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# UNIT 1 CSR ACCOUNTING

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## 1.1 INTRODUCTION

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Corporate Social Responsibility (CSR) enables business operations to voluntarily interact with relevant stakeholders and assume accountability for its impact on society and environment. (Commission of European Communities, 2001)<sup>1</sup>.

With new CSR regulation in India, the task of companies has increased. They are not only required to spend money but are also required to follow the disclosure and other statutory requirements. This condition calls for attention to various aspects of CSR accounting including CSR expenditure. In this unit we will discuss various issues related to CSR accounting. After reading this unit you will be able to:

- Explain the CSR components of the Act from CSR accounts perspective
- Define CSR expenditure
- Discuss the conditions of cessation of compliance of CSR

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## 1.2 EXPLAINING THE CSR COMPONENTS OF THE ACT FROM CSR ACCOUNTS PERSPECTIVE

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### 1.2.1 Provisions of the Companies Act, 2013

Ministry of Corporate Affairs, Government of India, through provisions of **Corporate Social Responsibility Policy Rules, 2014**, under the Companies

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<sup>1</sup>Commission (2001). Promoting a European framework for corporate social responsibility. Green Paper. Commission of European Communities.pp.1-32.

Act, 2013, has made it mandatory (with effect from 1st April, 2014) for certain companies that fulfil the criteria as mentioned under Sub Section 1 of Section 135 to comply with the provisions relevant to Corporate Social Responsibility. The CSR Rules state that every company including its holding or subsidiary, as well as foreign companies having a project office/branch in India, meeting the following criteria during any financial year, is required to comply with the CSR provisions. This statutory provision is applicable for every company with:



in a financial year.

Now let us consider the following example for better understanding of applicability of CSR:

#### Illustration 1

A company is formed as a charitable entity to carry on charity work. Management of this company believes that CSR provision is not applicable for them since charitable work is carried out in its normal course of business. Are they right in their understanding?

#### Solution:

Section 135 of Companies Act is applicable to every company meeting the specified criteria mentioned above. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This would imply that companies set up for the purposes of CSR/public welfare are also required to comply with the provisions of CSR.

#### Some Terms and Concepts for Explaining Applicability of CSR Rules

1. **"Any financial year"** refers to 'any of the three preceding financial years'.
2. **"Turnover"** means the aggregate value of the realization 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.
3. **"Net worth"** means the aggregate value of paid-up share capital and all reserves created out of profits and securities premium account, after deducting the aggregate value of 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.

## 1.2.2 Spending on CSR

The Board of Directors of the above-mentioned companies is to ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years on CSR.

4. **“Financial Year”**, ends on the 31<sup>st</sup> day of March every year. (i) If a company is incorporated on or after the 1st day of January of a year, then applicable financial year is the period ending on the 31<sup>st</sup> day of March of the following year. (ii) In case a holding company or a subsidiary of a company incorporated outside India follows a different financial year for consolidation of its accounts outside India, may follow any period as its financial year. Yet, within a period of two years, a company must align its financial year to the 31<sup>st</sup> day of March every year.
5. **“Average Net Profit”** is the amount as calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.

### *Calculating the Average Net Profit for CSR Spending*

CSR is applicable from FY 2014-15. For the purpose of CSR reporting the Net Profit shall mean average of the annual net profit before tax of the preceding three financial years. For **Example**

Particulars	Amounts (in INR)
Net Profit before tax as per books of FY 2017-18	2,500
Net Profit before tax as per books of FY 2016-17	1,700
Net Profit before tax as per books of FY 2015-16	1,000
<b>TOTAL (A)</b>	5,200
Average of annual net profit of the preceding three financial years	1,733
<b>B (A/3)</b>	
CSR expenditure for the FY 2018-19 - <b>(B*2%)</b>	34.67

In case a company spends more than the amount specified in Section 135(1) of the 2013 Act (i.e., more than 2 per cent of its average net profits of three preceding years) on CSR, the excess amount spent cannot be carried forward to the subsequent years and adjusted against the next year's CSR expenditure. However, the company's Board of Directors may carry forward any unspent amount out of the minimum required CSR expenditure to the next Financial Year. However, the carried forward amount would be over and above the next year's CSR allocation equivalent to at least 2 per cent of the average net profit of the company of the immediately preceding three years.

