ICAI: Frequently Asked Question on Accounting for amounts to be incurred towards Corporate Social Responsibility (CSR) pursuant to the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021

This FAQ has been issued by the Accounting Standards Board of the Institute of Chartered Accountants of India on May 10, 2021[1].

Question : On January 22, 2021, the Ministry of Corporate Affairs notified the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021. Pursuant to the amendment rules, companies are required to spend the required amount (2% of average net profits of the company made during the three immediately preceding financial years) in every financial year for Corporate Social Responsibility (CSR) activities as prescribed under schedule VII or transfer the unspent amount of ongoing projects in a special account called Unspent CSR Account within 30 days of the end of financial year for use within a period of three financial years from the date of such transfer (with the balance unspent out of such account at the end of the three financial years to be transferred to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year); or transfer unspent amount not relating to ongoing projects to such funds as mentioned in Schedule VII like Clean Ganga Fund or PMNRF etc. within 6 months of the end of financial year.

What is the effect of these amendments on the accounting of amounts to be incurred towards CSR?

Response: Section 135 of the Companies Act, 2013 lays down the requirements pertaining to CSR of a company.

- Section 135(1) lays down requirement for constituting a CSR committee by a company which meets either of the three criteria viz., net worth, turnover and net profit in the immediately preceding financial year.
- Section 135(4) requires the Board of Directors of a company to ensure that the activities as included in CSR Policy of the company are undertaken by the company.
- Section 135(5) requires the Board of Directors of every company referred to in subsection (1) to 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, in pursuance of its CSR Policy.

Every company to which Section 135 is applicable is required to spend a minimum amount on CSR activities during the financial year and if not spent, an explanation by the Board of Directors specifying the reasons for not spending such amount in that financial year is to be given, in the Directors report. The amendment to section 135 on

[1] This FAQ has been revised to add clarity in the paragraph relating to the accounting guidance for Interim Financial Statements.

22nd Jan 2021, now requires companies to additionally deal with the unspent amount as at the end of the financial year in a stipulated manner by transferring the same to specified accounts (Unspent CSR Account or Fund specified in Schedule VII, as applicable) depending upon the fact whether such unspent amount relates to ongoing project(s) or not.

Specific penal provisions have also been inserted by the amendment if the company makes default in complying with the minimum amount required to be spent on CSR activities or the treatment of the unspent amount, if any.

The issue is analysed below with reference to Companies (Indian Accounting Standards) Rules, 2015:

Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, defines liability and obligating event and explains past event as under:

> Liability
> "A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
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> Obligating event
> "An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation."
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> Past event
> "17. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:
>
> (a) where the settlement of the obligation can be enforced by law; or
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> (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

The obligating event arises as the CSR activities (spend/incur) are undertaken during the financial year in accordance with the CSR Policy and CSR projects approved by the Board of Directors of the company, and on the determination of the unspent amount as at the end of the financial year whether relating to ongoing projects or not, duly considering the following requirements of Section 135:
 the spend of two percent of average net profits of immediately preceding three years, represents the measurement basis for determining the minimum amount to be spent on CSR activities during the financial year; the "unspent amount":

- of ongoing projects is to be transferred to a special account called Unspent CSR Account within 30 days of the end of financial year (emphasis supplied) for use within a period of three financial years from the date of such transfer (with the balance unspent out of such account at the end of the three financial years to be transferred to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year); and
- not relating to ongoing projects is to be transferred to such funds as mentioned in Schedule VII like Clean Ganga Fund or PMNRF etc. within 6 months of the end of financial year (emphasis supplied).

Thus, the obligating events requiring recognition of CSR expenditure (and a liability, as applicable) occur as follows:

(a) during the financial year, when carrying on CSR activities (spending/incurring) ;

(b) at end of the financial year, to the extent of the "unspent amount" relating to:

(i) ongoing projects and (ii) other than ongoing projects.

Accordingly, CSR expenditure would be recognised as expense in the statement of profit or loss as and when such expenditure is incurred on the CSR activities undertaken as per the Board approved CSR Policy and CSR projects during the financial year. For the "unspent amount", a legal obligation arises to transfer to specified accounts depending upon the fact whether such unspent amount relates to ongoing projects or not. Therefore, liability needs to be recognised for such "unspent amount" as at the end of the financial year as per paragraph 17 (a) of Ind AS 37.

Further as per Ind AS 34, Interim Financial Statements, CSR obligation will be recognised based on the principles for recognition of the same in annual financial statements; the legal obligation for "unspent amount", whether relating to ongoing projects or not, which is determined as per the provisions of Section 135 arises only at the end of the financial year (emphasis supplied) and hence the liability for the same is recognised at the end of the financial year.

Provisions relevant for the instant issue under AS 29, Provisions Contingent Liabilities and
Contingent Assets, and AS 25, Interim Financial Statements, are similar to Ind AS 37 and Ind AS 34, respectively. Accordingly, conclusions drawn above equally apply under Companies (Accounting Standards) Rule, 2006 also.