absence of any specific and immediate actionable on the companies, one may take a view that the amended CSR provisions may be effective for the financial year 2020-21 and not 2019-2020.

Proposed Negative Attributes for CSR Activities

While CSR has been made into a *statutory obligation*, the Draft CSR Rules have marked certain negative attributes in the list for CSR activities which includes the following:

- Activities undertaken in the normal course of business by the spending company.

[1] http://feedapp.mca.gov.in/csr/pdf/draftrules.pdf

    - While this has been excluded specifically, however, similar restriction was placed by the rules under the definition of the CSR Policy as well under the clause of CSR Activities given under Rule 4 (1) of the Rules.

- Activities undertaken outside India.
    - This again was specifically excluded under Rule 4 (4) of the Rules.

- Contribution of any amount directly or indirectly to any political party under section 182 of the Act.
    - The same was already excluded by virtue of Rule 4 (7) of the Rules.

- Activities that significantly benefit the employees of the company and their families.
    - While there was a similar restriction, however, the Draft Rules define what is meant by the term 'significant benefit' to the employees which will make the activity ineligible to qualify as a CSR activity. Further, this negative attribute is on the number of beneficiaries being benefitted from the CSR activity carried out by the company.

VKC Comments: *The negative attributes enlisted are more or less similar to the restrictions placed under the Rules. However, the only interesting item is the last point which clearly brings out the fact that any activity which has effect of benefiting* ***25% or more of the employees*** *of the spending company will not be considered as a CSR activity. The fair comment on this would be that making CSR provisions heavy with the rules rather than being driven by principles may encourage the business houses to look for ways in which the benefit might go to less than 25% of the employees in number while the value of benefit may be comparatively be much higher. On the contrary, the onus should have been placed on the CSR committee to ensure that the CSR activities are broad based and reach out to large section of the public.*

Further, looking at the prevalent CSR practices for certain companies, the numerical limitation may have a significant impact on the existing arrangement of the companies where the number of beneficiaries under a CSR activity of a company are in excess of the aforesaid limitation.

Meaning and signifance of the term '*Ongoing Projects*'

One of the most important changes under the amended CSR provisions is the demarcation between '*On-going Projects*' and '*Non-Ongoing Projects*'. While the law brought these two terms, it did not clarify the exact meaning of the same.

On-going projects have been defined under the Draft CSR Rules to mean the following:

> *":"Ongoing Projects" means a multi-year project undertaken by Company in fulfillment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall also include such projects that were initially not approved as a multi-year project but whose duration has been extended beyond a year by the Board*

based on reasonable justification."
The definition of the said term has the following features:

- Multi-year project;
    - One time activitiy will not be qualifying for the same.
- Timeline to complete the project shall be 3 years excluding the year of commencement;

VKC Comments: While the definition has been brought with the aim of giving clarity, it is still covered with ambiguities. The manner of checking the multi-year coverage is not clear as to whether the same has to be tentative or fixed. Say for example a project has commenced in the month of February of one financial year and may continue for say 5 months or so, in that case, looking at the language, the same seems to be covered under multi-year project. Also, the restriction of three years on the said projects seems unreasonable considering the nature of activities involving CSR may have longer gestation periods.

CSR Implementation, Expenditure and Committee

Certain key takeaways in terms of the CSR expenditure, implementation and the Committee are given below:

- **Implementation**
  Unlike the existing provisions where a company can undertake CSR activity even through section 8 companies , registered trusts or societies belonging to anyone (provided it has a track record of 3 years in carrying of similar CSR activities), the Draft CSR Rules now restrict the implementation only through the following:

  (a) by itself or collaborating with any other company with separate monitoring;
  (b) a company established under section 8 of the Act, or
  (c) any entity established under an Act of Parliament or a State legislature.

The existing implementation arrangements prior to the commencement of the Draft CSR Rules will remain unaffected though.

Further, there are few new requirements like:

- For entities mentioned under clause (b) and (c) above to register themselves with the Central Government by filing e-form CSR-1 with fees.
- Engaging international organizations for designing, monitoring and evaluation of the CSR projects or programmes as per the CSR policy as well as for capacity building of their own personnel for CSR.
- Engaging the international organizations for implementing CSR with the prior approval of the Central Government
- Obtaining CFO certification for satisfying the Board that the funds have been utilized for the specific purposes.
- Board needs to monitor the time bound utilisation of the funds.

__VKC Comments:__ This proposal seems to be very interesting since the CSR activities would now be possible either through section 8 companies or entities established under an act of Parliament or State Legislature. Seemingly trust would not fall under the same. It only includes seems to include only incorporated entities and therefore, spending through the trust would cease to qualify. Hence, considering the practical scenario where thousands of companies have settled their own trust only for the sake of carrying out CSR will be of no use.

