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ETHICS, GOVERNANCE AND SUSTAINABILITY

MODULE 2

PAPER 6

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Lesson 3

Conceptual framework of Corporate Governance

Institutional Investors- Global Trends

1. New Corporate Governance Code for Finnish Listed Companies

Prologue

The new Corporate Governance Code for Finnish listed companies ("2020 CG Code") entered into force this January, and it will replace the previous Corporate Governance (CG) Code applied since 2016 ("2015 CG Code"). While the number of recommendations in the 2020 CG Code has decreased, the 2020 CG Code introduces additional requirements on listed companies, in particular in relation to remuneration and related party transactions as required by the Shareholders' Rights Directive and the national rules implementing the Directive.

The 2020 CG Code also introduces changes to the recommendation concerning the audit committee and clarifications to the recommendation concerning the assessment and disclosure of independence of board members.

The Making of the Code

In 2018, the Finnish Securities Market Association's board appointed a working group to update the CG Code to reflect the new regulations and the update needs to the 2015 CG Code development targets that had been identified over the years. Furthermore, the Shareholders' Rights Directive was implemented into Finnish company law in 2019 it created a need to amend and update the recommendations provided in the 2015 CG Code.

The Finnish Securities Market Association's board adopted the amended and updated CG Code in September 2019. As a result of which the new 2020 CG Code came into force in January 2020 replacing the previous Finnish CG Code.

Which companies must comply with the CG Code?

The Finnish CG Code is applicable to all companies that are listed on Nasdaq Helsinki Ltd (Helsinki Stock Exchange). According to the Rules of the Helsinki Stock Exchange, all issuers of shares that are traded on the official list must comply with the CG Code.

However, issuers of securities other than shares, as well as companies whose shares are listed, for example, on the Nasdaq First North Growth Market Finland (First North) marketplace, are not obliged to comply with the CG Code. Pursuant to the Securities Market Act, issuers of other securities traded on a regulated market, such as issuers of bonds, must include a CG statement in the management report or in a separate report. These and the companies traded on the First North marketplace may, of course, voluntarily apply the CG Code, either in full or partly.

Key changes to the 2015 CG Code

The key changes to the 2015 CG Code concern remuneration reporting and changes to the recommendations concerning related party transactions and the recommendation concerning the audit committee.

Remuneration reporting – remuneration policy and report for governing bodies

The structure of the remuneration section has been revised to correspond to the requirements of the Second Shareholder Rights Directive. For example, the company's remuneration statement has been replaced by the remuneration policy for governing bodies ("remuneration policy") and remuneration report for governing bodies ("remuneration report"), which are supplemented by information provided on the company's website.

The "governing bodies" referred to in the CG Code refer to the governing bodies of the company regulated in the Finnish Limited Liability Companies Act, i.e. the company's board of directors, supervisory board, if any, and the managing director and deputy managing director.

For this reason, the remuneration policy and report only concern the company's board of directors, supervisory board, if any, and the managing director and deputy managing director. It is not recommended that the management team's remuneration will be addressed in the remuneration policy or remuneration report.

However, Information on the remuneration of the rest of the management team will in future be provided on the company's website (on an aggregate level). The remuneration reporting section of the CG Code also includes a checklist to clarify the reporting obligations.

By law, listed companies must present the new remuneration policy to the annual general meeting held after 1 January 2020, i.e. companies listed on the Helsinki Stock Exchange will need to prepare and present their first remuneration policy to the annual general meeting of 2020 and publish the proposal for a remuneration policy earlier in 2020 (see below).

Depending on the content of the charter, preparing the remuneration policy and report can be included in the duties of the boards' remuneration committee (if such has been established).

Deadline for publishing the remuneration policy

It should be noted that although the 2020 CG Code came into force in January 2020, it is not mandatory for listed companies to disclose the remuneration policy from that date. The applicable remuneration policy shall be kept available on the company's website once published (as part of the summons to the annual general meeting or separately) and addressed by the annual general meeting.

According to the 2020 CG Code the remuneration policy to be proposed to the annual general meeting must be published as an appendix to a stock exchange release no later than three (3)

weeks prior to the general meeting dealing with the report, or at an earlier date, e.g. in connection with the publication of the summons to the general meeting.

