



CSR

NORMS AND PRACTICES

BACKGROUND AND APPLICABILITY OF CSR



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I INTRODUCTION

Corporate Social Responsibility (CSR) has emerged as a crucial aspect of organizational accountability, ensuring that entities contribute positively to the communities they impact while aligning with legal and ethical frameworks. Understanding the nuances of CSR is essential not only for corporations but also for non-profit organizations (NPOs) that often collaborate with businesses in implementing CSR initiatives.

In this context, FMSF is pleased to come with a quarterly series “CSR Norms”, aimed at providing practical insights and guidance on various aspects of CSR compliance and implementation. Each issue in this series will delve into key aspects of CSR, offering a detailed overview to help organizations understand regulatory requirements and effectively integrate CSR into their operations.

The first issue of this series begins with “Background and Applicability of CSR”, providing a comprehensive understanding of the thresholds, legal provisions, and organizational obligations under the CSR framework. This edition will serve as a vital resource for organizations looking to align their practices with CSR norms, ensuring they meet compliance requirements while maximizing their societal impact.

II BACKGROUND

Traditionally, businesses were primarily seen as profit-generating entities, with their main responsibility being to maximize shareholder value. Social responsibility, when considered, was often linked to improving business practices by offering better products at lower prices to enhance living standards. Some corporations also engaged in philanthropic activities, but these efforts remained voluntary and dependent on individual corporate choices.

Over time, corporate governance failures exposed a critical issue. While some companies contributed to social causes, their core business practices did not always align with ethical standards. In certain cases, philanthropy was used to overshadow profit-driven decisions that compromise integrity. Moreover, businesses operating in diverse legal and social environments struggled to maintain consistent ethical standards, raising concerns about the true intent behind CSR initiatives.

In India, the concept of CSR gained significant traction with the 11th Five-Year Plan (2007-2012), which emphasized inclusive growth and recognized the pivotal role of Voluntary Organizations (VOs) in socio-economic development. The

government acknowledged the complementary role of VOs, extending financial and other forms of support to those working to strengthen disadvantaged communities. The voluntary nature of CSR evolved with the introduction of the CSR Voluntary Guidelines in 2009, which set core principles for businesses, including ethical functioning, respect for stakeholder interests, environmental sustainability, and social development. These guidelines emphasized that CSR should be integrated into business strategy and governance, with a focus on transparency and accountability.

Building on these voluntary guidelines, the National Voluntary Guidelines (NVGs) on Social, Environmental, and Economic Responsibilities of Business were introduced in 2011.

The NVGs refined the earlier framework and incorporated inputs from various stakeholders, offering Indian businesses a comprehensive understanding and approach to responsible business conduct. These guidelines outlined nine key principles designed to steer businesses towards ethical and sustainable practices.

One of the key contributions of the NVGs was the introduction of the “triple bottom line” concept, which

emphasizes the three P’s, i.e. People, Planet, and Profit. This framework encourages businesses to balance financial performance with social and environmental responsibilities, ensuring that their operations contribute positively to society and the environment while also achieving economic success.

A landmark moment in the evolution of CSR in India occurred with the 21st Report of the Parliamentary Standing Committee on Finance, which led to the inclusion of CSR provisions in the statutory framework, effective April 1, 2014. This provision, under Section 135 of the Companies Act, 2013, made CSR spending mandatory for companies meeting specific financial threshold.

Since then, the regulatory framework for CSR has continued to evolve, with subsequent amendments and clarifications aimed at ensuring effective implementation, accountability, and transparency.

Today, CSR in India has transformed into a strategic and legally mandated approach that aligns business interests with societal needs, promoting inclusive growth and sustainable development.

III WHAT IS CSR?

Corporate Social Responsibility (CSR) refers to the proactive efforts made by businesses to contribute positively to society and the environment. It is a framework that encourages companies to go beyond mere profit generation by incorporating social, environmental, and ethical concerns into their operations. This concept urges businesses to take responsibility for the impact they have on their communities and the broader world.

