ACCOUNTING AND DISCLOSURE OF CGR FUND AS PER ICAI

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III. CSR

ACCOUNTING TREATMENT OF CSR EXPENDITURE AS PER ICAI

1. INTRODUCTION

1.1 As per Section 135(5) of Companies Act 2013, "The Board of every company which meets the limits prescribed under Section 135(1) shall ensure that the company 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 or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years.

1.2 If the company fails to spend such amount, the Board shall, in its report made shall specify the reasons for not spending the amount and, unless the unspent amount relates to any ongoing project referred transfer such unspent amount to a Fund specified in Schedule VII, **within a period of six months of the expiry of the financial year".**

1.3 As per the law, CSR expenditures can be made in various ways apart from direct expenditure, the other form of expenditure are provided below :

- Direct expenditure on charitable activities as per Schedule VII;
- Grant to Trust or Society;
- Transfer to other corporates under pooling of expenditure;
- Donation to Govt. recognised funds where 100% tax relief is available.

We need to understand the accounting & recognition of expenditures when they are incurred directly and by contributon to others. The ICAI has provided detailed guidelines in this regards, which have been provided in ***Annexure-39.***

2. ACCOUNTING & RECOGNITION WHEN CONTRIBUTION IS MADE TO SPECIFIED FUNDS

2.1 When a company gives donation under CSR to Government recognised funds where tax relief is available, such contribution/donation is made to a fund specif ied in Schedule VII to the Act, and the same would be treated as an expense for the year and charged to the statement of profit and loss.

2.2 However, for income tax purposes such CSR contribution shall not be treated as expenditure in the light of the amendments made to section 37 of the Income Tax Act. The same CSR contribution shall be treated as expenditure if it can be claimed under any other section of the Income Tax Act.

3. ACCOUNTING & RECOGNITION WHEN CONTRIBUTION IS MADE TO REGISTERED NPOs

3.1 When the company gives contribution or grants under CSR to registered NPOs including its own foundation, such contribution or grants shall also be treated as expenditure for the year and charged to the statement of profit and loss. However, for Income Tax purposes such CSR contribution shall not be treated as expenditure in the light of the amendments made to section 37 of the Income Tax Act. The same CSR contribution shall be treated as expenditure if it can be claimed under any other section of the Income Tax Act. Similarly, if CSR expenditure is made in any other manner, for instance through pooling of expenditure, the expenditure should be charged to the statement of profit and loss.

4. WHEN EXPENDITURE IS INCURRED DIRECTLY INCLUDING ASSETS

4.1 In case, where an expenditure of revenue nature is incurred on any of the activities mentioned in Schedule VII to the Act by the company on its own, the same should be charged as an expense to the statement of profit and loss. In case the expenditure incurred by the company is of such nature, which may give rise to an 'asset', a question may arise as to whether such an 'asset' should be recognised by the company in its balance sheet. In this context, it would be relevant to note the definition of the term 'asset' as per the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India.

As per the Framework, an 'asset' is a "resource controlled by an enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise". Hence, in cases where the control of the 'asset' is transferred by the company, e.g., a school building is transferred to a Gram Panchayat for running and maintaining the school, it should not be recognised as 'asset' in its books and such expenditure would need to be charged to the statement of prof it and loss as and when incurred. In other cases, where the company retains the 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 by the company in business prof it's in view of Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014.

5. ACCOUNTING ISSUES WHEN COMPANY SUPPLIES ITS OWN GOODS OR SERVICES

5.1 In some cases, a company may supply goods manufactured by it or render services as CSR activities. In such cases, the expenditure incurred should be recognised when the control on the goods manufactured by it is transferred or the allowable services are rendered by the employees. The goods manufactured by the company should be valued in accordance with the principles prescribed in Accounting Standard (AS) 2, Valuation of Inventories. The services rendered should be measured at cost. Indirect taxes (like excise duty, service tax, VAT or other applicable taxes) on the goods and services so contributed will also form part of the CSR expenditure.

6. WHEN THE COMPANY RECEIVES CSR GRANTS

6.1 In some cases, the company may receive CSR grant, for instance through pooling of CSR expenditure with other companies. Where a company receives a grant from other companies for carrying out CSR activities, the CSR expenditure should be measured net of the grant. In other words, such grant received on behalf of other companies cannot be considered for computing 2% requirement of CSR.

