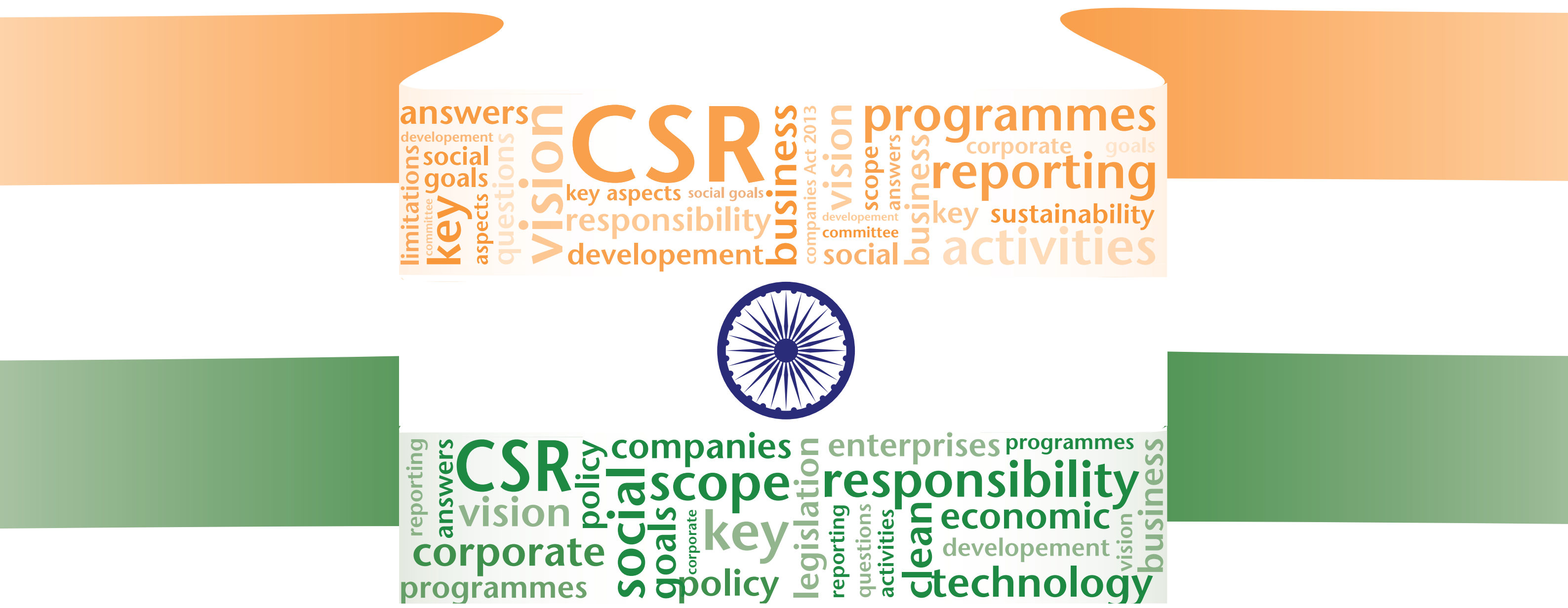
business solutions for a sustainable world



The India Companies Act 2013

A primer for WBCSD members with operations in India

wbcsd India

CII
Confederation of Indian Industry

CII-ITC Centre of Excellence for Sustainable Development

WBCSD and India

India is home to 1.2 billion people, a fast growing economy and vibrant business community, coupled with severe poverty, rapid urbanization, water stress and limited energy access. It is one of the front lines of sustainable development.

Achieving the Vision2050[1] set out by the World Business Council for Sustainable Development (WBCSD), a world in which 9 billion people live well and within the boundaries of the planet by mid-century, requires the active engagement and insight of the Indian business community.

The WBCSD has established a legal entity and staff team in India to support and increase the Indian representation within the membership of WBCSD, and to support more business action by members in India. The WBCSD India office provides a platform for members to engage with other Indian corporates, industry, policy, NGO and media audiences to address sustainability challenges. It also partners with other Indian organizations, most notably the CII-ITC Centre of Excellence for Sustainable Development, part of the WBCSD's Global Network of partner organizations[2], to accelerate and scale up progress toward business solutions for a sustainable world.

