From Compliance to Impact: Legal Framework for CSR Fund Allocation under Companies Act, 2013

[1]**P Sowjanya**,
Research Scholar, Dept of Law, Sri Padmavati Mahila Visvavidyalayam (Women's University), Tirupati, Andhra Pradesh, India.
[2]**Dr. A. Guravaiah**
Principal A. C. College of Law, Guntur. Sambasivapet, A. P, India.
[3] **Pamarthi Satyanarayana,**
Research Scholar, Acharya Nagarjuna University is a state university in Namburu, Guntur district, Andhra Pradesh, India.

Abstract

The evolution of Corporate Social Responsibility (CSR) in India from a philanthropic endeavour to a legal requirement under the Companies Act, 2013, is a landmark development in corporate governance and social responsibility. Section 135 of the Act, along with Schedule VII of the Companies Act, 2013, requires certain companies to spend at least two percent of their average net profits for CSR purposes. This article critically analyses whether such mandatory CSR expenditure in practice has moved from mere compliance ("obligation") to achieving social and developmental impact ("impact"). This research takes a doctrinal and analytical approach in examining the legal framework for allocation of CSR funds, including the amendments, compliance, reporting and penal provisions for non-compliance. It also assesses operational issues like under-spending, transparency, project inefficiencies and the vagueness surrounding the activities considered CSR. It also examines the role of corporate boards, implementing agencies, and regulatory enforcement mechanisms, to evaluate mechanisms of accountability. The article concludes that while the legislative framework has resulted in higher CSR spending, the lack of monitoring and impact assessment, and standardisation, has prevented CSR from achieving its full potential. It concludes with suggestions for legal and policy changes to improve governance, transparency and ensure that CSR expenditure is directed at sustainable development objectives, making CSR more than a statutory obligation and contributing to social change.

Keywords: Corporate Social Responsibility (CSR), Companies Act, 2013, CSR Fund Allocation, Corporate Governance, Sustainable Development.

I. Introduction

The journey of Corporate Social Responsibility (CSR) in India from being voluntary and philanthropic in nature to a statutory requirement is a significant one. Traditionally, Indian corporations, especially family-run businesses, undertook philanthropic initiatives based on moral principles, religious beliefs, and social good. Early industrialists like the Tatas and Birlas were active in education, health care and rural development long before laws were passed mandating CSR. But these activities were ad hoc in nature, lacked consistency, accountability and impact. The advent of economic liberalization in the 1990s and the rise of globalisation in India placed a greater emphasis on the role of corporations in social development, which demanded a more formal approach to CSR.

The turning point came with the enactment of the Companies Act, 2013, institutionalising CSR. India pioneered the legislative requirement for CSR spending, a world first in corporate governance. The Act's Section 135 brought in a threshold-based provision, requiring specified companies to spend at least 2% of their average net profits on CSR initiatives. This move signals a recognition that corporations are not only profit-making machines but also play a crucial role in sustainable development. This approach is in line with worldwide trends that stress the significance of environmental, social and governance (ESG) factors, though the Indian approach is novel in that it is mandatory.

ISSN PRINT 2319 1775 Online 2320 7876
 Journal UGC CARE Listed (Group-I) Volume 10, Iss 11 2021

The shift from voluntary to mandatory CSR raises questions about the nature of CSR. Some see mandatory CSR as undermining the essence of corporate philanthropism, reducing it to a legal obligation. Yet, others argue that compulsion guarantees regular social welfare contributions and helps fill developmental deficits that are beyond the State's capacity. The development of CSR in India is therefore a mixed model, blending ethical and legal obligations, and raises questions about its efficacy, implementation and impact. The enactment of CSR law has also broadened the conversation from spending to impact, requiring corporations to align their CSR policies with national social welfare and development goals such as poverty alleviation, education, health care and environment protection.

II. CSR: The Companies Act, 2013

The CSR law in India is primarily centred in Section 135 of the Companies Act, 2013 read with Companies CSR Rules 2014 and Schedule VII of the Companies Act, 2013. This provides the legislative foundation for CSR, outlining the criteria for applicability, types of activities, governance and reporting. Corporate entities that meet certain financial criteria, i.e. having a net worth of ₹500 crore or more, turnover of ₹1000 crore or more, or net profit of ₹5 crore or more, are mandated to set up a CSR Committee of the Board. This committee shall develop and recommend a CSR policy, identify activities and monitor the CSR implementation.

Schedule VII is key to this as it lists an indicative list of CSR activities, including eradicating hunger and poverty, promoting education, gender equality, environmental sustainability and rural development. This list is comprehensive but it has also been open to interpretation, resulting in inconsistencies in CSR. The government has released several circulars and clarifications to guide a liberal, but responsible, interpretation of CSR activities, focusing on substance. Moreover, the 2019 and 2020 amendments have improved the enforcement of CSR through a penalty for non-compliance and the mandatory transfer of unspent CSR expenditure to certain funds or accounts.