"Corporate Social Responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple- Bottom-Line Approach"), while at the same time addressing the expectations of shareholders and stakeholders."

-United Nations Industrial Development Organization (UNIDO)

As per The Companies (CSR Policy) Rules, 2014, Rule 2(d), "**Corporate Social Responsibility (CSR)**" refers to the activities a company undertakes in accordance with its statutory obligations set forth in **Section 135 of the Companies Act, 2013**, and in alignment with these rules. However, CSR does not include the following activities:

- **Normal Business Activities:** Any activities that are part of the company's regular business operations are excluded.
- **Activities Outside India:** CSR activities outside India are generally not covered, except for the training of Indian sports personnel who represent a state, union territory, or India at the national or international levels.
- **Political Contributions:** Contributions made directly or indirectly to any political party, as per Section 182 of the Companies Act, 2013, are excluded from CSR.
- **Employee Benefits:** Activities that primarily benefit the company's own employees, as defined under the Code on Wages, 2019 (Section 2(k)), do not qualify as CSR.
- **Marketing and Sponsorship Activities:** Activities undertaken on a sponsorship basis for marketing benefits related to the company's products or services are not considered CSR.
- **Statutory Obligations:** Any activity carried out to fulfill other legal obligations under any existing law in India does not qualify as CSR.

This clarifies the boundaries of CSR, ensuring that companies focus on genuine contributions to social welfare, sustainability, and community development, rather than activities that are part of their core business, marketing strategies, or statutory compliance.

IV CSR PROVISIONS

1. APPLICABILITY

Section 135(1) of the Companies Act, 2013 mandates that the Corporate Social Responsibility (CSR) provisions apply to every Indian company that meets at least one of the following criteria during the immediately preceding financial year:

- Net worth of rupees five hundred crore or more,
- Turnover of rupees one thousand crore or more,
- Net Profit of rupees five crore or more.

The Companies (CSR Policy) Rules, 2014 have expanded the scope of compliance obligations to include holding and subsidiary companies as well as foreign companies with branches or project offices in India. However, CSR applicability is determined individually based on the above prescribed criteria. This means that a holding or subsidiary company must independently meet the financial thresholds (net worth, turnover, or net profit) for CSR provisions to apply. The mere existence of a holding-subsidiary relationship does not automatically extend CSR obligations from one company to the other.

4. TURNOVER

Turnover refers to the total revenue or sales a company generates from its business activities during a specific period, typically a year. It includes all the money received from selling goods or services before any expenses are deducted. Turnover is a key indicator of a company's business activity and performance, showing how much business the company is doing.

Section 2(91) of The Companies Act, 2013 states that "turnover means the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year".

2. AMOUNT TO BE SPENT ON CSR

The companies to which CSR provisions apply, are required to spend in every financial year, at least **two percent of the average net profits** of the company made during the three immediately preceding financial years.

If the company has not completed three financial years since its incorporation, but it satisfies any of the criteria mentioned in section 135(1), CSR provisions will still apply. In such cases, the CSR amount shall be calculated based on the average net profit of the immediately preceding financial years.

Example: Company A is incorporated during FY 2023-24. Now, if Company A meets any of the CSR applicability criteria in the financial year 2023-24, such as having a net worth of ₹500 crore or more, a turnover of ₹1,000 crore or more, or a net profit of ₹5 crore or more, then the provisions of Section 135(1) of the Companies Act, 2013, will apply to the company from the financial year 2024-25 and the 2% CSR obligation will be based on its average net profit for F.Y. 2023-24.

5. NET PROFIT AND AVERAGE NET PROFIT

Net profit is the amount of money a company earns after subtracting all its expenses, taxes, and costs from its total revenue. It shows how much money a company actually keeps after covering all its operating costs, interest, and taxes. A positive net profit indicates the company is making money, while a negative net profit means the company is losing money. It's an important measure of a company's financial success.

Average net profit refers to the mean amount of net profit a company earns over a specific period, typically calculated over several months or years. To find the average net profit, you add up the net profits from each period and divide that total by the number of periods.