At time of going to print, 10 Indian headquartered companies are members of the Council, and more than 40 member companies members are engaged with WBCSD India on programs and action in the country.

This brief aims to provide WBCSD members with operations in India with a primer on India's legislative Corporate Social Responsibility (CSR) mandate. The ensuing pages capture the facts of CSR legislation in India, with the aim of providing fact-based information on the legislation in a detailed manner. Opinions or judgements on legislation are beyond the scope of the brief.

For information on your business and sustainability in India, including the WBCSD programs your company can engage in, please contact:

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1. See **www.wbcsd.org/vision2050.aspx**
2. The WBCSD's Global Network is an alliance of 66 CEO-led business organizations across 64 countries worldwide, united by a shared commitment to provide business leadership for sustainable development in their respective countries or regions. See **www.wbcsd.org/global-network.aspx**

Companies operating in India should also bear in mind three national initiatives of the **National Democratic Alliance (NDA)** government led by Prime Minister Narendra Modi, which came in to power in 2014:

Swaach Bharat Abiyan: a campaign focusing on provision of sanitation to all Indians by 2019, with improved municipal waste management and clean-up of India's river system, particularly the Ganga. See **www.swachhbharat.mygov.in**

Smart Cities Initiative: a scheme to bring better development and planning into 100 of India's cities, improving mobility, infrastructure, service provision and governance. See **www.smartcities.gov.in**

Make in India: an effort to make India a global manufacturing player, while providing an additional 10 million jobs a year as India's fast growing population come of working age. See **www.makeinindia.com**

"There is a real opportunity from a sustainability point of view to be creative on how we invest this money in areas such as renewable energy"

Tony Henshaw,
Group CSO, Aditya Birla Group

India's legislative CSR mandate

India's corporate law got a major upgrade in 2013 with the Companies Act 2013[3], drafting of which was influenced by corporate scandals in India and elsewhere. Its intent is to improve accountability and responsibility of companies when it comes to business conduct. The Act, which came into effect in April 2014, manages to clinch a couple of "first in the world" moves. One of them is Section 135, popularly known as "the CSR clause".

Interestingly, the Act makes Corporate Social Responsibility (CSR) a matter of corporate governance from planning, monitoring, and reporting perspectives. Contrary to the popular belief that the Act mandates 2% spending on CSR activities, it actually requires companies to spend this amount, or to explain why they did not.

The matter is mainly covered in Section 135 of the Companies Act 2013. Schedule VII of the Companies Act, attached to Section 135, lists development areas which CSR activities should be designed to address. Section 135 is implemented via CSR Rules 2014 .

The issue brief is structured along five subsections of Section 135. CSR Rules pertaining to each sub-section are covered wherever applicable. Schedule VII and accounting rules clarified by the Institute of Chartered Accountant of India (ICAI) are covered thereafter.

Applicability of the CSR clause

The first sub-section of Section 135 covers the financial scale of companies it applies to and the corporate governance structure requirement. It concerns companies with:

- A net worth of INR 500 crore or more (US$ 75 million), or
- A turnover of INR 1000 crore (US$ 150 million) or more, or
- A net profit of INR 5 crore (US$ 0.75 million) or more during any financial year.

This includes foreign companies defined under clause (42) of section 2 of the Act.[4]

Any company which does not meet the financial criterion mentioned above for three consecutive financial years does not have to constitute a CSR Committee. It also does not have to comply with the remaining provisions of Section 135.

3. Access the document at **www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf**
4. (42) "Foreign company" means any company or body corporate incorporated outside India which - (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner.

CSR Committee

A company having met the criterion, is supposed to constitute a CSR Committee of the Board. The CSR Committee should consist of three or more directors, out of which at least one should be an independent director. With respect to a foreign company, the CSR Committee shall be comprised of at least two persons, of which one person is nominated by the foreign company. The other person is the one who is authorized by the foreign company to accept on its behalf service of process and any notices or other documents required to be served on the company.

