The ICAI issues a guidance note on accounting for expenditure on corporate social responsibility (CSR) activities

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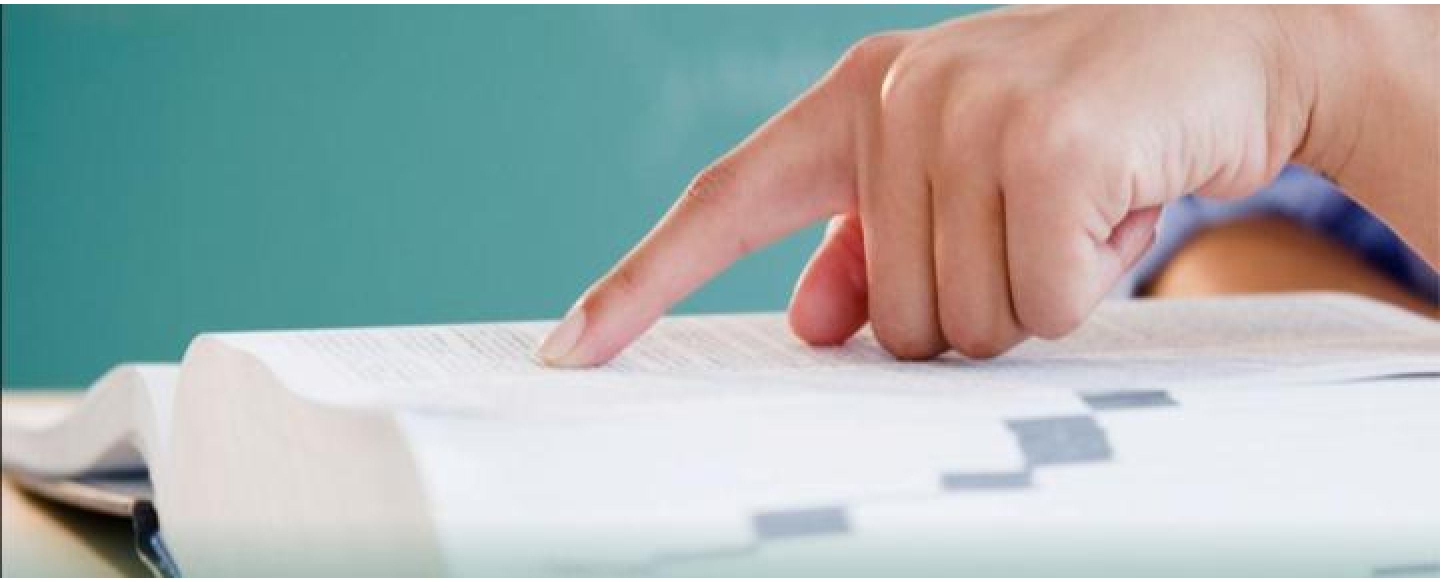

First Notes on:

- **Financial Reporting**
- Corporate law updates
- Regulatory and other information
- Disclosures

Sector:

- **All**
- Banking and Insurance
- Information, Communication, Entertainment
- Consumer and Industrial Markets
- Infrastructure and Government

Relevant to:

- **All**
- Audit committee
- CFO
- Others

Transition:

- **Immediately**
- Within the next 3 months
- Post 3 months but within 6 months
- Post 6 months

Background

The Companies Act, 2013 (2013 Act) lays down a framework for all companies meeting the prescribed criteria to contribute two per cent of their profits for a CSR purpose.

The CSR Rules (Rules) state that every company including its holding or subsidiary, as well as foreign companies having a project office/branch in India, meeting certain criteria (i.e. equaling or exceeding net worth of INR500 crore, or net profit of INR5 crore, or turnover of INR,1000 crore) during any financial year, is required to comply with the CSR provisions.

Activities which may be considered as eligible CSR spend are provided in the Schedule VII to the 2013 Act. The Ministry of Corporate Affairs (MCA) has also clarified that CSR activities enumerated in the Schedule VII to the 2013 Act are broad-based and are intended to cover a wide range of activities. Thus, these prescribed activities should be interpreted liberally to capture their essence.

In order to provide guidance on certain accounting issues relating to the expenditure on CSR activities, the Institute of Chartered Accountants of India (ICAI) on 15 May 2015 issued a guidance note on accounting for expenditure on the CSR activities (guidance note).

It provides guidance on the recognition, measurement, presentation and disclosure of expenditure on activities relating to CSR activities. It does not deal with the identification of activities that constitute CSR activities.

The ICAI had earlier issued the 'Frequently Asked Questions on the provisions of the CSR under Section 135 of the Companies Act, 2013 and Rules thereon' (FAQs) as an interim measure. On issuance of this guidance note, the FAQs related to areas covered by the guidance note stand withdrawn.

This issue of First Notes highlights key aspects of the guidance note issued by the ICAI.

