Corporate Social Responsibility (CSR)

The government introduced mandatory CSR requirements in the 2013 Act. The 2013 Act mandates companies to spend on social and environmental welfare, making India perhaps one of the very few countries in the world to have such a law and requirement. The CSR provision became effective from 1 April 2014. Significant amendments have been made to the CSR provisions through issuance of various notifications and clarifications (including FAQs) to streamline the implementation of the CSR provisions by companies. In the past, ICAI has also issued a Guidance Note on accounting for expenditure on CSR (GN on CSR) to provide guidance on accounting as well as suggesting best practice for disclosure and presentation of CSR expenses in the financial statements. We have highlighted the guidance given in the GN on CSR in this chapter.
Applicability

The 2013 Act mandates that every company (including its holding or subsidiary, as well as foreign companies with project office/branch in India) to undertake CSR activities if they meet certain thresholds.

Revised criteria for CSR eligibility under the Companies (Amendment) Act, 2017

A company would fall within the ambit of CSR provisions if any of the following thresholds are met:

- Net worth of INR500 crore or more
- Turnover of INR1,000 crore or more
- Net profit of INR5 crore or more during the immediately preceding FY.

(Emphasis added to highlight the change)

If a company meets any of the above threshold then it is required to spend two per cent of its average net profits (made during three immediately preceding FYs) as a CSR spend.

Calculation of net profit to compute CSR spend

As per the Companies (CSR Policy) Rules, 2014 (CSR Rules), net profit means the net profit of a company as per its financial statements prepared in accordance with the applicable provisions of the 2013 Act, but would not include the following:

- Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise
- Any dividend received from other companies in India, which are covered under and complying under Section 135 of the 2013 Act.

Accordingly, for a CSR contribution to be made in 2017-18, average of the net profits for the immediately preceding three FYs i.e. 2014-15, 2015-16 and 2016-17 would be computed.

While working with the requirements of CSR applicability, companies faced various issues. Few of those issues are as follows:

- **Applicability to holding or subsidiary companies:** One question raised was whether a holding or a subsidiary of a company (which fulfils the criteria for CSR applicability under the 2013 Act) also has to comply with the CSR provisions, even if such holding or subsidiary itself does not fulfil those criteria. The FAQs issued by the MCA clarify that a holding or a subsidiary of a company is not required to comply with the CSR provisions unless the holding or subsidiary itself fulfils the CSR criteria.

- **Applicability to Section 8 companies under the 2013 Act:** The FAQs issued by the MCA clarify that CSR provisions of the 2013 Act apply to ‘every company’ and no specific exemption is given to Section 8 companies. Hence, Section 8 companies are required to follow CSR provisions.

Every company that ceases to be covered under the CSR provisions would not be required to constitute a CSR committee and would not be required to comply with the CSR provisions (Section 135(2)-(5) of the 2013 Act).
Section 198 of the 2013 Act specifies additions/deletions to be made while calculating the net profit of a company (mainly it excludes capital payments/receipts, income tax, set-off of past losses). Additionally, the computation of net profit for CSR spend calculation would be based on profit before tax.

The CSR Rules provide that net profit in respect of a FY for which the relevant financial statements were prepared in accordance with the provisions of the 1956 Act would not be required to be re-calculated in accordance with the 2013 Act. Also in case of a foreign company, net profit would mean net profit of such company as per the statement of profit and loss prepared in terms of Section 381(1)(a) read with Section 198 of the 2013 Act.

CSR committee

Every company required to make a CSR spend should constitute a CSR committee. The CSR committee would comprise three or more directors, out of which at least one director should be an Independent Director.

However, an unlisted public company/private company which is not required to appoint an Independent Director, would constitute a CSR committee without an Independent Director (as per the CSR Rules (Rule 5(1)).

A private company with only two directors on its BoD would constitute its CSR committee with those two directors.

In respect of a foreign company, the CSR committee would comprise at least two persons of which one person should be as per the Section 380(1)(d) of the 2013 Act (i.e. person authorised to accept service of process and any notices or other documents on behalf of the foreign company) and another person should be nominated by the foreign company.

