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Corporate Social Responsibility: Fallacies in Its Effective Implementation in India

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ABSTRACT

When India enacted the Companies Act, 2013, it became one of the few countries of the world to make Corporate Social Responsibility (CSR), a legal obligation for a large number of Indian companies. Using a comprehensive analysis of company's CSR disclosures, this paper provides a bird's-eye view on the major issues plaguing the current regulatory framework on CSR in India. In addition, this paper also highlights the major differences between privately owned and government companies on their motivations, approaches and challenges to the implementation and enforcement of CSR law of India. This paper largely argues that, the Indian CSR regulations are excessively broad and provide wide flexibilities that are possibly being misused, and hence, need legislative amendments to make them more concise, and improve accountability and transparency. The author in this context makes a critical and doctrinaire study over the context to investigate its implementation by the Business entities. From a broader corporate law perspective, this paper finds that while the current company law in India may have adopted a more stakeholder-centric approach by its construction, the approach of many companies towards the enforcement and implementation of CSR and the law remains essentially shareholder centric. In light of the above observations, the author would like to suggest that the existing regulatory framework needs to be strengthened with several legislative measures such as stricter auditing and monitoring measures for third-party implementing agencies and pre-and post-project impact assessment mechanisms.

I. INTRODUCTION

On 29 August 2013, India's Parliament, enacted its new Companies Act, 2013, repealing the old Companies Act, 1956, and drew worldwide attention, by boldly mandating Corporate Social Responsibility (CSR), under its new company law. The Companies Act, 2013, and more specifically, section 135, and its accompanying rules, have stirred a global debate on extension of responsibilities of a corporation to the society and other stakeholders. Under these provisions of the Indian Companies Act, 2013, companies meeting specified financial criteria are required

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to spend a part of their profits on social welfare activities as prescribed under the law.

This mandate, unlike CSR regulations in other countries, not only directs companies how much they are required spend on CSR programs, but also how they are supposed to spend this money. In this article, the authors seek to provide a critical appraisal of the overall efficacy of the Indian CSR law, by uncovering the major issues with the compliance and enforcement of India's CSR regulations, and challenges to its effective implementation. This study uses comprehensive CSR disclosure analysis along with in-depth interviews of relevant stakeholders to provide extensive information on the state of compliance of CSR law by Indian companies, and subsequently, the challenges to its effective implementation, either due to certain lacunae in the drafting of the relevant provisions or lackadaisical enforcement by the companies. In particular, unlike previous studies on the implementation of CSR law of India, this article examines the state of compliance of the Indian CSR law in its totality and does not limit its analysis to the adherence of the spending requirements under the law by Indian companies. In addition, this research takes a step ahead from the previous legal literature on Indian CSR law, by providing recommendations for further legislative development. The list of activities prescribed under Schedule VII of the Act is not exhaustive, but merely prescriptive. Recently, Schedule VII² has been subjected to many changes that have added new types of activities to the existing list of recommended activities. For instance, on 28 March 2020, it was notified that any contributions made to the Prime Minister's Citizen's Assistance and Relief in Emergency Situations Fund (PM CARES), established by the Government of India in response to the COVID-19 pandemic, can constitute a 'valid' CSR expenditure by companies.⁹ The 2% average net profits are to be calculated as per s 198 of the Act, and are essentially Profits Before

² Activities which may be included by companies in their Corporate Social Responsibility Policies: Activities relating to: —

1 [(i) Eradicating hunger, poverty and malnutrition, ["promoting health care including preventive health care"] and sanitation [including contribution to the Swachh 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 groups. (iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water [including contribution to the Clean Ganga Fund set-up 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 art and handicrafts; (vi) measures for the benefit of armed forces veterans, war widows and their dependents; (vii) training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports (viii) contribution to the prime minister's national relief fund or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;

Tax (PBT)

While the law was intended in the right direction of community socio-economic development, the inherent limitations of the law and a ‘tick-the-box’ approach to the implementation of this law by many companies has inhibited the achievement of the true spirit and objective of this unique law. While the government has taken some important steps in the direction of improving compliance of CSR law by companies, there is still a long way to go to improve the overall number of companies meeting, at least, the spending requirement under this legal framework. Based on this study’s findings, this article recommends that the Indian government may either amend the existing CSR regulatory framework, or enact a sui generis law on CSR to incorporate some of the recommendations made by Ministry of Corporate Affairs.