Following the first annual general meeting following 1 January 2020 and the decision on the remuneration policy, the remuneration policy proposal will be presented to the annual general meeting every four years, or whenever material changes are proposed to it.

Companies must disclose the first new remuneration report for the financial year beginning on or after 1 January 2020, i.e. in practice the first report will be disclosed in 2021, no later than three weeks prior to the general meeting. The remuneration reports for the financial years preceding 1 January 2020 can elect to comply with the instructions for the remuneration statement contained in the 2015 CG Code.

A new element in the remuneration report is the requirement that the report should reflect the development of the remuneration during the past five financial years compared to the development of the average remuneration of the employees and the economic development of the group and the company during the same period.

The new remuneration report may, going forward, be published as an appendix to a stock exchange release at the same time and manner as the financial statements, management report and CG report. The current CG Code allows the remuneration report to be incorporated as part of the CG report.

Advisory decision by the general meeting on the remuneration policy and remuneration report

Under the amended Limited Liability Companies Act, the rules implementing the Shareholders' Rights Directive, the decision by the general meeting concerning the remuneration policy and remuneration report is only advisory in nature. Consequently, shareholders are not allowed to propose changes to the policy or report presented by the board to the general meeting or introduce any alternative policy or report proposals, only to adopt or reject the board's proposals.

However, as the CG Code and Limited Lability Companies Act's provisions require that the general meeting will address the remuneration policy and report, the agenda of the annual general meeting should be updated to include the disclosure and advisory vote on the remuneration policy.

According to the preparatory works of the amended Limited Liability Companies Act's provisions implementing the Shareholders' Rights Directive, the company must take into consideration the decision by the general meeting on the previous remuneration policy as well as positions presented during the general meeting in respect of the remuneration report addressed at the general meeting. Consequently, material positions taken by shareholders should be recorded in the minutes to fulfil this requirement (when supported by a significant minority shareholder or if it gains wide support at the general meeting).

Proposal to elect board members and evaluation of the candidates' independence (Recommendations 1 and 10)

The board of directors should evaluate the independence of the directors and report which of the directors are independent of the company and which are independent of the significant shareholders. The board of directors will re-evaluate the situation every year, and the evaluation will be included in the company's CG statement.

As a new element, the evaluation must also indicate the rationale based on which a board member is found not to be independent (e.g. cross-ownership or familial relationship). An updated evaluation will be published on the company's website if factors affecting the director's independence change during the year.

If the proposal was made by a shareholder, the proposing shareholder's assessment of independence must be provided to the company together with the proposal.

The board of directors can also carry out its evaluation on its own initiative, for example, if a proposal concerning a board member has been received from a shareholder.

The biographical details of all candidates must be presented on the company's website. The publication of the candidates' biographical details on the company's website allows the shareholders to form an opinion on the proposed composition of the board of directors, especially with regard to new director candidates. In the same connection, information about the independence of the candidates must be provided.

Audit committee, Recommendation 16 (and Recommendation 8)

The recommendation concerning the audit committee and the rationale for it have been clarified to comply with existing legislation with respect to the requirement concerning the competence and expertise of members of the audit committee. The recommendation concerning the composition of the board of directors (Recommendation 8) has been updated to reflect that at least one member of the company's audit committee must have the expertise required by law.

The audit committee must have sufficient expertise and experience to be able to challenge and evaluate the company's internal accounting function and the company's internal and external audit function. Due to the mandatory auditing duties, legislation also requires that at least one member of the audit committee must have expertise in accounting or auditing.

In addition, the mandatory duties of the audit committee, such as duties relating to auditing and other duties, have been clarified in the text of the rationale provided in this recommendation.

Other duties of the audit committee may include assessing the use and presentation of alternative key figures, defining principles for monitoring and assessing related party transactions and processing the account of non-financial reporting.

Related party transactions, Recommendation 27

One of the key changes to the Limited Liability Companies Act introduced by the implementation of the Shareholders' Rights Directive in June 2019 included a special decision-making requirement for related party transactions.

The recommendation and its rationale have been revised in their entirety. In future, the recommendation requires that companies define and report their principles for monitoring and assessing related party transactions. The purpose of the principles is to ensure proper decision making in related party transactions in accordance with the new requirements of the Limited Liability Companies Act.