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ACCOUNTING TREATMENT OF CSR INCOME AS PER ICAI

1. INTRODUCTION

1.1 A company may have income from CSR projects and activities. ICAI has provided detailed guidelines in this regard which is provided in ***Annexure-39.*** In nut shell the issues relating to treatment of income are as under :

a. Such income should be treated as income in the profit and loss account but cannot be treated as business income.

b. An immediate liability should be created against such income to nullify the effect of treating it as income in the profit and loss account.

c. Such income cannot also be included for the computation of the mandatory 2% requirement

2. RECOGNITION OF INCOME UNDER CSR

2.1 Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, requires that "the surplus arising out of the CSR projects or programs or activities shall not form part of the business prof it of a company". The term 'surplus' ordinarily means excess of income over expenditure pertaining to an entity or an activity. Thus, in respect of a CSR project, programme, or activity, it needs to be determined whether any surplus is arising from it. A question would arise as to whether such surplus should be recognised in the statement of profit and loss of the company. It may be noted that paragraph 5 of Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", inter alia, requires that all items of income which are recognised in a period should be included in the determination of net profit or loss for the period unless an accounting standard requires or permits otherwise.

2.2 As to whether the surplus from CSR activities can be considered as 'income', the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India, defines 'income' as "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 from CSR activities is not arising from a transaction with the owners, it would be considered as 'income' for accounting purposes.

In view of the aforesaid requirement, any surplus arising out of CSR project or programme or activities shall be recognised in the statement of profit and loss and since this surplus cannot be a part of business profit of the company, the same should immediately be recognised as liability for CSR expenditure in the balance sheet and recognised as a charge to the statement of profit and loss.

Accordingly, such surplus would not form part of the minimum 2% of the average net profits of the company made during the three immediately preceding financial years in pursuance of its Corporate Social Responsibility Policy.

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PRESENTATION & DISCLOSURE IN FINANCIAL STATEMENTS

1. INTRODUCTION

1.1 A company should suitably present and disclose the financial information pertaining to CSR. The ICAI has provided detailed guidelines in this regard (refer *Annexure-39*). In a nutshell, the issues related to treatment of income are as under:

a) As per the instructions under Schedule III to the Companies Act, 2013, CSR expenditure should be disclosed by way of a note to the statement of profit and loss account.

b) However, as a prudent and recommended practice, all CSR expenditures should be recognised as a separate line item 'CSR Expenditure' in the profit and loss account.

c) Further, the breakup of CSR expenditures should be provided as a note to the profit and loss account.

d) The note on CSR expenditure should provide :

i. gross amount required to be spent during the year

ii. amount actually spent during the year, including acquisition of assets

iii. detail of any related party disclosure under AS 18

iv. If there is any provision against contractual liability under CSR

2. PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS

2.1 The schedule III of the companies Act 2013 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 or loss. From the perspective of better financial reporting and in line with the requirements of Schedule III, it is recommended that all expenditures on CSR activities that qualify to be recognised as expense should be recognised as a separate line item as 'CSR expenditure' in the statement of prof it and loss. Further, the relevant note should disclose the break-up of various heads of expenses included in the line item 'CSR expenditure'.

2.2 The notes to accounts relating to CSR expenditure should also contain the following:

(a) Gross amount required to be spent by the company during the year.

(b) 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			

The above disclosure to the extent relevant, may also be made in the notes to the cash flow statement, where applicable.

(a) Details of related party transactions, e.g., contribution to a Trust.

(b) Where a provision is made in accordance with paragraph 8 above the same should be presented as per the requirements of Schedule III to the Companies Act, 2013. Further, movements in the provision during the year should be shown separately.

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GUIDANCE NOTE ON ACCOUNTING FOR EXPENDITURE ON CORPORATE SOCIAL RESPONSIBILITY ACTIVITIES

(ISSUED BY INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI) ON MAY 15, 2015)

GN (A) 34

Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities (Issued May 15, 2015)

(The Council of the Institute of Chartered Accountants of India (ICAI) has issued this ***Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities, which*** comes into effect from the date of its issuance. Pending f inalisation of the Guidance Note, as it was under discussion with the relevant authorities, the Corporate Laws & Corporate Governance Committee had issued 'Frequently Asked Questions on the provisions of Corporate Social Responsibility under Section 135 of the Companies Act 2013 and Rules thereon' which, inter alia, provided an interim guidance with regard to certain accounting issues. On issuance of this Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities, the FAQs related to areas covered by the Guidance Note stand withdrawn.)