II. THE CSR RULES, 2014 AND THE COMPANIES AMENDMENT ACT, 2019

The CSR Rules, 2014³ provides the modalities for the implementation of the CSR Activities. The Rules require companies to constitute a CSR Committee, consisting of at least 2 directors, in case of private companies, and minimum 3 directors, in case of public companies. The CSR Committee, is responsible for formulating the CSR Policy for the company, and recommending the activities which may be undertaken by the Company and their expected expenditure.⁴ The Board of the company, based on the recommendations made by the CSR Committee, must approve the CSR policy and implement its CSR activities for the particular financial year. The contents of the CSR policy must be disclosed in its Annual Report (AR) and, also on its website. Under the law, the Board is responsible for ensuring that the spending requirements are met in accordance with the CSR policy of the company. For spending this amount, the law encourages companies to give preference to ‘local areas’ and ‘areas in and around their areas of operation’ for spending the amount earmarked for their CSR activities. In addition to spending their profits on CSR activities every year, companies are also required to report as per the format provided under Annexure (1) of the Companies (CSR) Rules, 2014. Prima facie, India follows the ‘comply-or-explain’ CSR model, meaning that if any company fails to meet the 2 per cent spending requirement, companies must provide an ‘explanation’ for their default in its AR.⁵ In case any underspending company fails to explain, it faces penalty in the form of fines, which shall not be less than INR 50,000 (USD 653.59) but may extend to INR 2,500,000 (USD 32,679.31). The officer responsible for such default shall also be fined with INR 50,000 to INR 500,000 (USD 6535.86), and may also face imprisonment for a term of one year to three years.

³ The Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 5(1).

⁴ Companies Act, section 135(2); Companies (Corporate Social Responsibility Rules), r. 5 (i), (ii).

⁵ Companies Act, section 135(5); Section 134(3)(O).

The Companies (Amendment) Act, 2019, attempted to transform non-compliance of the spending requirements of the law from a civil offence to a criminal offence and replace the 'comply-or-explain' nature of section 135 to a more 'comply-or-get-punished' model. In view of the backlash the Ministry of Finance, Government of India received from Corporate India, the Finance Minister of India, Mrs Nirmala Sitharaman, decided to keep these penal provisions 'on hold' and has constituted a 'high-level Panel' for recommendations on further course of action. If made effective, the company and its officers may be imprisoned for period of up to three years, in addition to payment of fines. In addition, companies are also required open a 'special account', known as the 'Unspent Corporate Social Responsibility Account' to transfer any unspent CSR funds, pursuant to any ongoing project, in any scheduled bank, within a period of 30 days from the end of the financial year. The company must spend this amount in the next three financial years from the date of such transfer.⁶ Failure of the company to spend this amount within the given time frame would lead an automatic transfer of this unutilized amount to any of the Central or State government funds within 30 days from the date of completion of the third financial year.⁷ Accordingly, failure of the company to create and transfer its unspent amount to this 'CSR account' would also invoke the same penalties under section 134(8) of the Act. On 4 March 2020, the Union Cabinet, headed by the current Prime Minister of India, approved the legislative changes to the Companies Act, 2013, which may be brought by the Companies (Second) Amendment Bill, 2019. With respect to CSR obligations, companies which are required to spend INR 50 million or less in a year, now would not be required to constitute a CSR committee. Furthermore, companies which spend over the obligated 2 per cent on CSR in a particular year can carry it forward as credit for fulfilment of CSR obligations for the next few years as well. To become the law of the land, the Bill must be passed by both the Houses of Parliament and receive the President's assent.

The above sections provided detailed description on the findings derived from content analysis of the Annual Reports. In general, it may be observed from the findings that many companies approach CSR and the law as merely an obligation, which they want to complete simply to avoid any penalties or loss of reputation. among their shareholders as well as stakeholders. For many Indian companies, it seems that profits come first and stakeholder needs are secondary. CSR is usually never an end goal for the company, rather, a channel to achieve or further higher goals. In particular, for government companies, CSR and its compliance with the law translates

⁶ KR Srivatsa 'Ministry Keeps New CSR Amendments on Hold' (The Hindu Business Line, 18 August 2019) accessed 04 March 2020.