Net Profit means the net profit before tax of a company as per its financial statement prepared in accordance with Section 198 of the Act, but shall not include the following, namely:

- a) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise.
- b) Any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act.
- c) Profit from premium of shares/debentures.
- d) Profit from sales of Forfeited share.
- e) Profit in terms of capital natures (in terms of undertaking of company or any part of thereof).
- f) Profit from the sale of immovable property/fixed assets/any capital nature.
- g) Any surplus change in carrying amount of an assets or liability recognized in equity reserves.

Following shall not be considered as expenditure:

- i) Income tax and any other tax on income
- ii) Compensation, damages or other payments made voluntarily
- iii) Loss of capital natures including loss on sale of undertaking of company or any part of thereof
- iv) Any transfer to assets/liabilities revaluation/equity reserves.

### **1.2.3 Role of Board of Directors in CSR**

The board plays an important role in CSR activities. The role of the Board is as below:

- a) Approve CSR policy.
- b) Ensure its implementation.
- c) Disclose the contents of CSR policies in its report.
- d) CSR policies are made available on the company's website.
- e) Ensure that statutorily specified amount is spent by the company on CSR activities.

If the company fails to spend the statutory amount, the Board should mention in its report about the reasons for not spending the amount.

Companies that are covered under CSR rules are required to constitute a CSR Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. In case of a foreign company, the CSR committee shall comprise of at least two persons, out of which one person shall be nominated by the foreign company.

## 1.2.4 CSR Committee

The compliance of CSR provisions under the Companies Act, 2013, i.e., constitution of a CSR committee, formulation of CSR policy, the spending of requisite amount on CSR activities came into force from 01<sup>st</sup> April, 2014. The CSR committee is responsible for:

- a) Drafting the CSR policy and indicating the CSR activities to be undertaken by the company
- b) Recommending the amount of expenditure to be incurred on the proposed CSR activities and
- c) Monitoring the CSR policy of the company from time to time.

### Illustration 2

A soft drink manufacturing company has a net worth of INR 100 crores. Sales of soft drinks of this company were severely affected due to low demand. Following is the financial performance of the company for the current year and previous 3 years (INR in Crores):

Particulars	March 31, 2014 (Current year)	March 31, 2013	March 31, 2012	March 31, 2011
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Does the Company have an obligation to form a CSR committee since the applicability criteria are not satisfied in the current financial year?

### Solution

As per the act 'any financial year' implies 'any of the three preceding financial years'. A company which meets the net worth, turnover or net profits criteria in any of the preceding three financial years, but which does not meet the criteria in the relevant financial year, will still need to constitute a CSR committee.

As per the criteria to constitute CSR committee:

- 1) Net worth greater than or equal to INR 500 Crores: This criterion is not satisfied.
- 2) Sales greater than or equal to INR1000 Crores: This criterion is not satisfied.
- 3) Net Profit greater than or equal to INR 5 Crores: This criterion is satisfied in financial year ended March 31, 2013.

Hence, the Company will be required to form a CSR committee.

### 1.2.5 What constitutes CSR activities?

As per schedule VII, the following activities may be included by companies in their CSR policies:

- a) Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water.
- b) Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects.
- c) Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.
- d) Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water.
- e) Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts.
- f) Measures for the benefit of armed forces veterans, war widows and their dependents.
- g) Training to promote rural sports, nationally recognized sports, para Olympic sports and Olympic sports.
- h) Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Caste, the Scheduled Tribes, other backward classes, minorities and women.
- i) Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government.
- j) Rural development projects.

**Note: These activities undergo change from time to time as per government's orders.**

#### Illustration 3

From which Financial Year does CSR expenditure and reporting begin?

Every company which meets the criteria specified under sub-section (1) of section 135 is required to comply with CSR rules with effect from April 01, 2014. Companies must undertake CSR activities and spend the amount as required under section 135 during the F.Y. 2014-15 and reporting of the same would be done in 2015 Board's Report.

