

Accounting of CSR related expenses - Key considerations



This article aims to:

Summarise key guidance relating to accounting of expense pursuant to CSR activities as provided by ICAI in its technical guide.



Introduction

The Companies Act, 2013 (2013 Act) lays down a framework which mandatorily requires companies meeting the prescribed criteria¹ to contribute two per cent of their profits for the purpose of Corporate Social Responsibility (CSR). Schedule VII to the 2013 Act prescribes eligible activities which can be covered in CSR policy by companies.

From the time CSR provisions have been made effective², significant amendments have been made to these provisions through issuance of various notifications and clarifications to streamline its implementation by companies. The Companies (Amendment) Act, 2019 issued in July 2019 made utilisation of unspent amount earmarked for CSR activities mandatory for companies, failing which it would be transferred to the funds specified in the Schedule VII of the 2013 Act³.

In March 2020, another set of amendments were proposed to the CSR provisions through the Companies (Amendment) Bill, 2020⁴. The amendments, *inter alia*, proposed to allow set-off of amount spent in excess of the prescribed limit of two per cent in a given year against the requirement to spend for such number of succeeding FYs and in such manner, as may be prescribed.

CSR activities play a significant role in the nation building. In the present times, with the country dealing with the pandemic (COVID-19), corporates have been dedicating huge amounts of money towards CSR. This necessitates an evaluation whether various activities undertaken by companies in India qualify to be CSR activities. Accordingly, the Ministry of Corporate Affairs (MCA) recently, issued clarifications in the form of Frequently Asked Questions (FAQs) and provided much required guidance around various aspects of COVID-19 related activities undertaken by companies.

In June 2020, the Institute of Chartered Accountants of India (ICAI) has also issued a technical guide on 'Accounting for Expenditure on CSR Activities' (the guide) which provide detailed guidance on the recognition, measurement, presentation and disclosure of expenditure on activities relating to CSR. The guide also incorporates amendments made by the Companies (Amendment) Act, 2019⁵ and those proposed by the Companies (Amendment) Bill, 2020 and provide guidance on change in measurement and accounting of CSR consequent to the amendments. The technical guide supersedes the guidance note on CSR issued by ICAI in May 2015. In this article, we aim to summarise the key guidance around accounting of CSR expense as prescribed by ICAI in its technical guide.



1. Every company with a net worth of INR500 crore or more, turnover of INR1,000 crore or more or a net profit of INR5 crore or more during the immediately preceding Financial Year (FY) should contribute at least two per cent of its average net profits (made during the three immediately preceding FYs) for the purpose of Corporate Social Responsibility (CSR) in pursuant to its policy in this regard. (Section 135 of the 2013 Act).

2. CSR provisions became effective from 1 April 2014.

3. Provisions relating to CSR have not been notified yet.

4. This document is still in 'Bill' stage and has not been approved as an Act yet.

5. Yet to be notified.

CSR expenditure in cash

Creation of provision for unspent amount of CSR expenditure

Section 135(5) of the 2013 Act provides that if a company fails to spend the amount earmarked for CSR, then the Board of Directors (BoD) should specify the reasons for not spending the amount in its report. Further, Rule 8(1) of the Companies (CSR Policy) Rules, 2014 (CSR Rules) prescribe that the board's report of a company should include an Annual Report on CSR with specified details.

Basis the provision of the 2013 Act and the CSR Rules, the guide clarified that a provision may not be created in the financial statements for the unspent CSR amount. However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in such a case, provision for the amount to the extent of CSR activity completed during the year is required to be made in the financial statements in accordance with Ind AS 37, *Provisions, Contingent Liabilities, and Contingent Assets*.

Amendments made under the Companies (Amendment) Act, 2019 (yet to be notified)

Ongoing projects

As per the amendments, in case the CSR amount remains unspent pursuant to any ongoing CSR project undertaken by a company as per its CSR policy, then the company should transfer such unspent amount to a special account (named 'unspent CSR account') within a period of 30 days from the end of the FY. The company should spend the amount transferred to the unspent CSR account within a period of three FYs from the date of such transfer as per its obligation towards the CSR policy.

In case it fails to spend the amount within the specified period, it would be required to transfer the same to a fund specified in Schedule VII of the 2013 Act, within a period of 30 days from the date of completion of the third FY.