The board of directors should consider, in particular, how the company identifies related party transactions, who shall be the receiving party for related party transactions reports and how the procedure will be supervised.

A relevant "related party transaction" is defined as a transaction that is carried out outside the ordinary course of the company's business or that is not carried out on normal business terms. To identify these transactions, the company must be able to identify its related parties and the transactions carried out by the company with the related parties.

The main features of the related party transactions principles will be disclosed in the company's CG report. As a result of that, companies listed on the Helsinki Stock Exchange should without delay review and, if needed, update their related party transactions principles to enable them to fulfil the CG reporting requirements.

It should be noted that the CG report published by a listed company concerning the financial year 2019 must comply with the 2020 CG Code, i.e. there is no possibility to apply the 2015 Code to the CG report (unlike the remuneration report for the financial period 2019, which can be prepared in accordance with the 2015 CG Code).

Key amendments to the CG report under the 2020 CG Code

In addition to the disclosure requirement concerning the related party transactions policy, the CG report will include the corresponding information on the deputy managing director as on the managing director. The term 'other executives' has been replaced by the term 'rest of the management team'. In addition, the recommendation concerning board members' independence and disclosure of the basis of the assessment may have an impact on the content of the CG report.

Management team, Recommendation 21

Recommendation 21, which concerned other executives, has been removed and replaced with instructions concerning the rest of the management team as part of the reporting section.

The term 'other executives' is no longer used in the CG Code in general, and has been replaced by the more accurate 'rest of the management team', which refers to the company's management team with the exclusion of the managing director. Information on the remuneration of the rest of the management team is no longer part of the remuneration report, but it is provided on the company's website.

Repealed recommendations and certain other changes

Recommendations 21 (Organisation of Other Executives) and 24 (Structure of Remuneration) of the 2015 Code have been removed. The contents of these recommendations have, in practice, been transferred to the section dealing with remuneration reporting. In addition, the numbering of two recommendations has been changed: the recommendation concerning the nomination committee is numbered 18 (18a), and the recommendation concerning the shareholders' nomination board is numbered 19 (18b).

For more details and further reading, please refer:

1. https://www.borenius.com/2020/02/28/new-corporate-governance-code-for-finnish-listed-companies-what-actions-are-required/

2. https://ecgi.global/sites/default/files/codes/documents/corporate-governance-code-2020.pdf

Japan Stewardship Code 2020
(Revisions to Japan's Stewardship Code in 2020)

Introduction

Japan's stewardship code is a set of regulatory guidelines to establish fiduciary duty by institutional investors on behalf of their clients. The code was proposed in 2012, following fallout from the 2008 financial crisis, and ratified in 2013. The Code defines principles for institutional investors to behave as responsible financial stewards with due regard both to their clients and beneficiaries and to investee companies. The Code primarily targets institutional investors investing in Japanese listed shares.

On 24 March 2020, Japan's Financial Services Agency (FSA) finalized and published the second revised version of Japan's Stewardship Code (the Code). The revised Code (the Revision Code) is intended to progress the Japanese government's corporate governance reform, one of the key pillars of Prime Minister Abe's economic revival program, following revisions to Japan's Corporate Governance Code in 2018.

Since its initial release, the Code has continued to embrace the following approach:

i) ***Soft Law Approach*** – although the Code is not legally binding, the FSA encourages institutional investors to voluntarily adopt the principles of the Code by disclosing a list of institutional investors who have become signatories.

ii) ***Principles-Based Approach*** – the Code adopts a principles-based approach (instead of a rules-based approach) so that the way in which the Code's principles are applied in practice, can differ depending on factors such as the investor's size and investment policies, as long as the purpose and spirit of these principles are followed.

iii) ***"Comply or Explain" Approach*** – the Code adopts a "comply or explain" approach under which an institutional investor can either disclose its intention to comply with a principle or provide sufficient explanation as to why it is not suitable to adopt such principle.

