

A note on latest Changes in CSR Rules

(Companies (CSR Policy) Amendment Rules 2020)

(Please note these are draft rules. Govt has requested for comments by 28 March, after which, presumably by 31st March we would get Final Rules. So if there are any provisions, with which one is uncomfortable, it is strongly suggested that comments be posted on MCA website on following link.)

<http://feedapp.mca.gov.in/csr/>

1. New Definitions

A specific definition of CSR has been provided in context of S.135, however largely it is on similar lines as earlier provisions, except following:

1.1 CSR Activities which provide benefit to employees too

Earlier there were no restrictions, and the words used were ‘*should not be only restricted to employees*’¹. Thus rule technically allowed expenditure on employees as long as the same was not restricted to employees only. **However new rule restricts CSR expenditure upto a maximum of 25% to employees and their families. [Rule 2(1)(c) proviso]**

This would be an improvement in terms of spirit of CSR.

1.2 CSR Policy

Earlier definition talked of projects / activities to be undertaken under CSR. This created confusion amongst practitioners of CSR, whether so called CSR Policy was to be a policy document or list of projects to be undertaken. This has been made more logical, with CSR Policy definition now specifically requiring Board (based on CSR Committee recommendation) to provide **approach and direction** for selection, implementation etc. of the activities. Of course these activities (read projects) have to be within the confines of Sch VII.

¹ Earlier Rule 4(5) now removed and covered through CSR Definition under Rule 2(1)(c)

1.3 CSR Action Plan

Rule 5(2) now specifically requires CSR Committee to prepare CSR Annual Action Plan which would include

- list of CSR Projects or Programmes,
- Identify who will be implementing the project (i.e. company or an implementing agency)
- Implementation schedule (i.e. whether an ongoing project or otherwise)
- Monitoring & Reporting mechanism
- Need and Impact Assessment details

1.4 International Organisations

Rules now have a new definition of International Organisation, which has to be as per *Section 3 of United Nations (Privileges & Immunities) Act 1947*. This seems to be result of hard lobbying by UN institutions to be able to access CSR funds both for implementation, as well as design, monitoring, evaluation of projects and capacity building of its staff.

It may be noted for implementation purposes there has to be a prior approval by the central Govt. **[Rule 4(3)]**

1.5 Net Profit

There is no change in the definition of 'Net Profit', which continues as per earlier Rules.

1.6 Ongoing Projects

- CSR Rules now recognise that for better impact projects would need to last longer than one year, accordingly it has now defined something called as 'Ongoing Projects'. However the Rules still define such projects for a period of maximum of 3 years. Although the initial period (year in which it was initiated) would not be counted in 3 years. In a way Govt is recognising that for long projects, a large part of first year may be spent on planning & mobilising, hence it has allowed such projects to be 3+ years.
- Managements are now required to identify such projects and disclose them separately in its list of CSR projects & report at the end of the year.

- Rule 4(5) further requires Board to monitor ongoing projects, with reference to timelines, year-wise allocation, implementation, etc. It would also be competent to make changes in smooth functioning of such projects within permissible overall timelines.
- Govt has also allowed to convert any current project, initially considered restricted to the year in which it was initiated, to be classified as an 'ongoing project'. This would be important as this would allow managements to consider projects which have not been completed in the year of initiation to be extended beyond one year. This will allow companies to transfer the funds to an *Unspent Corporate Social Responsibility Account*. **Failing this the amount may need to be transferred to a Govt specified fund.**

2. CSR Implementation

Several major changes have been made under this section.

2.1 Section 8 Companies to implement CSR projects

One of the drastic change brought in these draft rules is that companies required to implement CSR can do so either directly or only through a S.8 company. This would be a major dampener on CSR execution, as presently 90% of the organisations in the Voluntary Sector are Trusts or Societies. Not clear what Govt would achieve through such restriction on this form of non-profit entities. All those who would implement CSR would need to file Form CSR-1 with ROC. (see Form CSR-1 at the end of the Note). As societies & Trusts are not registered as corporate entities, they would not be able to file this Form. This seems to be the only logical explanation why the Govt has limited the implementation to S.8 companies. We only hope that the Govt will understand what a spanner it would be in the CSR implementation process and would allow Societies & Trusts also to implement, with due representations from the Sector, otherwise it in all probability would significantly dampen pace of execution of CSR projects.

It may be noted that projects already approved prior to commencement of these amended rules will not be affected by these changes. Hence if companies have already initiated projects with a Society or Trust, that can continue without interruption.

It may be further noted that requirement of 3 year successful track record condition as imposed on non-profits is no longer there.

2.2 CSR Expenditure incurred needed to be certified by CFO

Specific requirement has been included in the Rules for Board to satisfy that the expenditure incurred on CSR is in the manner as approved by it. CFO or 'equivalent' is now required to certify to this effect. Though rule is slightly modified, earlier requirement was to have the CSR Annual report signed by the CEO/MD and Chairperson of CSR Committee. The report also includes a responsibility statement almost to the same extent. Obviously without CFO's approval Board would not have signed such a statement / report.

But now with this rule, Govt has directly made Finance Head of the organisation accountable for the CSR Report.

3. **Administrative Expenses**

Earlier rule 4(6) on administrative expenses has been removed and replaced with a new rule 7(1). Since earlier rule while limiting administrative overheads to 5%, also referred to expenditure incurred on capacity building of staff as well that of the implementing agencies. Many took a very strict interpretation of admin expenses that it included admin expenses of everyone, that is, of the company and of the implementing agencies. Companies started imposing unrealistic conditions on admin expenses of NGOs.