What's striking about the CSR regime is its focus on corporate governance. The Board of Directors must report CSR policies and expenditure in the annual report, promoting transparency, and corporate accountability. It also acknowledges the role of implementing agencies - registered trusts, societies, and non-governmental organisations - enabling synergies between the corporate and social sectors. However, the growing regulatory complexities of compliance have led to concerns of bureaucratic drift and potential shifting of corporate attention away from CSR strategy to compliance.

In summary, the regulatory framework strikes a balance between flexibility and control. It offers corporate flexibility in choosing CSR initiatives, but also places rigorous disclosure and compliance requirements. This allows for a balance between legal compliance and social significance of CSR activities, and in turn strengthens the goal of inclusive and sustainable development.

III. CSR Fund Allocation: Legal Framework and Compliance

Indian statutes on CSR fund allocation have a structured mechanism to ensure compliance and accountability. Section 135 requires companies to invest at least 2% of their average net profits for the last three financial years in CSR. This numerical standard is a key aspect of the Indian CSR framework, setting it apart from voluntary approaches in other countries. The allocation process commences with the CSR Committee, which drafts a CSR policy that identifies the priority areas and projects, along with the budget allocation. The Board of Directors follows up on the policy by approving and overseeing the execution.

Recent changes have considerably improved compliance. Companies must now transfer unspent CSR monies contributed for ongoing projects into a "Unspent CSR Account" within 30 days from the close of the financial year to be used within three years. If not, the unspent amount must compulsorily be transferred to funds listed under Schedule VII, like the Prime Minister's National Relief Fund. Further, non-compliance leads to penalties, making CSR spending legally binding. These measures seek to resolve the above-mentioned problem of companies merely reporting their unspent amounts.

The requirement for impact assessment of substantial CSR projects is another pivotal step in CSR compliance. Organisations with substantial CSR commitments must conduct third-party impact assessments for projects above a certain financial threshold. This guarantees that CSR expenditure is not only compliant, but also efficient in delivering desired results. Additionally, the need for specific disclosures in the Board's Report adds to accountability, allowing stakeholders to assess the scope and impact of CSR measures.

However, there are still issues with allocation. Businesses face difficulties in selecting reliable implementers, developing effective projects and effective funds utilisation. There is also a bias towards investing CSR funds in areas that are easy to measure like education and health, to the detriment of other important areas. Additionally, the regulatory focus can result in a "check-box" approach, with emphasis on compliance rather than meaningful social change. Therefore, although the legal framework provides for the allocation and accountability of CSR spending, it can only be effective to the extent that it aligns with the strategic priorities and commitment of corporations.

IV. Issues with CSR Implementation: Transparency, Accountability, and Usage

Despite a strong legal foundation, CSR implementation in India faces a number of challenges that hinder its impact. A key issue is transparency in CSR initiatives. While firms are expected to report CSR spending and policies in their annual reports, the level of detail and transparency can often be lacking. Often, these reports are merely descriptive and highlight financial spending rather than qualitative results. This makes it difficult for stakeholders, such as regulators and the public, to evaluate the effectiveness of CSR programs.

Another key concern is accountability. Although the Act places the responsibility on the Board and the CSR Committee, the lack of a central watchdog body leads to oversight gaps. Monitoring is largely based on voluntary disclosures, which may not Further, the role of several implementing agencies such as NGOs and trusts presents risks of fund misuse and non-standard practices. There are reports of fund misappropriation, project duplication and underutilization, which points to a need for better oversight.

Finishing CSR funds can also be problematic. Companies often struggle to find appropriate projects and partners, resulting in underutilisation or delays in spending CSR funds. The need to allocate a certain percentage of profits may lead to rushed decisions and hasty initiatives, especially in the latter part of the financial year. Furthermore, the focus on particular geographical areas, often the regions in which companies are located, results in a lack of balanced distribution of benefits, neglecting underdeveloped regions.

The vagueness of the law, especially with regard to the types of CSR activities allowed under Schedule VII, is another issue. Although the government has taken a liberal interpretation, the absence of clear definitions may result in inconsistent practices and misuse. Moreover, the regulatory burden of the CSR framework may hinder innovation, with companies focusing more on compliance rather than innovative solutions for impact.

These issues highlight the need for a holistic and impact-driven approach to CSR. Improving transparency through reporting standards, accountability through independent audits and efficiency through strategic planning are key to unlocking the potential benefits of CSR in India.

V. Measuring Impact: From CSR Expenditure to Social Benefits

The journey from mandatory CSR expenditure to social impact is a crucial but challenging component of CSR in India. Although the mandatory component guarantees a continuous investment in social causes, the challenge is to assess the impact of these investments on social outcomes. The measurement of impact (or impact assessment) is thus crucial in determining the success of CSR efforts. But social impact assessment is complex, as many CSR activities have qualitative and long-term effects.