Noteworthy Changes in the Revised Stewardship Code 2020

1. Stress on Sustainability including ESG Factors: There was no mention of sustainability or ESG in the previous version of the Code. In light of the increasing focus on sustainability and ESG factors in corporate valuation, one of the main purposes of the Revision Code is to address issues of sustainability including ESG factors. The Revision Code redefines "stewardship responsibilities" and clearly instructs institutional investors to consider sustainability (medium- to long-term sustainability including ESG factors) according to their investment management strategies in the course of their constructive engagement with investee companies.

The Revision Code also requests that institutional investors clearly explain, in their stewardship policies, how they consider sustainability issues according to their investment management strategies. Furthermore, it unequivocally states that in case of dialogue with investee companies, with respect to sustainability issues, institutional investors should ensure that such dialogue is consistent with their investment management strategies and leads to the medium-to long-term increase in corporate value and sustainable growth of investee companies.

2. Disclosure of reasons for votes on agenda items- The previous version of the Code stated that institutional investors should, in principle, disclose voting records for each investee company on an individual agenda item basis, noting that it would contribute to the enhancement of visibility for institutional investors, explicitly to explain why they voted for or against an agenda item. The Revision Code has taken this position further and specifically instructs institutional investors to disclose their voting rationale, whether they voted for or against agenda items, that are considered important from the standpoint of constructive dialogue with investee companies (including those perceived to give rise to a conflict of interest or those that need explanation in light of their voting policy).

3. Application of the Code to Asset Classes other than Listed Shares- The previous version of the Code stated that the Code mainly targets institutional investors investing in Japanese listed shares. While that remains unchanged, the Revision Code explicitly adds that it may also apply to other asset classes, as far as it contributes to fulfilling stewardship responsibilities as defined in the Code.

4. Stewardship activities of Asset Owners such as Corporate Pension Funds- To help corporate pension funds understand stewardship activities set forth in the Code, the Revision Code clarifies stewardship responsibilities of asset owners. The Revision Code instructs asset owners to encourage asset managers to engage in effective stewardship activities accordingly to their size and capabilities, in order to secure the interests of the beneficial owners. When asset owners manage funds and exercise their voting rights by themselves, they should engage in stewardship activities such as holding dialogues with investee companies accordingly to their size and capabilities.

5. Principles applied to Service Providers for Institutional Investors- The Revision Code adds Principle 8, which states that service providers for institutional investors, such as proxy advisors and investment consultants for pensions, should endeavor to contribute to enhancing the functions of the entire investment chain by appropriately providing their services, so that institutional investors can fulfil their stewardship responsibilities.

The Revision Code instructs service providers for institutional investors to establish and disclose clear policies on how to effectively manage circumstances that may give rise to conflicts of interest. The Revision Code notes that other principles of the Code (i.e. Principles 1 - 7), including the guidance, also apply to service providers for institutional investors as long as these principles do not conflict with Principle 8.
(Please refer the following link:
https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/01.pdf for the Principles).

For proxy advisors, the Revision Code expects them to develop appropriate and sufficient human and operational resources, including setting up a business establishment in Japan, in order to provide asset managers with proxy recommendations based on accurate information on each company. Proxy advisors should also disclose the voting recommendation process such as their primary information source or whether (and how) they conduct dialogue with investee companies to ensure transparency.

Additionally, the Revision Code recommends that proxy advisors actively exchange views with companies as necessary. This may contribute to assurance of transparency, as proxy advisors provide investee companies with opportunities to confirm accuracy of information, on which their proxy recommendations are premised (if requested by investee companies), and provide the opinions submitted by such companies to their clients together with their own recommendations.

For more details, please refer:

1. https://www.borenius.com/2020/02/28/new-corporate-governance-code-for-finnish-listed-companies-what-actions-are-required/

2. https://www.dlapiper.com/en/uk/insights/publications/2020/04/revisions-to-japans-stewardship-code/#:~:text=It%20sets%20out%20the%20principles,constructive%20engagement%20or%20purposeful%20dialogue.

3. https://www.fsa.go.jp/en/refer/councils/stewardship/20140407/01.pdf

4. https://www.investopedia.com/articles/investing/062515/japans-stewardship-code.asp#:~:text=Japan's%20stewardship%20code%20is%20a,crisis%2C%20and%20ratified%20in%202013.