In a nutshell, the CSR Committee is a mandatory board-level committee, similar to an Audit Committee or Remuneration Committee. The company should have roles and responsibilities of the CSR Committee documented and communicated clearly to Committee members and other boards, and also disclose these roles and responsibilities along with those of other Board Committees.

The CSR Committee is required to:

- Formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
- Recommend the amount of expenditure to be incurred on the activities referred to in the CSR Policy; and
- Monitor the CSR Policy from time to time.

The CSR Rules mention that the CSR Committee should put in place a transparent monitoring mechanism for implementation of CSR projects or programs or activities undertaken by the company. The Rules do not define the concept of "transparent". The Rules also do not prescribe monitoring mechanisms for implementation of CSR projects.

Since the notification of the Act and the CSR Rules, there have been formal discussions between the Ministry of Corporate Affairs, business, and other stakeholders on monitoring mechanisms. For now, it is left to the companies to develop their own monitoring mechanisms, considering the diversity of development areas and varied approaches different projects in the same development area might follow.

Responsibilities of the Board

While the CSR Committee is responsible for implementing and monitoring the CSR Policy, the Board is responsible for approvals and ensuring that the CSR Policy is implemented. Section 135 states that the Board shall:

- After taking into account the recommendations made by the 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;
- Ensure that the activities as are included in CSR Policy of the company are undertaken by the company; and
- Ensure that the company spends its annual CSR budget.

How much to spend?

Every company, in each financial year, is required to spend at least two per cent of its average net profits during the three immediately preceding financial years. For instance, to determine CSR budget for FY16, the average of net profits (i.e., profit before tax) of FY13, FY14 and FY15 is calculated. Two percent of that average is the CSR budget for FY16.

Section 135 mentions that CSR spend should be at least two percent each financial year. That means companies may spend more than two percent in any financial year. However, that extra spend cannot be adjusted or compensated for less than two percent spends in subsequent financial years.

When any company has met the qualifying financial criteria, but its average net profit for the past three years is not positive, which effectively means there is no money to spend on CSR, the company still has to constitute a CSR Committee, have a CSR policy in place, and disclose that it did not have money to spend.

In case the company fails to spend at least two percent in a given financial year, the Board is required to specify the reasons for not spending the amount and disclose that in the annual Director’s Report. This “comply or explain” clause of Section 135 effectively means that it is not mandatory for companies to spend at least two percent on CSR.

What is a CSR Policy?

The concept of "CSR Policy"relates to the activities to be undertaken by the company as specified in Schedule VII and the expenditure thereon. The CSR Policy should include the following:

- A list of CSR projects or programs which a company plans to undertake falling within the purview of Schedule VII;
- Specify modalities of execution of such project or programs;
- Implementation schedules for the same; and
- Monitoring process of such projects or programs.

Policies typically are documents of intent or commitment. Policies do not include annual activities and action plans. This is where CSR Policy requirements seem to go beyond a typical policy. The way to resolve this is to structure the CSR Policy into two parts:

1. The actual policy with the company's philosophy or vision for social responsibility, developmental and geographical areas of intervention, approach to project or program implementation, CSR budgets, and governance and monitoring mechanisms. This part remains more or less constant over years.
2. The annual plan, to be posted on the company's website. It does not have to be detailed, but should provide a good overview.

Development areas mentioned in the CSR Policy should relate to the areas mentioned in Schedule VII. The Policy should also specify that surplus arising out of the CSR projects or programs or activities will not form part of the business profit of a company, but should be ploughed back into CSR activities.

"As well as working on sustainability in the core business, we are using a part of our profits to support social and economic change and give back to the people we are working with. 3% of our profits are directed towards these activities, primarily strengthening education systems, and primarily through the Jain Charitable Trust."