Accordingly, amongst other things, the constitution of a CSR committee, preparation of CSR policy, the spending of an amount on CSR activities needs to be done during the financial year 2014-15.

**Expenditure on CSR Activities which Qualify as CSR Expenditure**

- a) Only CSR activities undertaken in India shall amount to CSR Expenditure.
- b) CSR activities can be undertaken by a company, either as new or as on-going projects/programmes/activities as per its CSR Policy, but excluding activities which the company would carry on in its normal course of business.
- c) CSR activities can be carried out in collaboration with other companies in such a manner that the CSR Committees of respective companies are in a position to report separately on such CSR activities undertaken.

**Illustration 5**

How can companies with small CSR funds take up CSR activities in a project/ programme mode?

**Solution**

Companies can combine their CSR programmes with other similar companies by pooling their CSR resources. As per Rule 4 of the CSR Rules, a company may collaborate with other companies for undertaking projects or for CSR activities in such a manner that the CSR committees of the relevant companies are in a position to report separately on such projects in accordance with the prescribed Rules.

**Expenditure on Which CSR Activities do not Qualify as CSR Expenditure**

The following activities are not considered as CSR in accordance with section 135 of the Act.

- Activities that benefit only the employees of company and their families shall not be considered as CSR activities
- One off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes, etc., would not qualify as CSR expenditure.

- Expenses incurred by companies for the fulfilment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act, etc.) would not count as CSR expenditure under the Companies Act.
- Contribution of any amount directly or indirectly to any political party shall not be considered as a CSR activity.
- Activities undertaken by the company in pursuance of its normal course of business.

### Illustration 6

PQR Ltd. manufactures office stationaries like pens, pencils, erasers, highlighters, etc. As part of its CSR policy, it has decided that for every pack of these goods sold, INR 0.50 will go towards the 'Educate India Foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the end of the year, the company sold 50,000 such packs and a total of INR 25,000 was recognized as CSR expenditure. However, this amount was not paid to the Foundation at the end of the financial year. Will the amount of INR 25,000 qualify as CSR expenditure?

### Solution

An amount earmarked out of sale for CSR activities cannot be treated as CSR expenditure. The amount must actually be spent to qualify as CSR expenditure. Hence, INR 25,000 will not be automatically considered as CSR expenditure until and unless it is spent on CSR activities.

### Activity 1

Visit the CSR Department of a company and find out what are the CSR expenses made by the company and list out the activities under which these expenses were made.

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**Notes:** a) Write your answers in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

1. What do you understand by Turnover?

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2. Expenditure on which CSR activities qualifies as CSR expenditure?

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### 1.3 CSR EXPENDITURES

#### 1.3.1 CSR – Spending

Companies covered under section 135 are required to spend at least 2% of average net profits during the three immediately preceding financial years. A few important points of CSR spending are as follows:

- a) A company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.
- b) In case of multi-locational operations, company could exercise discretion in choosing the area for which it wants to give preference.
- c) Where the company fails to spend such amount, the Board shall, in its report, specify the reasons for not spending the amount.
- d) The CSR committee shall formulate and recommend CSR policy to the Board.
- e) CSR policy shall indicate the activities to be undertaken by the company as specified in Schedule VII.
- f) The CSR Committee shall recommend the amount of expenditure to be incurred on activities referred in CSR Policy
- g) The CSR Policy of the company shall be monitored by the CSR committee from time to time.