Italian Corporate Governance Code, 2020

In January 2020, the Italian Corporate Governance Committee released the new edition of the Corporate Governance Code. The Corporate Governance Code ("Code") applies to all companies with shares listed on the Italian main market ("Mercato Telematico Azionario", hereinafter "MTA") managed by Borsa Italiana ("companies").

The companies adopting the Code are required to apply it starting from the first financial year that begins after 31 December 2020, while the disclosure shall be provided in the corporate governance report to be published during 2022.

The Italian Corporate Governance Code,2020 focuses on the following:

i) Article 1- Role of the board of directors

ii) Article 2- Composition of the corporate bodies

iii) Article 3- Functioning of the board of directors and the role of the chair.

iv) Article 4- Appointment of directors and board evaluation.

v) Article 5- Remuneration

vi) Article 6- Internal control and risk management system.

Sustainability and proportionality are at the heart of the new Corporate Governance Code for listed companies recently approved by the Italian Corporate Governance Committee (the "New CG Code").

The New CG Code - which replaces the current Corporate Governance Code (the "2018 CG Code") and will be applicable on a "comply or explain" basis, starting from the first financial year beginning after 31 December 2020 – has a renewed structure, divided into "Principles" and "Recommendations".

For more details, please refer: https://www.chiomenti.net/public/files/3109/New-Italian-Corporate-Governance-Code-for-listed-companies.pdf

https://ecgi.global/node/8009

Rule 4 of the Companies (Meetings of Board and its Power) Rules, 2014

Matters not to be Dealt With in a Meeting Through Video Conferencing or Other Audio Visual Means

The following matters shall not be dealt with in any meeting held through video conferencing or other audio visual means.-

(i) the approval of the annual financial statements;

(ii) the approval of the Board's report;

(iii) the approval of the prospectus;

(iv) the Audit Committee Meetings for consideration of financial statement including consolidated financial statement if any, to be approved by the board under sub-section (1) of section 134 of the Act; and

(v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Provided that where there is quorum presence in a meeting through physical presence of directors, any other director may participate conferencing through video or other audio visual rneans.

For the period beginning from the commencement of the Companies (Meetings of Board and its Powers) Amendment Rules, 2020 and ending on the 30th June 2021 , the meetings on matters referred to in sub-rule (1) may be held through video conferencing or other audio visual means in accordance with rule 3.

For more details, please refer: http://ebook.mca.gov.in/

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Lesson 13- Corporate Social Responsibility

2020 Corporate Social Responsibility Trends

1. Be Transparent and Thorough

With information now able to be rapidly distributed through digital platforms, CSR transparency have been key in 2020. Companies must demonstrate sincerity, authenticity, and honesty, or else they risk brand damage and disapproval from consumers, investors, and employees. For example, sustainable clothing brand Reformation faced public backlash after an employee revealed how she felt the company founders acted with discrimination toward her as a Black woman among many white peers. In a similar story, an Adidas employee has been on strike to protest the lack of admission and apology she requested from her employer for racism she has experienced in the workplace. Publishing statements of intent to change is no longer sufficient; stakeholders want to see action.

Transparency and proactive demonstration of CSR initiatives will help companies build a trustworthy brand. Consumers are more aware of rhetoric that can be used to better a company's image without translating to actionable improvements, so now the proof lies in the numbers. Therefore, external audits are on the rise to verify that companies perform true to their word. Without taking these steps to perform CSR initiatives with authenticity, companies risk losing trust from investors, losing business from dissatisfied customers, and losing valuable employees to other companies with better CSR performance.

2. Involve Employees in CSR

Listening, understanding, and accommodating the needs of employees is paramount in this time. Employees are increasingly urging company leadership to support communities in need and to take a stand on social issues. They want their employers to promote a platform for accountability and take an actionable stance. Not only does CSR improve employee satisfaction and retention, it can also benefit a company's recruiting efforts, especially since social impact is important to younger generations entering the workforce. Workforce diversity should also be reevaluated in recruiting processes to acknowledge calls of recent protests to eliminate discrimination and intolerance.