⁷ Companies Amendment Act 2019 (n 18)

to contributing to the national government's projects and schemes. At the same time, current trends indicate the government may also be compelling its companies to facilitate its projects and schemes, in cases where it is unable to do so due to various reasons. Thus, CSR may have also become a tool in the hands of the government delegate its responsibilities of nation building and social well-being to the PSUs by 'requesting' them to invest in its pet projects. Such activities of the government itself raise serious doubts and concerns on the true intent of the government to enact this law and serious questions may be raised on whether the government enacted the law merely to shift its responsibilities of nation building towards the companies. These observations have important implications on the enforcement of corporate regulations in India, in particular the Companies Act, 2013, which, unlike its predecessor, the Companies Act, 1956, has adopted a strong stakeholder-centric approach. As this study as uncovered, that, while the new Companies Act, 2013 strong stakeholder-centric inclinations by design, the attitude, perceptions and approaches of the companies towards CSR remains strongly shareholder-centric. In this regard, there are wide gaps between the construction and drafting of the CSR provisions under the new companies' law in India and its actual implementation by the companies. The CSR law of India may be a step forward in the right direction of achieving social responsibility of the corporations, however this is an evolving law which needs further restructuring and development. The current construction of the law indicates towards and even encourages 'corporate philanthropy' and 'corporate charity' rather than 'CSR'. Instead of encouraging companies to integrate CSR into their business model and corporate strategies, Indian CSR legal framework has restricted its meaning to merely spending profits on social development activities. While the law has been successful to some extent in making companies to become more sensitive to a corporation's impact on their internal and external stakeholders, the state of compliance of the CSR regulatory framework, as assessed by this study, demonstrates lack of motivation and understanding of the short-term and long-term benefits of CSR among the companies. Therefore, it is uncertain to say whether India took the correct step by mandating CSR, as against having only a voluntary regime. Given that the current interpretation to the law by companies is varied and demonstrates companies' behaviours towards 'a check-the-box compliance', it is debatable whether the law can truly make companies more socially responsible. Further, current trends indicate that the MCA is moving in the direction of making non-meeting of the spending requirements under the law a criminal offence, inviting both fines and jail term, if the penal provisions under the Companies (Amendment) Act, 2019 are implemented. The authors raise concern whether such measures can steer companies towards more stakeholder-centrism and making them more social

responsible. Rather such measures may be counter-productive and compel companies to divert their focus towards CSR budget utilization, and hence, implement more short-term activities, rather than a productive use of these funds for long-term projects for any actual benefit to the community. While the government has begun to undertake reformatory measures to strengthen the enforcement of the Indian CSR law, it has concentrated mostly on the meeting of the spending requirements under the law. In fact, to the contrary, the government seems to be moving in the direction of relaxing the CSR obligations under the law. Such trends and approaches are myopic and do not address many of the issues regarding compliance with the CSR regulatory framework of India, and hence, in this regard, the government must assess the actual compliance of the law more comprehensively.

III. FALLACIES IN THE EXISTING LAW

The law must also provide mechanisms that encourage companies to plan and undertake long term rather than short term activities. Moreover, as seen from the above discussion, section 135 and its related provisions allow companies to meet their CSR obligations by simply disbursing their stipulated CSR funds to NGOs and other implementation agencies. Due to these fallacies, as seen from the findings of the study, companies have not established robust procedures for any internal monitoring and auditing of the funds utilised by implementing agencies, and whether the company's CSR initiatives have actually penetrated to local beneficiaries. In this regard, the law must provide clear parameters for auditing and detailed disclosures of the CSR funds used by NGOs and other implementing agencies, including their own foundations or trusts established for the purpose of undertaking CSR activities under section 8 of the Act. Further, as observed from the findings of the study that companies seem to align their CSR activities on those focus areas which can potentially give them some tax rebates, under sections 30–36 and 80G of the Income Tax Act, 1961, the law may be amended to provide uniform tax rebates for all types of CSR activities.