Dr. Dilip Kulkarni,
President, Agri-Food Division,
Jain Irrigation

Disclosures

The CSR legislation rests on the premise of comply or explain. It does not mandate CSR spend but mandates reporting spend and the lack of it. Everything about Section 135 – governance, policy, activities, and spends – should be disclosed in the Board's report as part of the Annual Report. The Director's Report should disclose composition of the CSR Committee, specifying the Chairperson, the mandate of the CSR Committee, and the number of times the CSR Committee met in a financial year. This part should be supported by an Annexure on CSR. The format of the Annexure is provided in the CSR Rules. In the case of a foreign company, the balance sheet filed as per the requirements of the Companies Act 2013 should contain the Annexure on CSR.

As per the format for the Annexure on CSR, the company should disclose:

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs;
2. The Composition of the CSR Committee;
3. Average net profit of the company for the last three financial years;
4. Prescribed CSR Expenditure (two per cent of the amount as in item 3 above);
5. Details of CSR spent during the financial year;

   a. Total amount to be spent for the financial year;

   b. Amount unspent, if any.

The format for the Annexure also prescribes a table to provide details of the CSR activities. Companies may choose to adapt the table but should cover all the tabs mentioned in the format.

1	2	3	4	5	6	7	8
Serial Number	CSR Project or activity identified	Sector in which the project is covered	Projects or Programs: 1. Local area or other 2. Specify the state and district where projects and programs were undertaken	Amount outlay (budget)	Amount spent on the projects or programs sub-heads: 1. Direct expenditure on projects or programs 2. Overheads	Cumulative expenditure up to the reporting period	Amount spent: direct or through implementing agency
				Total			

In case the company has not managed to spend the two per cent of the average, it should provide the reasons for not spending the amount in its Board report.

The annexure on CSR should be signed off by the CEO, Managing Director, or Director, as well as the Chairman of the CSR Committee, along with a responsibility statement of the CSR Committee that the implementation and monitoring of the CSR Policy is in compliance with CSR objectives and Policy of the company.

What is CSR?

CSR is defined as projects or programs that relate to activities or development areas mentioned in Schedule VII of the Companies Act – as outlined below. In this context, it is important to underscore that the activities or development areas mentioned in Schedule VII are fairly broad, and that the Ministry has clarified that these need to be liberally interpreted.

Other points to consider while determining CSR projects or programs:

- Companies should give preference to the local area and areas where they operate;
- The target audience should preferably be the poor, vulnerable, marginalized, or disadvantaged. However, there might be projects or programs that are targeted at the general population, e.g. consumer awareness, road safety, etc.;
- Projects may be undertaken in rural or urban areas, wherever the target audience is located;
- Projects can be undertaken only in India.

What themes does Schedule VII stipulate?

1. Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water:
2. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
3. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centers and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
4. 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;

5. 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:
6. Measures for the benefit of armed forces veterans, war widows and their dependents;
7. Training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports;
8. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
9. Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
10. Rural development projects.

What is not eligible for funding under the 2%?

CSR Rules do exclude certain type of activities from being considered for CSR, namely:

- Projects or programs or activities that benefit only the employees of the company and their families;
- Contribution of any amount directly or indirectly to any political party under section 182 of the Companies Act;
- One-off marketing or sponsorships, even if for a social cause;
- Activities undertaken in pursuance of normal course of business. The Companies Act does not define “normal course of business”. Companies may use the Memorandum of Association or equivalent document for definition. Standard operations or functions to conduct business may be considered as normal course of business;
- Activities undertaken outside India.

How to implement CSR activities?

CSR activities may be implemented in following ways:

- Directly by the company, wherein the company develops and implements CSR projects and works directly with beneficiaries;
- Through implementing agencies, where the company appoints organizations with relevant expertise. Implementing agencies should be organizations registered as a Trust, a Society or a Section 8 Company, with an established track record of three years in undertaking similar programs or projects. Foreign companies operating in India should ensure that the implementing agencies receiving funds for CSR activities should have regulatory clearance to receive foreign funds (see FCRA section below);
- Through a Corporate Foundation, where the company mandates its corporate foundation to conduct CSR activities as per the CSR Policy of the company. Corporate foundations can be registered as a Trust, Society or Section 8 Company;
- Through any other company that is also required to comply to Section 135 of the Companies Act. A company may also collaborate with other companies for undertaking projects or programs 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 programs in accordance with these rules.