While this change is proposed mostly in view of the provisions of compulsory spending of the CSR funds, however, the rule driven intent again becomes evident. There are strong chances of that this particular proposal might face strong opposition from big corporate houses who carry out CSR activities through in-house foundations.

- **Expenditure**
  - **Building implementation agency -** shall not exceed five percent of total CSR expenditure of the company for the financial year and companies undertaking impact assessment, in pursuance of sub-rule (3) of Rule 8, may incur administrative overheads not exceeding ten percent of total CSR;
  - **Surplus dealing** – will not form part of the business profits but ploughed back to same project or Unspent CSR account.
  - **Holding of assets acquired** – shall be held by a section 8 company (charitable objects) only and any assets acquired as on the date of commencement of these rules, shall be transferred to such section 8 company within 180 days + 90 days with specific permission of the board for reasonable justification.

__VKC Comments:__ The most interesting part under this segment is that a company will not be holding the assets it acquired for the CSR purposes and transfer it to a section 8 company only. This leaves no scope for the companies to benefit from the assets so acquired.

- **Committee, Policy, Reporting and Website Disclosure**

I. The CSR committee will be required to frame *an annual action plan* in line with the CSR Policy which shall 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;
- the modalities of utilization of funds and implementation schedules for the projects or programmes; and
- monitoring and reporting mechanism for the projects or programmes.
- details of need and impact assessment, if any, undertaken by the company.

II. "CSR Policy" will now be required to contain the *approach and direction given by the board* of a company, as per recommendations of its CSR Committee, for selection, implementation and monitoring of activities to be undertaken in areas or subjects specified in Schedule VII of the Act.

III. A company with the average spending obligation of INR 5 cr or more in the immediately preceding three financial years shall be required to *undertake impact assessment* for their CSR projects or programmes, and shall disclose details of the same in its Annual Report on CSR.

IV. Disclosure of the CSR committee, CSR Policy as well as the Projects approved by the board on the website of the company is proposed to be made mandatory.

VKC Comments: *Looking at the proposed rules, it is evident that Indian business houses will not be able to carry on CSR as a philanthropy or charity but as a strategic, conscious and responsible call towards the society with the sole intent of bringing a positive change and upliftment.*

Framing of the action plan is one such move in the direction. Further, the CSR Policy will no longer be in its existing form since it will be now required to include the approach and direction of the board members for selecting the CSR areas they want to focus on. Accordingly, framing the action plan seems to be one of the immediate actionable as mechanical listing of activities will no longer serve the purpose.

Also, companies with large CSR spending have been made to undertake the impact assessment out their contribution to the society through their CSR activities.

Detailed report on CSR

The additional items proposed to be included in the detailed report on CSR are as follows:

i. Web-link where composition of CSR committee, CSR Policy and CSR projects approved by the board is disclosed on the website of the company;

ii. Details of Impact assessment of CSR projects carried out in pursuance of sub-rule (3) of Rule 8 of Companies (CSR Policy) Rules, 2014, if applicable (attach the report);

iii. Surplus arising out of the CSR projects/ programmes or activities for the financial year;

iv. CSR amount spent / unspent for the financial year along with the date of transfer;

v. Bifurcation of the amount spent in on-going and other than on-ongoing projects;

vi. Administrative overheads;

vii. Details of CSR amount spent/ unspent for the preceding three financial years with details of transfer to Unspent CSR account, National Unspent CSR Fund and details of the funds remaining to be spend in succeeding financial years;

viii. Amount transferred to 'Unspent CSR Account' pursuant to sub-rule (4) of Rule 7 of Companies (CSR Policy) Rules, 2014 for the financial year 2014-15 to 2019-20;

ix. Details of any asset created through CSR

Conclusion

Looking at the intent of the Draft CSR Rules, it is evident that CSR will not be a simple affair anymore. Also, the lawmakers are focusing on sustainable CSR and will not allow any CSR fund to be left unspent either with the company or in the National Unspent CSR Fund which is proposed to be constituted for carrying out CSR activities. Also, it is imperative to mention that the discussion in this write-up is based on the draft set and therefore, one will have to wait to see the final set once out to accurately comment on the impact. Having said that, it is equally important to understand the fact that companies would need a reasonable time period to respond to these changes and effectively carry out the same in tune with the intent. Accordingly, while CARO, 2020 has made one the reporting points on CSR, it will be important to see the commencement date of the amended provisions on CSR.