Basis above, ICAI in its guide clarified that once the amendment is notified, a company would be obliged to transfer the unspent amount to a separate bank account within 30 days of the end of FY and eventually any unspent amount out of that to a fund specified in Schedule VII. Therefore, it would be required to recognise a provision for liability to the extent to which the amount is to be transferred within 30 days of the end of the FY.

Other than ongoing projects

In other cases, the unspent amount is required to be transferred to a fund specified in Schedule VII of the 2013 Act within a period of six months from the expiry of the FY.

Accordingly, the guide clarifies that a provision for liability representing the extent to which the amount is to be transferred, would need to be recognised in the financial statements in cases other than ongoing projects subsequent to the notification of the amendment.

In both the cases i.e. ongoing and other than ongoing projects:

- If a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, provision for liability for the amount representing the extent to which CSR activity was completed during the year needs to be recognised in the financial statements even though the payment for the same has not been made during the year.
- The amount transferred to the separate bank account would be the full amount, however, provision would be created after deducting the provision created for the CSR activity completed, if applicable and as provided.



Carry forward of the excess amount spent on CSR activity to next year

A company may spend an amount in excess of the prescribed limit of two per cent on CSR activity in a given year.

The guide clarifies that amount specified under the provisions of the 2013 Act to be spent on CSR i.e. two per cent of average net profits of a company is the minimum amount required to be spent by a company. In case a company spends an amount in excess of the specified limit, then currently it is not allowed to set-off such excess amount against the amounts to be spent on CSR activities in future period.

Further, MCA in its general circular (no. 01/2016) dated 12 January 2016 also clarified that any excess amount spent cannot be carried forward to the subsequent years and adjusted against that year's CSR expenditure. Accordingly, it has been clarified that no asset is required to be recognised for the excess amount spent by the company in its financial statements.

Proposed amendments under the Companies (Amendment) Bill, 2020

The amendments proposed allow a company which spends an amount in excess of the prescribed amount of two per cent, to set-off excess amount against the requirement to spend for such number of succeeding FYs and in such manner, as may be prescribed.

Once the above provision is notified, as per the guide, if the company decides to adjust excess amount spent against future obligation, then an asset would have to be recognised to the extent of such excess amount spent.

If a company decides not to carry forward excess spend in full or in part, then excess amount would be recognised as an expense.



CSR expenditure in kind

The technical guide includes certain examples of expenditure made in kind which can be considered as eligible CSR expenditure. Those are as follows:

- Acquisition/purchase of goods and subsequent distribution/use of the goods in its CSR project is an eligible CSR spend.
- A company manufacturing/dealing in goods or services distributes those goods/services itself free of charge may not be covered in CSR spend. However, donation of medicines by a pharmaceutical company is a permissible CSR activity as it has not been undertaken in pursuance of company's normal course of business which is relatable to health care or any other entry in Schedule VII to the 2013 Act.
- A hospital rendering free medical services to, for instance, 25 per cent patients as per local government guidelines may not be considered as CSR spend. However, free medical services rendered beyond 25 per cent may be allowed as CSR expenditure.
- A company manufacturing goods distributes/sells goods other than those which it manufactures in the normal course of business. For example, a manufacturer of steel rods, manufactures steel medical beds. If these beds are sold (irrespective of cost incurred), then it is not a CSR spend. However, giving it free of charge would be a CSR expenditure.

Other considerations

Modes for undertaking CSR and related accounting treatment

The board of a company may decide to undertake its CSR activities approved by the CSR committee either on its own, making contribution to the funds specified in Schedule VII to the 2013 Act or through a third party being trust/society/company established under Section 8 of the 2013 Act/Non-Government Organisation (NGO). The technical guide prescribes the accounting treatment with respect to the CSR activities undertaken through these channels which are discussed below:

A. CSR activities undertaken through a company/trust/society or by making contribution to the funds specified in Schedule VII to the 2013 Act:

The amount spent would be treated as an expense for the year to be charged to the statement of profit and loss.

B. CSR activities undertaken by a company on its own:

When the expenditure is of the following nature:

- *Revenue in nature:* The amount of expenditure should be recognised as an expense to be charged to the statement of profit and loss.
- *Other than revenue in nature i.e. expenditure gives rise to an asset:* In such a case, an asset would be recognised on the basis of an evaluation of control over the asset and accrual of future economic benefits to the company. Based on technical guide, it seems that a company would be unlikely to demonstrate either the control or future economic benefits criteria for the CSR assets.