Accounting of the CSR expenditure in the financial statements

Requirements under the 2013 Act and Rules

Rule 4 prescribes the manner in which a company should undertake CSR activities:

- Rule 4(1) -The CSR activities should be undertaken by the company, as per its stated CSR policy, as projects/programmes/activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

- Rule 4(2) -The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under Section 8 of the 2013 Act by the company, either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company, or otherwise:

  Provided that, if such trust, society or company is not established by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company; if the company has specified the project or progammes to be undertaken through these entities, the modalities of utilisation of funds on such projects and programmes and the monitoring and reporting mechanism.

- Rule 4(3) - A company may also collaborate with other companies for undertaking projects or programmes or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programmes in accordance with these Rules.

Accounting treatment prescribed in the guidance note

The guidance note prescribes the accounting treatment for expenditure incurred on the CSR activities which is as follows:

- *Contribution to a fund specified in the Schedule VII-* In case a company contributes to a fund specified in the Schedule VII to the 2013 Act, the contribution should be treated as an expense for the year and charged to the statement of profit and loss.

- *Expenditure incurred by a company itself on the CSR activities* - In case a company incurs expenditure on any of the activities as per the Schedule VII to the 2013 Act, the company would need to analyse the nature of the expenditure keeping in view the need to analyse the '*Framework for Preparation and Presentation of Financial Statements'* (the framework) issued by the ICAI. If the company incurs expenditure which is revenue in nature, it should generally be charged as an expense for the year to the statement of profit and loss. In cases where expenditure may give rise to an 'asset', the company would need to assess whether it has control over the asset and is able to derive future economic benefits from it. In cases, where the control of the asset is transferred by the company, it should not be recognised as an 'asset' in its books and such expenditure should be charged to the statement of profit and loss. In other cases, where the company retains control of the asset then it would need to be examined whether any future economic benefits accrue to the company. Invariably, future economic benefits from a 'CSR asset' would not flow to the company as any surplus from CSR cannot be included in business profits in view of Rule 6(2).

- *Expenditure through a trust, society,etc.*- Similarly, in case a company incurs expenditure on the CSR activities as per Rule 4(2), it should be treated as an expense for the year and charged to the statement of profit and loss.

- *Received grant from other companies 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.

- *CSR activities by supplying goods manufactured by the company* - In case a company supplies goods manufactured by it or renders services as CSR activities, the expenditure incurred should be recognised when the control in the goods is transferred or the allowable services are rendered by the company. Accordingly, the goods manufactured would be accounted for as per principles of AS 2, *Valuation of Inventories* and services rendered should be measured at cost. The guidance note clarifies that all indirect taxes such as excise duty, service tax, VAT, etc. on such goods and services contributed would also form part of the CSR expenditure.

Recognition of income earned from CSR projects/ programmes or during the course of conduct of the CSR activities

Requirements under the 2013 Act and Rules

In respect of a CSR project/programme/activity undertaken by a company, it needs to be determined whether any surplus arises from it. Rule 6(2) requires that the surplus arising out of the CSR projects or programmes or activities would not form part of the business profit of a company.

Accounting treatment prescribed in the guidance note

The guidance note provides that a company needs to assess whether the surplus arising from the CSR activities can be considered as an 'income. The framework defines 'income' as "increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease of liabilities that result in increase 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. Accordingly, surplus arising out of the CSR activities should be recognised in the statement of profit and loss. As per the guidance note, since such surplus does not arise out of 'ordinary course of business', it cannot be part of the business profits. Thus, the surplus should immediately be recognised as a liability for the 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.

Accounting for shortfall/excess spend and creation of provision in case of short spent

Requirements under the 2013 Act and Rules

Section 135(5) of the 2013 Act provides that the board of every company covered under the CSR requirements should ensure that it spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy.

The proviso to this sub clause states that if such a company fails to spend such an amount, the board should, in its report as per Section 134(3)(o) give details about the policy developed and implemented by the company on the CSR initiatives taken during the year and specify the reasons for not spending the amount.

Further, Rule 8(1) prescribes that the board's report of a company under these Rules should include an annual report on CSR, containing particulars specified in the annexure to the said Rules, which provide a format in this regard.

Accounting treatment prescribed in the guidance note

As per the 2013 Act, expenditure on the CSR activities is required to be disclosed in the board's report. The guidance note clearly states that in case there is a shortfall in spending on CSR activities below the prescribed threshold, no provision is required to be made for the shortfall. However, if the company has incurred a contractual liability then a provision should be created for the amount to be spent representing the extent to which the CSR activity was completed during the year in accordance with the generally accepted principles of accounting. The director's report should disclose the reasons for not spending the prescribed amount as per the 2013 Act.

In case a company spends more than the prescribed threshold of two per cent on the CSR activities in a particular year, then such excess amount spent cannot be carried forward to subsequent years in the books of account for set off against the CSR expenditure required to be spent in the future.

Presentation and disclosure in the financial statements

Requirements under the 2013 Act and Rules

The Schedule III to the 2013 Act provides '*General Instructions for Preparation of Statement of Profit and Loss'.* Under these instructions, a company should disclose the amount of expenditure on the CSR activities by way of a note to the statement of profit and loss.

Requirements of the guidance note

- The guidance note recommends that expenditure on the CSR activities that qualify to be recognised as an expense should be presented as a separate line item as the 'CSR expenditure' in the statement of profit and loss. Further, the relevant note relating to the CSR expenditure should disclose break-up of various heads of expenses included in the line item 'CSR expenditure'.