- h) Contribution in kind is not considered as CSR because to qualify as a CSR activity the company has to spend the amount.
- i) Salary paid by the companies to regular CSR staff as well as employees, who render their services for CSR, will be part of administrative overheads and should not exceed 5% of the total CSR expenditure as per rule 4(6) of CSR Rules 2014.
- j) The Finance Act, 2014, provides that any expenditure incurred by an assessee on CSR activities is not permitted as business expenditure incurred for computation of taxable business income.
- k) Contributions to the Prime Minister's Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc., which finds place in Schedule VII, already enjoy exemptions under different sections of the Income Tax Act, 1961. Hence no specific tax exemptions have been extended to CSR expenditure per se.
- l) A holding company or subsidiary of a company which already fulfils the CSR criteria under section 135(1) doesn't make the company liable to comply with section 135, unless the company itself fulfils the criteria.
- m) A foreign company is not required to prepare a directors report. Yet it is mandatory for a foreign company to report on CSR.
- n) Contribution to Corpus of a Trust/ Society/ Section 8 companies, etc., will qualify as CSR expenditure as long as it is created exclusively for undertaking CSR activities.
- o) If a company spends in excess of the mandatory minimum '2% of average net profits of immediately preceding three years' the excess amount cannot be carried forward against the CSR expenditure required to be spent in future.

### **Illustration 7**

Sri Lanka suffered immense loss due to a cyclone. An Indian pharmaceutical company undertook various commercial activities with considerable discounts and concessions in the affected areas of Sri Lanka for a continuous period of 3 months after the cyclone. Management has shown in its Financial Statements for the year 2018-19, as CSR expenditure incurred on such activity. State whether this action taken by the management of the company is correct. Explain with reasons.

### **Solution**

The Companies Act, 2013 mandated that activities carried out in the ordinary course of business cannot be treated as CSR expenditure. Hence commercial activities carried out at concessional rates are nothing but the ordinary course of business activities of the company. Therefore, the financial treatment of showing the expenditure incurred on such

commercial activities as CSR expenditure, is incorrect. Additionally, CSR statutory guidelines require deployment of funds for the development and benefit of local area of the Company. Since expenditure is incurred in Sri Lanka, i.e., another country, it shall not qualify as CSR expenditure.

Following are the details of CSR spending by companies listed on NSE and the top 10 countries with highest amount spent on CSR for FY 2017-18.

**Table 1: CSR spending by companies listed on National Stock Exchange (NSE) for 4 years from 2014-15 to 2017-18**

CSR spending by companies listed on NSE	2017-18	2016-17	2015-16	2014-15
Average Net Profit of last 3 years (INR crore)	5,35,353	4,80,069	4,51,744	4,09,714
Amount Required to be spent (INR crore)	10,686	9,688	9,103	8,214
Amount Decided to be spent (INR crore)	10,886	9,954	9,280	8,388
Amount Unspent (INR crore)	1,717	1,574	1,891	2,455
Final Actual Amount spent (INR crore)	10,030	9,060	8,418	6,461
CSR spend as a % of Net Profit	1.87	1.89	1.86	1.58

Source: nseinfobase.com

**Table 2: Top 10 companies with highest amount spent on CSR for FY 2017-18**

Company Names	Avg. net profit for last 3 years (In Rs. Million)	CSR expenditure to be incurred (In Rs. Million)	Amount spent on CSR activities (In Rs. Million)	CSR amount unspent (In Rs. Million)
Reliance Industries Ltd.	351,541.90	7,030.80	7,450.40	-
Oil & Natural Gas Corpn. Ltd.	24,352.00	4,870.40	5,034.40	-
Tata Consultancy Services Ltd.	248,680.00	4,970.00	4,000.00	970.00
H D F C Bank Ltd.	182,460.00	3,650.00	3,740.00	-
Indian Oil Corpn. Ltd.	163,971.10	3,279.40	3,279.40	-
Infosys Ltd.	155,130.00	3,102.50	3,126.00	-
I T C Ltd.	145,234.00	2,904.70	2,909.80	-
N T P C Ltd.	110,373.00	2,207.50	2,415.40	-
Tata Steel Ltd.	42,809.60	856.20	2,316.20	-
Wipro Ltd.	91,647.00	1,833.00	1,866.00	-