These amendments would reduce the general tendency of companies to spend on limited 'thrust areas' as observed under the study's research findings. For effective monitoring and implementation of CSR law, a specialised agency or regulatory body, along the lines of the Company Law Board and the Securities and Exchange Board of India (SEBI) may be established to regulate, supervise and advise companies and other stakeholders on implementation of Indian CSR law. Establishment of an independent and specialised agency to supervise CSR activities of companies may minimise government interference into CSR-based initiatives of companies, and may provide more organisational freedom to companies to

invest their CSR funds onto desirable activities. Such a 'regulatory watch dog' can also provide an effective mechanism of 'checks and balances' on companies diverting their CSR funds for private gains. However, the regulatory body must be given adequate power to punish defaulters and enact bye laws, notifications and rules for the effective monitoring and implementation of the various provisions. It must be headed and manned by experienced and unbiased professionals. It must be empowered to take cognizance of all cases dealing with CSR by granting supervisory, regulatory and advisory jurisdiction for adjudication of all CSR related disputes

IV. CONCLUSION

To conclude, the current Indian legal framework contains wide flexibilities, intended to provide a blanket guidance framework to the companies on which this law is applicable, are possibly being misused by many companies for their own private interests. The author, therefore, suggest that the Indian CSR law must be strengthened by either enacting a sui generis law on CSR or by introducing appropriate legislative amendments to mitigate and possibly annihilate the lacunae and anomalies arising out of the many ambiguities that are present in the drafting and construction of the extant framework. Firstly, there is huge ambiguity and inconsistency in the meaning and scope of CSR under section 135 of the Act within the companies and the government itself, which has led to varied self-interpretation of the law by the companies to suit their own private needs.

Therefore, the law must be amended to introduce a comprehensive definition of 'CSR' for the purposes of section 135 of the Act. In particular, the law must contain detailed procedures for extensive stakeholder consultations in pre-and post-project implementation stages, third party auditing of CSR reports and a uniform reporting format for disclosing reasons in case of any underspending. In this regard, the government may also introduce legislative amendments to give effect to some of the key recommendations made by the Ministry of Corporate Affairs' Second High-Level Committee Report, 2018: mandatory impact assessment and its disclosure for CSR projects valued at INR five crore or more (INR 50 million or more) (USD 1022058.96) for a given financial year and uniform tax benefits for all CSR activities. In fact, at the time of writing of the article, the Draft Companies (CSR Policy) Amendment Rules, 2020 has given effect to the above recommendation, and hence, this is a right step taken by the government in the direction of improving accountability of companies for their CSR activities. Taking a step further, the author recommends that the government must also prepare a uniform impact assessment reporting format, containing qualitative and quantitative parameters for assessment,

and compulsory third party auditing of such impact assessments. Introduction of uniform tax benefits shall ensure that companies are incentivised to take up more innovative and long-term CSR activities. In addition, the law must remove the emphasis on ‘preference given by companies for spending in local areas’ as this has resulted in uneven geographical distribution of CSR projects on few already-developed areas and neglect of underdeveloped areas. Appropriate legislative amendments are also required for enacting compulsory auditing, monitoring and disclosures in a uniform format for CSR fund utilization by NGOs and CFs,⁸ established under section 8 of the Act, for the implementation of company’s CSR projects. Companies also seem to interpret CSR as those compensatory measures undertaken in areas where the government has failed to achieve to date, since the findings also revealed indications of government interference in several CSR-based activities of companies. Such indications also raise questions about whether the government introduced legislated CSR simply in order to provide a legitimate route to compel companies to pursue its own agenda. Seemingly, the government expects companies to ‘invest in social development’, rather than undertake ‘CSR’ in actuality. Therefore, to term what are, in reality, ‘corporate social investments’ as ‘corporate social responsibility’ is perhaps, at best, a misnomer and misconstrued. Based on the above research findings and the conclusions drawn, this article suggests that the Indian CSR law must be strengthened by introducing appropriate legislative amendments or enacting a sui generis law on CSR. Legislative intervention is the need of the hour to mitigate, or even possibly annihilate the ambiguities that are present in the drafting and construction of the extant framework, and subsequently strengthen the efficacy of its implementation. Firstly, this study found that if and when companies under-spend, the language used in the reasons furnished by such companies is often vague, boiler-plate and generic. In this regard, supplementary guidelines or rules may be enacted to provide a uniform reporting format that requires companies to provide qualitative details on the reasons for under-spending for the particular financial year. As seen from the above discussion, there are grave insufficiencies within the language of the law on the concept of CSR to be followed by companies.

The companies practicing CSR should provide information about the after effects of their CSR initiative. This would help the stakeholders to understand the initiative better. Companies should focus more on CSR initiatives as it leads to the growing profits for the company.

⁸ Rule 4, Companies (CSR) Rules, 2014 permits CSR spending companies to establish their own ‘foundations’ or trusts for implementing their CSR projects, also known as section 8 companies, or ‘Companies with Charitable Purpose’

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