- In case there is a contractual liability incurred for which a provision has been created in the balance sheet for the amount to be spent on the CSR activity. Such provision should be presented as per the Schedule III to the 2013 Act. Additionally, movements in the provision during the year should be shown separately.

- The guidance note also recommends expenditure on the CSR activities should be disclosed by way of notes to accounts as follows:
  - Gross amount required to be spent by the company during the year
  - Amount spent during the year on:

	CSR activities	In cash	Yet to be paid in cash	Total
(i)	Construction/acquisition of any asset			
(ii)	On purposes other than (i) above			

- Disclosure to be made by in the notes to the cash flow statement, (where applicable)

- Details of related party transactions, e.g. contribution to a trust controlled by the company in relation to the CSR expenditure as per AS 18, *Related Party Disclosures*.

Our comments

The guidance note recognises that in many cases the expenditure on CSR activities should be charged to the statement of profit and loss. In limited circumstances, depending on the facts and circumstances, an expenditure may be capitalised as an asset, if it meets the definition of an asset under the framework. For an item to meet the requirement of an asset recognition it should be a resource controlled by the entity capable of earning future economic benefits which in several cases is expected to fail for CSR assets.

The bottom line

The guidance note is expected to bring about uniformity of practice for companies in India. It also aims to bring about greater transparency in the area of accounting for expenditure on CSR activities.

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Introducing KPMG in India IFRS Institute

KPMG in India is pleased to re-launch IFRS Institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

IFRS Notes

The IASB issues a formal proposal to defer the effective date of the new revenue standard

On 19 May 2015, the IASB published an ED of proposed amendments to IFRS 15, *Revenue from Contracts with Customers to* change the effective date of IFRS 15. It proposes that IFRS 15 would apply for annual reporting periods beginning on or after 1 January 2018. Earlier application would continue to be permitted. Entities would also continue to be permitted to choose between applying the standard either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application.

The IASB and FASB Joint Transition Resource Group have discussed a number of application issues. In light of those issues, the IASB has tentatively decided to propose amendments to IFRS 15 which are expected to clarify, instead of change, the requirements of the standard. These amendments are expected to be included in an ED which is slated to be published later in 2015. These amendments are expected to include: a) Clarification to the guidance on licences b) Addition of examples illustrating the guidance on identifying performance obligations and c) Clarifications to the guidance on principal vs agent considerations. In the light of the given proposed amendments, the IASB discussed whether it should propose to defer the effective date of IFRS 15.

Missed an issue of Accounting and Auditing Update or First Notes?

May 2015

The May 2015 edition of the Accounting and Auditing Update captures the recent issue of the application guide on the provisions of Schedule II to the Companies Act, 2013. This month we cover an overview of the Real Estate Investment Trust (REIT) Regulations issued by the Securities and Exchange Board of India (SEBI) and also discuss the relevant accounting requirements for an investment property under Ind AS. We also highlight the requirements of the Companies Act, 2013 with respect to the share application money and bring out key differences vis-à-vis Companies Act, 1956.
The Institute of Chartered Accountants of India (ICAI) recently issued a guidance note on accounting for rate regulated activities. We have provided an overview of the requirements of the guidance note in this issue. In addition, we cast our lens on the recently issued ICAI's Expert Advisory Committee's opinion on accounting of discounts by a company. We also provide a perspective as per Ind AS 115, *Revenue from Contracts with Customers*, on the accounting treatment of discounts.
Finally, in addition to our regular round up of regulatory updates, we have also provided an update on the proposed amendment on accounting for income taxes on intercompany transfers and balance sheet classification of deferred tax asset and liability including transition guidance under the U.S. GAAP.

The ICAI issues a guidance note on accounting for derivative contracts

There has been some lack of guidance on the accounting for derivative contracts and hedging activities. In order to bring uniformity of practice in accounting for derivative contracts by various entities in India, on 12 May 2015, the ICAI issued a guidance note of accounting for derivative contracts (guidance note).

This guidance note provides guidance on recognition, measurement, presentation and disclosure for derivative contracts. The guidance note does not deal with macro-hedging and accounting for non-derivative financial assets/liabilities which are designated as hedging instruments since its objective is to provide guidance on accounting for derivative contracts only and not hedge accounting in its entirety. The guidance note also provides illustrative examples for application of the guidance note. It becomes applicable for accounting periods beginning on or after 1 April 2016. Early voluntary adoption is encouraged.

Our issue of First Notes highlights the key aspects of the guidance note issued by the ICAI.

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 20 May 2015, we covered following topics :

(1) salient features of Indian Accounting Standard (Ind AS) 16, *Property, Plant and Equipment*, and Ind AS 38, *Intangible Assets*

(2) key differences between AS 10, AS 26, Ind AS 16 and Ind AS 38

(3) key aspects of application guide issued by the Institute of Chartered Accountants of India (ICAI).

Feedback/queries can be sent to aaupdate@kpmg.com

Back issues are available to download from: www.kpmg.com/in