### 1.3.2 Measurement of CSR expenditure

- a) In case the CSR expenditure incurred by a company results in building an asset, then should this be recognised as an asset by the company in its balance sheet? As per the Institute of Chartered Accountants of India (ICAI) 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 an asset in its books. Rather it should be treated as CSR expenditure and must be reflected in the statement of profit and loss of the company, as and when incurred.
- b) Alternately, if the company retains control of the asset then it is important to examine as to whether any future economic benefits would be available to the company or not. Economic benefits from those assets irrespective of whether they are owned and operated by the company or transferred to a third party, shall not 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 profits as per Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014.
- c) A company might supply goods manufactured by it or render services as CSR activities. In such cases, expenditure incurred should be recognised only when the control on goods manufactured by it is transferred or allowable services are rendered. Manufactured goods and services rendered should be measured at cost including GST and that will be the total CSR expenditure.
- d) If a grant is received by a company for carrying out CSR activities, then CSR expenditure should be measured net of the grant.
- e) Contribution to a fund specified in the Schedule VII of the 2013 Act, by a company will be treated as CSR expense for the year.
- f) If a company incurs expenditure on CSR activities through a trust, society, etc., as per Rule 4(2), it should be treated as CSR expense.

#### Illustration 8

Can money donated to a trust by a company be treated as CSR expenditure of the company?

#### Answer

Contribution to the corpus of a trust/ society/ Section 8 companies, etc., will qualify as CSR expenditure as long as (a) the trust/ society/ Section 8 companies, etc., is created exclusively for undertaking CSR activities, or (b)

where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act

### Illustration 9

There are certain corporate groups who run hospitals and educational institutions. Will this be considered as a CSR activity?

### Answer

If the hospitals and educational institutions are part of business activity of the company they would not be considered as CSR activity. However, if some charity is done by these hospitals or educational institutions, without any statutory obligation to do so, then it can be considered as CSR activity.

### 1.3.3 Key tax benefits of CSR expenditure

The CSR expenditure does not specifically qualify for exemptions under the Income Tax Act, 1961. However, certain activities forming part of Schedule VII of Companies Act, 2013 are covered under tax exemptions. For example, spending on certain activities such as the Prime Minister's National Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc., (part of the Schedule VII to the 2013 Act) would be eligible for exemptions under the Income Tax Act, 1961 (IT Act).

#### Activity 2

Visit the accounts section of any Company doing CSR and ask them about the tax benefits of CSR expenditure availed by them and write below.

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### 1.3.4 Presentation and Disclosures of CSR Activities in Financial Statements

A company within the ambit of CSR provisions has to provide following disclosures:

- Financial statements

Companies must disclose the CSR expenditure incurred as a note to the statement of profit and loss. Guidance note on CSR activities must be presented in profit and loss account as a separate line item under the head 'CSR expenditure'. A detailed note on components of CSR expenses

along with provision if any created for unspent CSR amount must be clearly reported. 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:

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

- **Cash flow statement**

Companies must disclose the expenditure incurred on CSR provisions as notes to cash flow statement.

- **Board of Director's Report**

It should include the details about the policy developed and implemented by the company on CSR initiatives along with the annual report on CSR undertaken during the year. A company is required to display these reports on the company's website, if any. A foreign company should also contain an annexure regarding the report on CSR in its balance sheet (filed under Section 381(1)(b) of the 2013 Act).

### 1.3.5 Accounting treatment of CSR expenditure

As per 2013 Act, expenditure on CSR activities, is to be disclosed in the board of director's report. If there is a shortfall in spending on CSR activities below the prescribed threshold, 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.

#### Illustration 10

PQR Company is covered under CSR rules. An amount of INR 17,00,000 was spent on CSR activity towards environmental protection. Average net profit of this company for the past three years was INR 80,00,000. Since the Company incurred a CSR expense in excess of what is required by the rules, it decided to utilize this expense as a carry forward to the next year and reduce next year's CSR spend by INR1,00,000. Can the excess expenditure towards CSR be carried forward to next financial year?

There is no provision for carrying forward the excess CSR expenditure spent in a particular year. Any expenditure over 2 per cent could be considered as voluntary higher CSR spend for that year.