The new rule 7(1) while still keeps admin expenses limit to 5%, with some exceptions, refers to administrative expenses incurred in implementation of CSR projects. This while does not directly refer to implementing agencies, but many with past experience may still interpret it to cover admin expenses of the company as well as the implementing agencies. Intention during discussions with CSR High Level Committee was that it should be interpreted as admin expenses of the company. Hence the companies may wish to represent to Ministry of Corporate Affairs to make it adequately clear by changing phrase '*...admin exps. incurred in pursuance of sub-section 4(b) of section 135...*' to

*'...admin exps. incurred by **the company** in pursuance of sub-section 4(b) of section 135'*

However the new rule specifically allows 10% of admin expenses in the year in which it undertakes Impact Assessment Studies. Does this rule leave a loophole for a company to spend 10% on admin expenses in each year, if it undertakes an impact assessment report in every year. (also refer to para 7 below to know more about Impact Assessment)

4. Surplus arising from CSR projects

Earlier rule only stated that the surplus arising out of CSR projects / activities will not form part of business profits, however *the proposed rules* now state that such funds will be either used for the same project or these will be deposited in Unspent CSR Account, and will be utilised in pursuance of CSR Policy and CSR Action Plan of the company. **[Rule 7(2)]**

Hence in future, it is important that the companies build in provisions in the projects on how any income generated from project activities will be utilised in future.

5. Assets arising out of CSR Projects

No specific provision is there in existing rules on how assets would need to be treated. The *proposed rules* suggest that an asset created out of CSR funds should be either handed over to a Section 8 company with charitable objectives or a ‘public authority’ as defined under RTI Act of 2005². It further states that, in case, on the date of these rules coming into effect, there are any such assets not held by such entities (*S.8 company or public authorities*), then they would need to be transferred to such bodies within 180 days of the rules becoming effective.

This would mean that any asset currently held by a society / Trust may need to be transferred to such specified entities / authorities.

6. Transfer of Unutilised Funds to Unspent Accounts

For transfer of funds, projects can be classified in two broad categories ‘ongoing projects’ i.e. multi-year projects as defined in these rules and ‘other than on-going projects or say one year project’.

² The RTI Act defines “public authorities” in Section 2(h) –

A “public authority” means any authority or body or institution of self- government established or constituted – (a) by or under the Constitution; (b) by any other law made by Parliament; (c) by any other law made by State Legislature; (d) by notification issued or order made by the appropriate Government, and includes any – (i) body owned, controlled or substantially financed; (ii) non-Government organization substantially financed, directly or indirectly by funds provided by the appropriate Government.

- a) As per second proviso of S.135(5), any unspent funds for projects, which are not 'ongoing projects' would need to be transferred to one of the Govt funds as specified under Sch VII, within six months of the end of the Financial Year.
- b) As per S.135(6), in case of 'ongoing projects', a company would need to transfer any unspent fund to a separate account (owned by the company) named *Unspent Corporate Social Responsibility Account*. It will be allowed to spend these funds within next 3 years, however any fund remaining unspent at the end of these 3 years, would need to be transferred to one the Fund accounts specified under Sch VII.

This would throw up a question, how funds transferred to an implementing agency as per agreement and not completely utilised at the end of the year, even if it is an ongoing project, would the agency need to transfer back the funds to company at year-end, which will then transfer it to Unspent CSR fund account, and then again transfer to the implementing agency.

This could unnecessary create complications, and may result in companies changing their accounting policies of recognising any advance given as an expenditure in their books or asking the implementing agency to implement on reimbursable basis. All these are unnecessary complications and rules need to suitably amended.

Another important issue would be exactly when do these provisions relating to transfer of funds, become applicable. Considering current financial year (2019-20) is drawing to close, and companies did not have any opportunity to classify projects as ongoing or otherwise. It is likely that the requirements of transfer of funds would be applicable only after end of FY 2020-21. A clue to this effect can also be seen, within Rule 7(4) relating to transfer of funds, which states 'transfer of funds from the end of FY 2020-21'.

It may be noted that statutory auditors are now required to report on this aspect of compliance (transfer of funds) through its CARO report (Companies Auditor's Report Order 2020).

7. Reporting requirements (Rule 8)

- 7.1 While requirement of reporting are generally same as earlier, that is through Directors' Report in the Annual Report. However details of

Annexure have undergone several changes. See attached new Annexure format at the end of this Note.

- 7.2 Companies having ‘obligation’ to spend Rs 5 crore in immediate three preceding financial years would **need to undertake Impact Assessment of their CSR projects** and disclose the details of the same in the CSR Annual Report.
- 7.3 A foreign company would need to attach the CSR Annual Report in the same format with its Balance Sheet filed and prepared under S.381 of the Companies Act.

8. Display on Website (Rule 9)

A company would need to mandatorily disclose following on its website for public viewing:

- Composition of CSR Committee
- CSR Policy
- Projects approved by the Board in the format as provided in the Annexure

While rules do not mention, exactly when these are to be displayed, considering these are documents which require Board approval, it is presumed that these should be displayed soon after these have been approved by the Board.

Disclaimer: This Note has been prepared for general understanding of proposed changes made in Draft CSR Rules 2020, and our understanding of the laws as currently applicable, and have been provided for enhancing knowledge for preparing reader to understand various aspects of changes proposed in CSR legislation. It does not form any contractual relationship for any action taken by anyone based on this Note.