The new law requiring impact assessment of large CSR projects is an important milestone in this regard. The law aims to guarantee impartial and reliable assessment through independent reviews. These evaluations generally address aspects like project relevance, efficiency, effectiveness, sustainability and scalability. But the lack of uniform metrics and methods can result in evaluation inconsistencies, making it challenging to compare outcomes across projects and industries.

Finally, there is a risk that companies will prioritise short-term, measurable results over long-term transformative change. For example, infrastructure development or resource allocation may have short-term outcomes but may not impact structural problems like poverty and inequality. For impact, CSR activities need to align with other development priorities, such as the United Nations Sustainable Development Goals (SDGs). This involves moving beyond individual projects to a more systemic, multi-stakeholder approach including government, civil society and local communities.

Additionally, integrating CSR strategies with business goals can improve outcomes and sustainability. Organisations that embed CSR into their business practices are more likely to have long-term impact than those that view CSR as an external requirement. For instance, skill-building programs can build a talent pool for the community as well as the company.

VI. Conclusion

The institutionalization of CSR in India is an innovative attempt to align corporate responsibility with national goals. The legal framework has been successful in mobilising a significant amount of corporate resources for social good, thereby supplementing the role of government. But as our analysis shows, the efficiency of CSR is limited by issues associated with implementation, transparency, accountability and evaluation. To overcome these challenges, a holistic and future-oriented approach is needed to enhance legal and policy frameworks.

An important focus of reform is on improving monitoring and evaluation. Creating a regulatory agency or enhancing institutions could enhance oversight and compliance. The development of reporting standards and impact assessment tools would also ensure uniformity and allow for comparisons to inform decision making. Furthermore, using technology, such as online systems for CSR reporting and monitoring can help streamline processes and prevent misuse of funds.

Finally, flexibility in the regulatory framework is crucial. Although minimum spending guarantees continuity, this should be complemented with incentives for innovative and effective projects. Fostering partnerships between businesses, government and the community can result in more holistic approaches. The law should also ensure a balanced distribution of CSR funds, with a focus on less developed areas.

Capacity building is equally crucial. Businesses, especially SMEs, need support in developing CSR initiatives. Capacity building, best practices, and knowledge exchange platforms can increase their effectiveness. Additionally, linking CSR projects with national priorities and global agendas, such as the SDGs, can enhance their effectiveness.

In summary, CSR in India can be a driver for inclusive development. But to achieve this, CSR needs to move from a compliance-based approach to one focused on strategy, impact, innovation and collaboration. The development of the legal and policy framework, along with a culture of active corporate responsibility, will help drive the transformation of CSR from compliance to sustainable social impact.

References

1. Companies Act, 2013, s 135.
2. Ministry of Corporate Affairs, Companies (Corporate Social Responsibility Policy) Rules 2014.
3. Schedule VII of the Companies Act, 2013.
4. Nayan Mitra & René Schmidpeter, Corporate Social Responsibility in India (Springer 2016).
5. Kshama Kaushik, CSR in India: Steering Business toward Social Change (LexisNexis 2017).
6. Rupanjana (ed), Corporate Social Responsibility: Law, Accounting and Taxation Aspects (Bloomsbury 2018).
7. PwC, India, Handbook on Corporate Social Responsibility in India (2013).
8. Dhammika Dharmapala and Vikramaditya Khanna, 'The Impact of Mandated Corporate Social Responsibility: Evidence from India's Companies Act of 2013' (2018) 56 International Review of Law and Economics 92.

ISSN PRINT 2319 1775 Online 2320 7876
 Journal UGC CARE Listed (Group-I) Volume 10, Iss 11 2021

9. Afra Afsharipour and Shruti Rana, 'The Emergence of New CSR Regimes in China and India' (2014) 14 UC Davis Business Law Journal 175.
10. Surya Deva, 'Socially Responsible Business in India' (2012) 41 Common Law World Review 299.
11. S Gopalan and A Kamalnath, 'Mandatory CSR as a Vehicle for Reducing Inequality' (2015) 10 Northwestern Journal of Law and Social Policy 34.
12. D M Prasad, 'Companies Act 2013: Incorporating Stakeholder Theory' (2018) 39 Statute Law Review 292.
13. M Kansal, M Joshi and G S Batra, 'CSR Reporting in Central Public Sector Enterprises' (2018) 151 Journal of Business Ethics 813.
14. Rajkumar Shah, 'Corporate Social Responsibility (CSR) in India - Justification of a Move Towards Regulation' (2014).
15. S K Sharma and R Agarwal, 'Corporate Social Responsibility: An Overview' (2014) Prabandhan Guru 78.
16. A Verma and CV Kumar, 'A Study of CSR Spendings of Indian Companies' (2014) 7 Indian Journal of Corporate Governance 82.