### 1.3.6 Accounting treatment of income arising from CSR activities

Recognition of income if any earned from CSR projects or during the course of conduct of CSR activities, requires application of Rule 6(2). This rule clearly states that any surplus arising out of CSR projects or programmes or activities would not form part of business profits of a company, since such surplus does not arise out of 'ordinary course of business'. The surplus should immediately be recognized as a liability for CSR expenditure in the balance sheet and recognized as a charge to the statement of profit and loss. So, in order to compute the limit of two per cent of average net profits criteria as per Section 135 of 2013 Act, such surplus would not be included in the computation.

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## 1.4 IMPACT OF CSR PROVISION

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The Companies Act 2013 was much awaited. With the new Act coming into force, lots of new provisions came in picture. One such new provision was relating to CSR activities. This provision was much debated. Many companies said that this new provision will create financial burden on them as they need to spend specified percentage of their profits. Now, since the new Act is in force, every company is following the new regulation. Considering the intent of law that companies take so many resources from society they should give back something to it, the provision of CSR is justified. Also, there are few good points for Companies like:

1. The companies can spend less than specified percentage. In such case the board need to disclose the reason for lower spending in its report.
2. The Institute of Chartered Accountants of India (ICAI) also issued a guidance note that clarifies that no provision is required in books of companies for CSR spending. The need is to book only actual expenditure.

Also, the above spending will help in benefitting the underprivileged who are deprived of basic necessities. In long run the society as a whole would surely stand benefitted from it. In cost benefit analysis of this provision, its sure that its benefit will far exceed its cost.

### Illustration 11

- a) A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the

financials regarding this?

- b) During 2015, XYZ Ltd. falls under the purview of CSR provisions since its net profit for the financial year exceeded Rs.5 crore. Company discharged CSR obligations in the year 2016. However, the net profit of the year 2016 was less than Rs.5 crores. Also, it was also not satisfying the other two criteria of section 135 for CSR compliance. Therefore, XYZ company stopped performing CSR activities from the year 2017 onwards. Comment on the company's accountability for CSR.

### Answers

- a) Item 5 (a) 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 profit and loss. Note should also disclose the details with regard to the expenditure incurred in construction of a capital asset under a CSR project.
- b) Once a company has fulfilled the net worth / turnover / net profit criterion for one year it has to fulfil its CSR obligations for the subsequent three financial years, even if it does not fulfil any of these criteria in those years. In the given case XYZ Ltd. falls in the ambit of CSR obligations by fulfilling the criteria of net profit exceeding Rs.5 crores in the year 2015. So it has to discharge its CSR obligations by spending two percent of its average profit every year starting from 2016 till 2018. It cannot stop spending on CSR activities as per the Act after 2016 until the average net profit of preceding three years becomes zero and it also doesn't fulfil the other two criteria.

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## 1.5 CESSATION FROM COMPLIANCE OF CSR

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Every company which ceases to be a company as per the Act for three consecutive financial years shall not be required to –

- a) constitute a CSR Committee; and
- b) comply with the provisions till such time it meets the criteria specified under section 135.

A four year lock in period is applicable for a company fulfilling CSR criterion in one financial year. It may be noted that once a company has fulfilled the net worth / turnover / net profit criterion for one year it has to fulfil its CSR obligations for the subsequent three financial years, even if it does not fulfil any of these criteria in those years.

For example, if ABC Ltd. fulfils the turnover criterion under section 135(1) in the financial year 2015-16, it would continue to be within the scope of section 135(1) for the three financial years from 2016-17 to 2017-18,



irrespective of fulfilment or otherwise of any criterion in those years. If it has not fulfilled any of the three criteria in the three subsequent financial years, it would be outside the scope of CSR in the financial year 2018-19. If in any of the three intermittent years, its average net profit figure is negative, it need not comply with the CSR requirement for that year.

Particulars	F.Y. 2015 -16	F.Y. 2016 -17	F.Y. 2017- 18	F.Y. 2018 -19	F.Y. 2019 -20
Net Worth / Turnover / Net Profit Criterion	√	×	×	×	×
Situation I					
Average Net Profits	Positive	Positive	Positive	Positive	Positive
CSR Obligation	√	√	√	√	×
Situation II					
Average Net Profits	Positive	Positive	Positive	Negative	Positive
CSR Obligation	√	√	√	×	×

### Illustration 6

If a company with a turnover of Rs.1000 crores or more has incurred loss in any of the preceding three financial years, then is the company required to comply with the provisions of the section 135 of Companies Act, 2013?