"The Godrej Group has always actively championed social responsibility. Twenty-five percent of the shares of our Group's holding company are held in trusts that support healthcare, education and environmental sustainability. As part of our Vision 2020, we are committed to creating a more employable workforce, building a Greener India and innovating for good and green products. Till date, we have trained over 1,30,000 youth in skills that will enhance their earning potential. In line with our greener India commitment, we are making environmental sustainability a key part of the manufacturing process and value chain across our businesses. And through innovation in our product pipeline, we are developing products that are safe and environmentally sustainable. Thus we are completely in sync with the current CSR bill."

Vikas Goswami / विकास गोस्वामी
Head Good and Green
Godrej Industries Limited and Associate Companies

The Foreign Contribution Regulation Act (FCRA)

FCRA regulates foreign contributions to non-profit organizations (NPO) in India. Under the FCRA, NPOs can only accept contributions from a foreign source once they register with or obtain prior permission from the Central Government. Without FCRA approval, grantee organizations in India may not legally receive foreign contributions from any donor.

According to Section 2(j) of the FCRA that defines 'foreign source', any entity with over 50% investment from foreigners, PIOs (People of Indian Origin), OCIs (Overseas Citizenship of India), foreign companies or FIIs is considered a foreign source. Therefore, an Indian subsidiary of a foreign company and any Indian company which have foreign ownership of more than 50% is treated as foreign sources.

If an Indian subsidiary of a foreign company or Indian company with substantial foreign ownership wants to create a foundation for undertaking its CSR obligation, it will have to obtain FCRA registration before doing so. They will also have to ensure that implementing agencies that are not-for-profit will have to register in order to receive contributions from such foreign sources.

The NPO must be at least three years old to even qualify for registration. Thus, the only way for a new foundation to accept foreign contributions is to obtain prior permission from the government. This permission is applicable to a specific project and specific amount, which means that the NPO cannot use it for a different project or for additional funding for the same project.

FCRA's applicability depends on the way CSR is implemented. If a foreign source company pays NGOs to do charitable work, the NGO must have FCRA permission. If the company works directly with beneficiaries, then no FCRA is required. The most common way in which CSR is administered in India, however, is through the company's own foundation or trust. These trusts should get FCRA registration before accepting any grant or donation from the mother company.

If the foundation contracts another NGO, the latter should have FCRA registration or prior permission. Secondly, the CSR grant and the interest on these funds will be foreign contributions. All the usual FCRA restrictions come into play. These funds cannot be given to political parties, media, and government officers. FCRA does not cover use of facilities without charge, or volunteering. It also leaves out some receivers such as hospitals.

From awareness to action: Six steps to good CSR

India's CSR legislation provides a governance and reporting framework for companies to make their CSR activities strategic, planned, and disciplined. In between governance and reporting, a lot depends on the company's management to give it the necessary attention and importance. The value created by CSR activities for stakeholders as well as the company will increase, provided CSR policy is aligned to business vision and strategy. Contrary to popular interpretation, CSR legislation allows companies to do that, instead of undertaking CSR as a separate activity from business.

While CSR legislation provides a governance and reporting framework, the WBCSD and the CII-ITC Centre of Excellence for Sustainable Development advice companies to take the following six steps to making CSR worth the effort.

1. Have a Vision
2. Put strategy in place
3. Set targets & KPIs
4. Identify capacities & capabilities
5. Measure to manage
6. Review to improve

1. Have a Vision

Begin with a vision of the community or the society you want to build or influence. What difference does the company want to make? What will be the impact on beneficiaries, areas, brand, and organizational culture? The vision for CSR should align with the organization's vision and mission.

2. Put strategy in place

Identify the developmental and geographic areas, and determine the degree of CSR's alignment with business: is it connected to business at all? Does it secure or strengthen the necessary social license to operate? What direct benefit does it bring to business growth?