C. CSR activities by supplying goods manufactured by company or render services:

The expenditure incurred should be recognised when the control on the goods manufactured by the company is transferred or the services are rendered by its employees. The goods manufactured would be measured in accordance with Ind AS 2, *Inventories* and services rendered would be measured at cost. The technical guide clarifies that all indirect taxes such as excise duty, service tax, Value Added Tax (VAT), etc. on such goods and services contributed would also form part of the CSR expenditure.

D. Receipt of grant for CSR activities:

In case a company receives a grant from others for carrying out CSR activities, the CSR expenditure should be measured net of the grant.

Surplus from CSR activities - income

Rule 6(2) of the CSR Rules requires that the surplus arising out of the CSR projects, programmes or activities should not form part of the business profit of a company. The technical guide requires that the fact should be stated by the company in its CSR policy.

The *Framework for Preparation and Presentation of Financial Statements* issued by the ICAI, defines 'income' as an 'increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants'.

Since the surplus arising out of CSR activities does not arise from transactions with shareholders, accordingly, it meets the definition of 'income' for accounting purposes. Therefore, it has been clarified that surplus arising out of CSR project, programme, activities would be recognised in the statement of profit and loss. Also, since this surplus cannot form part of business profits of the company, the same should immediately be recognised as a liability for CSR expenditure in the balance sheet and recognised as a charge to the statement of profit and loss.

Also, in order to compute the limit of two per cent of the average net profits criteria as per Section 135 of the 2013 Act, such surplus would not be included in the computation.

Presentation and disclosure in financial statements

The *General Instructions for Preparation of Statement of Profit and Loss* under Schedule III to the 2013 Act requires a company to disclose the amount of expenditure on the CSR activities by way of a note to the statement of profit and loss.

The technical guide recommends expenditure on CSR activities to be presented as a separate line item under the term 'CSR expenditure' in the statement of profit and loss. Further, the relevant note should disclose the break-up of various heads of expenses based on nature and materiality included in the line item 'CSR expenditure'. This should, *inter alia*, includes, amount approved by the board to be spent during the year, amount spent during the year on construction/acquisition of assets and other purposes and details of related party transactions.

Further, in case a company incurs losses, but it meets the other criteria for formulating CSR committee, the guide still requires companies to disclose the reasons for not spending any amount on CSR activities in the board's report.

Amendments made under the Companies (Amendment) Act, 2019 (yet to be notified)

Once the amendments made by the Companies (Amendment) Act, 2019 would come into effect, ICAI in its guide requires following disclosures to be made by companies in their notes to accounts:

Unspent amount on CSR

Opening balance	Amount deposited in specified fund within six months	Amount required to be spent during the year	Amount spent during the year	Closing balance
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Excess amount spent on CSR:

Opening balance	Amount required to be spent during the year	Amount spent during the year	Closing balance
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Details of ongoing project in addition to below:

Opening balance		Amount required to be spent during the year	Amount spent during the year		Closing balance	
With company	In separate CSR unspent A/c		From company's bank A/c	From separate CSR unspent A/c	With company	In separate CSR unspent A/c

Companies would also be required to disclose the amount of provision recognised in pursuance of its liability in case of ongoing and other projects and an asset would be recognised in case of excess CSR spent (as discussed above).

Consider this

- The technical guide is expected to bring uniformity in application of CSR accounting by companies in India. With the detailed disclosure on CSR expenditure and activities undertaken pursuant to the provisions under the 2013 Act, it also aims to bring greater transparency in the area of accounting of CSR related expenditure.
- Amid COVID-19 outbreak, the scope of eligible CSR activities as prescribed under Schedule VII to the 2013 Act has been widened to include expenditure on various activities related to COVID-19 such as promotion of healthcare including preventive healthcare and sanitation, disaster management and contribution to PM CARES Fund.
- The guide also incorporates accounting of new provisions consequent to amendments made by the Companies (Amendment) Act, 2019⁶ and proposed by the Companies (Amendment) Bill, 2020. Companies should take cognisance of the requirements as once notified it would lead to a big shift in their current accounting of CSR expenditure. Companies should look out for further developments in this area.

6. Yet to be notified.