### Answer

As per the provisions of section 135 of the Act, one of the three criteria has to be satisfied to attract Section 135. Therefore, if a company satisfies the criterion of turnover, although it does not satisfy the criterion of net profit, it is required to comply with the provisions of Section 135 and the Companies (CSR Policy) Rules, 2014. But, since there were no profits, the company did not spend any amount on CSR activities it must explain the reasons for not spending any amount in its Board's reports.

### Check Your Progress - 2

**Notes:** a) Write your answers in about 50 words.

b) Check your answer with possible answers given at the end of the unit.

1. What are the tax benefits of CSR expenditure?

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2. How should the income arising from CSR activities be treated?

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## 1.6 LET US SUM UP

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The main goal of social responsibility accounting is to evaluate whether organizations have met their social responsibilities adequately or not. Social responsibility accounting must include revealing information to beneficiaries, providing feedback for management, and improving social footprints of its projects. In this unit you have read about CSR components of Companies Act from CSR accounts perspective. The unit also discusses what CSR pending is and how CSR expenditure is measured. The impact of CSR provisions has also been discussed. Finally, the conditions for cessation of compliance of CSR have also been discussed.

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## 1.7 KEYWORDS

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**Turnover:** Turnover is the total sales made by a business in a certain period. It is sometimes referred to as 'gross revenue' or 'income'.

**Net worth:** Net worth is the value of the assets a person or corporation owns, minus the liabilities they owe.

**Average Net Profit:** Net profit refers to the amount of money left in the company following the deduction of all expenses from the total sales made.

**Financial Statement:** Financial statements are written records that convey the business activities and the financial performance of a company. Financial statements are often audited by government agencies, accountants, firms, etc., to ensure accuracy and for tax, financing, or investing purposes.

**Cash Flow Statement:** A cash flow statement is a financial statement that summarizes the amount of cash and cash equivalents entering and leaving a company. The cash flow statement measures how well a company manages its cash position, meaning how well the company generates cash to pay its debt obligations and fund its operating expenses.

## 1.8 BIBLIOGRAPHY AND SELECTED READINGS

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## 1.9 CHECK YOUR PROGRESS – POSSIBLE ANSWERS

### Check Your Progress – 1

**Answer 1:** Turnover means the aggregate value of the realization 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.

**Answer 2:** Expenditure on CSR Activities which Qualify as CSR Expenditure are as follows

- a) CSR activities undertaken in India only shall amount to CSR Expenditure.
- b) CSR activities can be undertaken by a company, either as new or as ongoing projects/programmes/activities as per its CSR Policy, but excluding activities which the company would carry on in its normal course of business.
- c) CSR activities can be carried out in collaboration with other companies in such a manner that the CSR Committees of respective companies are in a position to report separately on such CSR activities undertaken.

### Check Your Progress – 2

**Answer 1:** The CSR expenditure does not specifically qualify for exemptions under the Income Tax Act, 1961. However, certain activities forming part of Schedule VII of Companies Act, 2013 are covered under tax exemptions. For example, spending on certain activities such as the Prime Minister's National Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc., (part of the Schedule VII to the 2013 Act) would be eligible for exemptions under the Income Tax Act, 1961 (IT Act).

**Answer 2:** Recognition of income if any earned from CSR projects or during the course of conduct of CSR activities, requires application of Rule 6(2). This rule clearly states that any surplus arising out of CSR projects or

programmes or activities would not form part of business profits of a company, since such surplus does not arise out of 'ordinary course of business'. The surplus should immediately be recognized as a liability for CSR expenditure in the balance sheet and recognized as a charge to the statement of profit and loss. So, in order to compute the limit of two per cent of average net profits criteria as per Section 135 of 2013 Act, such surplus would not be included in the computation.



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