Organizations should include employees in their materiality efforts at the beginning of the CSR process. Employees can also be a great resource for promoting a company's CSR initiatives, especially when they are provided with opportunities to contribute to causes they are passionate about. Paid volunteer days show support for employee interests and can also foster relationships with diverse employees across functions. Employees can even be further involved in CSR initiatives with positions implemented to manage sustainability, diversity and inclusion efforts, and social impact. Encouraging employees to pursue these initiatives will help a company maintain focus and promote daily interaction with social issues, demonstrating commitment to change and identifying issues that can be further improved upon, which can be monitored through people analytics.

3. Center Business Activities around CSR

In 2020, a company's CSR initiatives must be built into the foundation of their business and demonstrated in daily operations.
Even though social issues are a major focus of this year, environmental impact is still a major concern. Zero waste is the new goal, and rather than just limiting or reducing a company's impact on the environment, carbon neutrality is the call from stakeholders. Additionally, companies are not meeting the benchmarks expected of the 2015 UN Sustainable Development Goals, which were designed to tackle many social issues at scale by 2030. This means that private companies need to work harder on their CSR initiatives, possibly through partnerships with public entities. Consider intersectional environmentalism as a method to best approach these issues from a social and environmental lens.

Additionally, companies need to incorporate CSR into their purpose as a company. This provides a platform to inspire employees and creates an effort that customers want to support long term. As a guiding force, emphasis on CSR is non-negotiable and must demonstrate the idea that profitability is not damaged by efforts to meet social impact goals. Businesses can use their core business to create change to solve problems, but this only succeeds with an established purpose. Companies can even produce services or products aimed at solving social issues, such as sustainability and diversity. It is also important to consider how a company can effectively track and measure impact to be able to report progress and meet goals, especially for issues that require systemic change. Employee surveys are a great way to observe consistency between employee interests and company purpose to help optimize relevant core activities.

4. Take More Responsibility for Community Wellbeing

CSR initiatives evolve as business evolves, but communities are increasingly impacted by the decisions that large companies make. This gives companies a position of power to solve issues, enabling them to make long lasting, effective change. In the context of COVID-19 prevention and policy, businesses that did not implement sufficient safety precautions had rippling negative effects on the surrounding communities, as seen in the shutdown of many meat processing and packing plants back in Spring 2020 due to COVID-19 outbreaks. Many employees were exposed to the virus, which endangered their safety and the safety of their families, caused potential profits to be lost by the meat processing companies, and reduced availability of meat for consumers. This shows how influential – both in negative and positive ways – companies have the power to be as they decide on policy and disaster management, especially when they do not consider their supply chains.

Business leaders are also taking more action to vocalize support for various issues. This advocacy has been demonstrated in the forms of philanthropic contributions and volunteerism, public statements and open letters.

For more details, please refer: https://clarkstonconsulting.com/insights/corporate-social-responsibility-trends/

Impact of 'The Companies (Amendment) Bill, 2020' on CSR

Objectives of the Bill

- To decriminalize some provisions of the Act, based on their gravity;
- To amend various provisions of the Act to decriminalize minor procedural or technical lapses
- under the provisions of the said Act, into civil wrong
- To constant Endeavour of the Government to facilitate Greater Ease of Living of Law-abiding corporates;
- To provide greater ease of living to corporates through certain other amendments to the Act
- Introduction of provisions for Producer Company in Companies Act, 2013.

Key highlights

1. Setting off excess CSR expenditure

Currently, excess CSR spend cannot be carried forward. Therefore, a third proviso has been added to sub-section 5 of Section 135 whereby: if the company spends an amount in excess of two per cent of the average net profits of the company made during the three immediately preceding financial years, such company may set off such excess amount against the requirement to spend under this sub-section for such number of succeeding financial years and in such manner, as may be prescribed.

In other words, companies that spend more than the mandatory two per cent on CSR in a particular financial year may carry it forward as credit for fulfillment of CSR obligations for the next few years.

2. Amendment's link to Social Stock Exchange

This amendment also appears to tie-in with the vision of the proposed new Social Stock Exchange in India. Companies which are spending more than the mandatory two percent of their pre-tax profits on Corporate Social Responsibility (CSR) may soon be able to trade this excess CSR expenditure. This has also been recommended by market watchdog SEBI's High-Powered Committee on Social Stock Exchange (SSE).

Under this allowance, companies that are spending more than the limit of two per cent set under Section 135(5) of the Indian Companies Act 2013 can sell or trade this surplus to those companies which have failed to meet their annual quota.