3. Set targets & KPIs

Qualitative and quantitative indicators, monetary as well as non-monetary, are important to track progress on strategy. Identify the individuals directly responsible to address accountability. Accountability should rest with managers as well as CSR Committee members. Make these KPIs part of the organization's balanced scorecard and even functional or business balanced scorecards. In turn, the alignment to business and the efficiency in carrying out business as well as CSR activities will improve.

4. Identify capacities & capabilities

Mark out the domains where organizational knowledge or expertise can be leveraged. With respect to KPIs, identify what are the new capacities and capabilities required – and are these to be created, bought, hired, and/or acquired? Identify partners and implementing agencies. Put systems, processes, and structures in place so that implementing agencies know what is expected of them.

5. Measure to manage

Measure outputs, outcomes, impacts and returns. Engage stakeholders in measurement, remaining as independent and non-influential in the process. It is not just about displaying numbers, but also about the societal value created by various CSR activities. This should also help the CSR Committee and company board to decide which projects or programs to undertake or continue, and which ones to stay away from.

6. Review to improve

Independent stakeholder reviews and external benchmarking are important to learn from the well- and the less-performing parts of the strategy and processes of doing CSR. Identify variations from targets and do a root-cause analysis.

Looking ahead

Companies are experimenting with ways to leverage this mandated spend to have lasting impacts across the sustainability spectrum. The WBCSD and the CII-ITC Centre of Excellence for Sustainable Development will monitor developments and distill best practice. At the same time, we also acknowledge that irrespective of the legal framework, the scale of poverty and other sustainability challenges in India means that many companies operating in India are engaging in social investment.

We will continue to advocate the role, responsibility, and opportunity of business addressing societal concerns through business solutions: business-led ventures that are impactful, scalable, measurable, replicable, and going beyond business as usual.

We are guided by the conviction that these solutions represent opportunities for strengthening companies' license to operate and for driving their ability to innovate and grow. Furthermore, these solutions can only be delivered at scale through core business, rather than philanthropic programs. Lastly, solutions must be underpinned by better measurement, valuation and reporting of companies' social performance. This is essential to enable a better understanding of the business role in contributing to inclusive growth and to improve management decision-making and accountability. Ultimately, this should incentivize further business engagement by creating the conditions where more sustainable companies will succeed and be recognized.

Of course, none of this can be accomplished by business alone – good governance, economic incentives, appropriate and robust legal and institutional framework conditions, and public-private partnerships are essential for business to maximize its role.

About the Confederation of Indian Industry and the CII-ITC Centre of Excellence for Sustainable Development

The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes. CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 7400 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 250 national and regional sectoral industry bodies.

A pioneering effort by CII, the CII-ITC Centre of Excellence for Sustainable Development is an institution that creates a conducive, enabling climate for Indian businesses to pursue sustainability goals. It creates awareness, promotes thought leadership, and builds capacity to achieve sustainability across a broad spectrum of issues. CESD is the fountainhead of ideas and practices to promote sustainability. It enables Indian businesses to become sustainable, and channels the potential of Indian industry to power India's agenda for inclusive growth and sustainable development.

www.sustainabledevelopment.in

About the World Business Council for Sustainable Development

The World Business Council for Sustainable Development (WBCSD), a CEO-led organization of some 200 forward-thinking global companies, is committed to galvanizing the global business community to create a sustainable future for business, society and the environment. Together with its members, the Council applies its respected thought leadership and effective advocacy to generate constructive solutions and take shared action. Leveraging its strong relationships with stakeholders as the leading advocate for business, the council helps drive debate and policy change in favor of sustainable development solutions.

The WBCSD provides a forum for its member companies - who represent all business sectors, all continents and a combined revenue of more than $7 trillion - to share best practices on sustainable development issues and to develop innovative tools that change the status quo. The Council also benefits from a network of 65+ national and regional business councils and partner organizations, a majority of which are based in developing countries.

www.wbcsd.org

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Disclaimer

This publication is released in the name of the WBCSD and the CII-ITC Centre of Excellence for Sustainable Development. It is the result of a collaborative effort by both organizations. The document broadly represents the perspective of the WBCSD and CII membership. It does not mean, however, that every member company agrees with every word.

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