Section 135 has not defined the term 'Net Profit' though explanation to Sec. 135 says "For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198".

3. NET WORTH

Net worth of a company is the *difference between its total assets (everything it owns, like cash, property, and equipment) and its total liabilities (everything it owes, like loans and debts)*. It shows how much the company would be worth if it sold all its assets and paid off all its debts. A positive net worth means the company has more assets than liabilities, while a negative net worth means the company owes more than it owns. It's a key measure of a company's financial health and stability.

Section 2(57) of The Companies Act, 2013 states that "net worth means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation".

As per rule 2 (h) of The Companies (CSR Policy) Rules, 2014 - net profit means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:-

- any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
- any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381, read with section 198 of the Act;

V COMPUTATION OF NET PROFIT

As per Section 198 of Companies Act, 2013, the net profit of a company shall be computed in the following manner:

Statement of Computation of Net Profit	Amount
Profit before tax as per Profit and Loss Statement	
Add (+) the following items if debited to Profit and Loss Statement before arriving profit before tax	
Managerial remuneration	
Provision for Bad doubtful debts	
Loss on sale/disposal/discarding of assets	
Loss on sale of investments	
Provision for diminution in the value of investments	
Fixed assets written off	
Fall in the value of foreign currency monetary assets	
Loss on cancellation of foreign exchange contracts	
Write off of investments	
Provision for contingencies and unascertained liabilities	
Lease premium written off	
Provision for warranty spares/supplies	
Infructuous project expenses written off	
Provision for anticipated loss in case of contracts	
Loss on sale of undertaking	
Provision for wealth tax	
Compensation paid under VRS or otherwise	
Deduct (-) the following if credited to P&L statement for arriving at profit before tax:	
Capital profit on sale/disposal of fixed assets (the same should be added if the company's business comprises buying & selling any such property or asset) and revenue profit (difference between original cost and WDV should not be deducted)	
Profit on sale of any undertaking (or its part) of the company	

Profit on buy-back of shares	
Profit/discount on redemption of shares or debentures	
Profit on sale of investments	
Compensation received on non-compete agreements	
Write back of provision for doubtful debts	
Write back of provision for doubtful advances	
Appreciation in value of any investments	
Compensation received on surrender of tenancy rights	
Profit on sale of undertaking	
Write back of provision for diminution in the value of investments	
Profit on sale of forfeited shares & shares of subsidiary/ associated companies	
Net Profit as per Section 198	

NOTE:

Sums representing bounties and subsidies received from any Government or public authority, unless directed otherwise by the Central Government, to be added to the net profit. Although these sums are not part of regular business operations, they are legally allowed to be considered and credited to the Profit and Loss Account. If not already credited, they can be added to the net profit, increasing the net profit as per the Profit and Loss Account. However, if these sums have already been credited, no further action is needed.

In case of Foreign Companies the Net Profit of such company shall be determined as per the profit and loss account prepared under Section 381(1)(a) read with Section 198 of the Companies Act, 2013.

VI CONCLUSION

In conclusion, understanding the applicability and requirements of CSR is crucial for both corporations and NPOs. As CSR has evolved into a statutory requirement for certain companies under the Companies Act, 2013, it presents opportunities for NPOs to collaborate with the corporate sector, especially for those engaged in social, environmental, and developmental initiatives. By aligning their work with CSR frameworks, NPOs can not only leverage corporate funding but also play a key role in driving sustainable and inclusive development.

For NPOs, it is important to recognize that CSR is not just about receiving funds; it is about creating meaningful partnerships with businesses that share similar values. By staying informed about the CSR norms and engaging with the corporate sector on shared social goals, NPOs can enhance their impact, ensuring that both their mission and the CSR initiatives of companies can mutually benefit communities. As CSR continues to grow as a vital tool for promoting positive change, NPOs must be proactive in identifying opportunities to engage, collaborate, and contribute to long-term societal well-being.



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