3. Managing unspent CSR expenditure

Sub-section 6 to Section 135 which was proposed earlier under clause 21 of the Indian Companies (Amendment) Act 2019 appears to have been left unchanged.
Accordingly, any amount remaining unspent under sub-section (5) of Section 135, pursuant to any ongoing project, fulfilling such conditions as may be prescribed, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the "Unspent Corporate Social Responsibility Account", and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

This sub-section will require companies having ongoing projects to transfer unspent CSR funds within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the "Unspent Corporate Social Responsibility Account", and such amount shall be spent by the company in pursuance of its obligation towards CSR within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

4. Penalty for non-compliance
According to the new sub-section 7 to Section 135: "If a company is in default in complying with the provisions of sub-section (5) or sub-section (6), the company shall be liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less, and every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or two lakh rupees, whichever is less."

Earlier under Article 21 of The Companies (Amendment) Act 2019 it was proposed that if a company contravenes the provisions of sub-section (5) or sub-section (6), the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of such company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Now under the new sub-clause 7 to Section 135 of the Indian Companies Act 2013, the penalty for non-compliance is twice the unspent amount required to be transferred by the company. However, the maximum penalty that can be imposed for default is a sum of one crore rupees.

The penalty for every officer of the company who is in default shall be one-tenth of the amount required to be transferred by the company. However, the maximum penalty that can be imposed for default on each officer is a sum of two lakh rupees.

5. CSR Committee

Under the new sub-clause 9: "Where the amount to be spent by a company under sub-section (5) does not exceed fifty lakh rupees, the requirement under sub-section (1) for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company."

In other words, smaller companies who have less than fifty lakh rupees to spend on CSR activities need not constitute a CSR committee and the CSR obligations may be fulfilled by the Board of Directors of such company.

6. Uncertainty still looms for Trusts & Societies

While the uncertainly looming over Article 21 of the Indian Companies (Amendment) Act 2019 'criminalizing' certain defaults in compliance under the Indian Companies Act 2013 have been put to rest under the Indian Companies (Amendment) Bill, 2020, the amendments proposed under the Indian Companies (CSR Policy) Rules 2020 remain unresolved.

One of the proposals under the Indian Companies (CSR Policy) Rules 2020 was regarding implementation of CSR activities only by the company itself or through a company established under section 8 of the Act, or any entity established under an Act of Parliament or a State legislature. This, proposed amendment, by inference, eliminated public charitable trusts and societies registered under the Act of 1860 as CSR implementing agencies.

For more details, please refer:
https://www.prsindia.org/sites/default/files/bill_files/Companies%20%28Amendment%29%20Bill%2C%202020.pdf

https://capindia.in/impact-of-the-companies-amendment-bill-2020-on-csr-some-reliefs-some-anxieties/

https://taxguru.in/company-law/key-takeaways-companies-amendment-bill-2020.html

http://www.mca.gov.in/MinistryV2/faq+on+csr+cell.html

CSR Audit

To ensure that the companies comply with the provisions of Section 135 and rules made thereunder and genuinely spend the CSR amount on the eligible welfare projects, it is imperative to improve governance and transparency in CSR sphere.

Akin to other areas of corporate activity requiring compliance, need for a dedicated independent professional has been felt in the arena of social responsibility as well. In this regard, an independent CSR Audit/ Review and issue of CSR Audit/Review Report by the Company Secretaries in Practice shall not only give the existing CSR mechanism much needed support and give necessary comfort to the stakeholders, regulators and the society at large that the companies are Complying with the legal requirements but will also give authentic information about the Utilisation of CSR funds by the companies in specified CSR activities.

It is heartening to note that The Institute of Companies Secretaries of India (ICSI) has suggested to Ministry of Corporate Affairs **for 'Requirement of Monitoring Mechanism in CSR'.**

For more details, please refer: https://taxguru.in/chartered-accountant/icsi-requests-introduction-csr-audit-csr-review-mechanism.html

https://taxguru.in/chartered-accountant/icsi-suggests-introduction-csr-compliance-certificate.html

https://taxguru.in/chartered-accountant/consider-introduction-csr-compliance-certificate-cs-practice-icsi.html