Introduction

1. Section 135 of the Companies Act, 2013 (the Act), requires the Board of Directors of every company having a net worth of Rupees 500 crore or more, or turnover of Rupees 1,000 crore or more or a net prof it of Rupees 5 crore or more, during any f financial year, to ensure that the company spends in every f financial year at least 2% of the average net prof its of the company made during the three immediately preceding f financial years on Corporate Social Responsibility (CSR) in pursuance of its policy in this regard. The Act requires such companies to constitute a Corporate Social Responsibility Committee which shall formulate and recommend to the Board a Corporate Social Responsibility Policy which shall indicate the CSR activities to be undertaken by the company as specif ied in Schedule VII to the Act.

Objective

2. The objective of this Guidance Note is to provide guidance on recognition, measurement, presentation and disclosure of expenditure on activities relating to corporate social responsibility.

Scope

3. What constitutes CSR activities is specif ied in Schedule VII to the Act. Reference is also invited to the circular issued by the Ministry of Corporate Affairs (MCA) No. 21/2014 dated October 24, 2014. Accordingly, the Guidance Note does not deal with identification of activities that constitute CSR activities but only provides guidance on accounting for expenditure on CSR activities in line with the requirements of the generally accepted accounting principles including the applicable Accounting Standards.

Definitions

4. For the purpose of this Guidance Note, the definitions mentioned at sl. nos. (a) to (f) are reproduced from the Companies Act, 2013, and the Companies (Corporate Social Responsibility Policy) Rules, 2014 and in the event of any change in the Act or the Rules made thereunder, these definitions shall stand automatically revised/modif ied to that extent:

   (a) **Any financial year:** "any financial year" referred under sub- section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014, implies 'any of the three preceding financial years'. (Clarif ication vide MCA General Circular No. 21/2014)

   (b) **Average Net Profit:** Average Net Prof it is the amount as calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

   (c) **Financial Year:** "financial year", in relation to any company or body corporate, means the period ending on the 31ST day of March every year, and where it has been incorporated on or after the 1ST day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

   Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

   Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause;

   (d) **Net Prof it:** "net prof it" means the net prof it 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:-

   (i) any prof it arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

   (ii)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 net prof it in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be recalculated in accordance with the provisions of the Act:

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

   (e) **Net worth:** "net worth" means the aggregate value of the paid- up share capital and all reserves created out of the prof its 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;

   (f) **Turnover:** "turnover" means the aggregate value of the realisation 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;

(g) **Spend:** The term 'spend' in accounting parlance generally means the liabilities incurred during the relevant accounting period

5. Rule 4 of the Companies (Corporate Social Responsibility Policy) Rules, 2014, requires that the CSR activities that shall be undertaken by the companies for the purpose of Section 135 of the Act shall exclude activities undertaken in pursuance of its 'normal course of businesses. The Rules also specify that CSR projects or programmes or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with the requirements of the Act. Such programmes or projects or activities, that are carried out as a pre-condition for setting up a business, or as part of a contractual obligation undertaken by the company or in accordance with any other Act, or as a part of the requirement in this regard by the relevant authorities cannot be considered as a CSR activity within the meaning of the Act. Similarly, the requirements under relevant regulations or otherwise prescribed by the concerned regulators as a necessary part of running of the business, would be considered to be the activities undertaken in the 'normal course of business' of the company and, therefore, would not be considered CSR activities.

Recognition and Measurement of CSR Expenditure in Financial Statements

Whether Provision for Unspent Amount required to be created?

6. Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least 2% of the average net prof its of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy". A proviso to this Section states that "if the company fails to spend such amount, the Board shall, in its report ... specify the reasons for not spending the amount".

7. Further, Rule 8(1) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, prescribes that the Board Report of a company under these Rules shall include an annual report on CSR, containing particulars specif ied in the Annexure to the said Rules, which provide a Format in this regard.

8. The above provisions of the Act clearly lay down that the expenditure on CSR activities is to be disclosed only in the Board's Report in accordance with the Rules made thereunder. In view of this, no provision for the amount which is not spent, i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period, may be made in the financial statements. The proviso to section 135 (5) of the Act, makes it clear that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the 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 accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the

financial statements.

9. Where a company spends more than that required under law, a question arises as to whether the excess amount 'spent' can be carried forward to be adjusted against amounts to be spent on CSR activities in future period. Since '2% of average net prof its of immediately preceding three years' is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount cannot be carried forward for set off against the CSR expenditure required to be spent in future.

Other Considerations in Recognition and Measurement

10. A company may decide to undertake its CSR activities approved by the CSR Committee with a view to discharge its CSR obligation as arising under section 135 of the Act in the following three ways:
    a) making a contribution to the funds as specified in Schedule VII to the Act; or
    b) through a registered trust or a registered society or a company established under section 8 of the Act (or section 25 of the Companies Act, 1956) 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, or otherwise ; or (c) in any other way in accordance with the Companies (Corporate Social Responsibility Policy) Rules, 2014, e.g. on its own.

11. In case a contribution is made to a fund specif ied in Schedule VII to the Act, the same would be treated as an expense for the year and charged to the statement of prof it and loss. In case the amount is spent in the manner as specif ied in paragraph10 (b) above the same will also be treated as expense for the year by charging off to the statement of prof it and loss. The accounting for expenditure incurred by the company otherwise e.g. on its own would be accounted for in accordance with the principles of accounting as explained hereinafter.

CSR activities carried out by the company covered under paragraph 10(c)

12. In cases, where an expenditure of revenue nature is incurred on any of the activities mentioned in Schedule VII to the Act by the company on its own, the same should be charged as an expense to the statement of profit and loss. In case the expenditure incurred by the company is of such nature which may give rise to an 'asset', a question may arise as to whether such an 'asset' should be recognised by the company in its balance sheet. In this context, it would be relevant to note the definition of the term 'asset' as per the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India. As per the Framework, an 'asset' is a "resource controlled by an enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise". Hence, in cases where the control of the 'asset' is transferred by the company, e.g., a school building is transferred to a Gram Panchayat for running and maintaining the school, it should not be recognised as 'asset' in its books and such expenditure would need to be charged to the statement of prof it and loss as and when incurred. In other cases, where the company retains the 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 by the company in business prof its in view of Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014.

13. In some cases, a company may supply goods manufactured by it or render services as CSR activities. In such cases, the expenditure incurred should be recognised when the control on the goods manufactured by it is transferred or the allowable services are rendered by the employees. The goods manufactured by the company should be valued in accordance with the principles prescribed in Accounting Standard (AS) 2, Valuation of Inventories. The services rendered should be measured at cost.. Indirect taxes (like excise duty, service tax, VAT or other applicable taxes) on the goods and services so contributed will also form part of the CSR expenditure.

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

Recognition of Income Earned from CSR Projects/Programmes or During the Course of Conduct of CSR Activities

15. Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, requires that "the surplus arising out of the CSR projects or programs or activities shall not form part of the business prof it of a company". The term 'surplus' ordinarily means excess of income over expenditure pertaining to an entity or an activity. Thus, in respect of a CSR project, programme, or activity, it needs to be determined whether any surplus is arising therefrom. A question would arise as to whether such surplus should be recognised in the statement of profit and loss of the company. It may be noted that paragraph 5 of Accounting Standard (AS) 5, Net Prof it or Loss for the Period, Prior Period Items and Changes in Accounting Policies, inter alia, requires that all items of income which are recognised in a period should be included in the determination of net prof it or loss for the period unless an Accounting Standard requires or permits otherwise. As to whether the surplus from CSR activities can be considered as 'income', the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India, defines 'income' as "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 from CSR activities is not arising from a transaction with the owners, it would be considered as 'income' for accounting purposes.

16. In view of the aforesaid requirement any surplus arising out of CSR project or programme or activities shall be recognised in the statement of prof it and loss and since this surplus cannot be a part of business profits of the company, the same should immediately be recognised as liability for CSR expenditure in the balance sheet and recognised as a charge to the statement of prof it and loss. Accordingly, such surplus would not form part of the minimum 2% of the average net profits of the company made during the three immediately preceding financial years in pursuance of its Corporate Social Responsibility Policy.

Presentation and Disclosure in Financial Statements

17. Item 5 (A)(k) of the General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of prof it and loss. . From the perspective of better financial reporting and in line with the requirements of Schedule III in this regard, it is recommended that all expenditure on CSR activities, that qualify to be recognised as expense in accordance with paragraphs 10-14 above should be recognised as a separate line item as 'CSR expenditure' in the statement of prof it and loss. Further, the relevant note should disclose the break-up of various heads of expenses included in the line item 'CSR expenditure'.

18. The notes to accounts relating to CSR expenditure should also contain the following:

a) Gross amount required to be spent by the company during the year.

b) Amount spent during the year on:

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

The above disclosure, to the extent relevant, may also be made in the notes to the cash flow statement, where applicable.

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

d) Where a provision is made in accordance with paragraph 8 above the same should be presented as per the requirements of Schedule III to the Companies Act, 2013. Further, movements in the provision during the year should be shown separately.

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