Additional adjustments to be made while computing net profits as per the Companies (Amendment) Act, 2017

While calculating net profits of the company, any amount representing unrealised gains, notional gains or revaluation of assets have to be excluded from net profits.

However, any amount representing profits by way of premium on shares or debentures of the company, which are issued or sold by an investment company should not be excluded from the net profits as per the Companies (Amendment) Act, 2017.

Responsibilities of the CSR committee as per the Companies (Amendment) Act, 2017

The CSR committee would be responsible for the following activities:

a. Formulation and recommendation to the BoD, a CSR policy indicating the activities to be undertaken by the company in areas or subject, specified in Schedule VII to the 2013 Act
b. Recommendation of the amount of expenditure to be incurred on the activities referred to in clause (a) above and
c. Monitoring the CSR policy of the company from time to time.

The BoD of the company are required to approve CSR policy after considering the recommendations made by the CSR committee and should also ensure that the activities included in the CSR policy are undertaken by the company.

Eligible activities for CSR spend

Schedule VII to the 2013 Act lays down a list of activities which are eligible for the CSR expenditure and could be included by companies in their CSR policies. Following are the key headline activities specified in the Schedule VII of the 2013 Act:

a. Eradication of hunger, poverty and malnutrition, promotion of health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the CG for the promotion of sanitation and making available safe drinking water
b. Promotion of education including special education and employment enhancing vocation skills
c. Promotion of gender equality and empowerment of 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. Environmental sustainability

e. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art

f. Measures for the benefit of armed forces veterans, war widows and their dependents

g. Training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports

h. Contribution to the Prime Minister’s National Relief Fund or any other fund set up by the CG or the state governments for socio-economic development and relief and funds for the welfare of the scheduled castes, 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 CG

j. Rural development projects

k. Slum area development.

Companies should give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.

The MCA has also clarified that the 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.

**Different forms for undertaking CSR activities**

A company can undertake CSR activities in the following ways:

a. **CSR activities itself:** A company could undertake the CSR activities itself as per its stated CSR policy either in new projects or ongoing projects.

b. **CSR activities through a company/trusts/society established under Section 8 of the 2013 Act:**

   i. **Companies established by the company or with any other company:** A company established under Section 8 of the 2013 Act, a registered trust, or a registered society established by the company along with any other company and

   ii. **Companies established by the central or state government:** Section 8 company, a registered trust, or a registered society established by the central or state government or any entity established under an Act of Parliament or a state legislature

   iii. **Companies established by others:** Any other Section 8 company, registered trust, or a registered society.

   If a company decides to undertake CSR activities through a company established Section 8 of the 2013 Act, a registered trust or a registered society (which are neither established by it or central/state government) then such Section 8 company, trust or registered society should have an established track record of three years in undertaking similar programmes or projects.

   Additionally, the company (under the obligation of CSR provisions) would have to specify the projects and programmes to be undertaken by such Section 8 company, trust or registered society, including modalities of utilisation of funds of such projects and programmes and the monitoring and reporting mechanism.

c. **CSR in collaboration with other companies:** A company could collaborate with other companies for undertaking projects/programmes or CSR activities in such a manner that CSR committees of respective companies are in a position to report separately on such projects/programmes.

d. **Building CSR capacities of personnel and implementing agencies:** Companies could build CSR capacities of their own personnel as well as those of their implementing agencies through institutions with established track records of at least three FYs. However, such expenditure including expenditure on administrative overheads should not exceed five per cent of the total CSR expenditure of the company in one FY.

e. **Contribution to funds specified in the Schedule VII:** Companies could also contribute in the funds specified in Schedule VII of the 2013 Act, for example:

   - Swach bharat kosh set-up by the CG for the promotion of sanitation and making available safe drinking water
   - Prime minister’s national relief fund or any other fund set up by the CG or the state governments for socio-economic development and relief and funds for the welfare of the scheduled castes, the scheduled tribes, other backward classes, minorities and women
   - Contribution or fund provided to technology incubators located within academic institutions which are approved by the CG.
Ineligible activities for CSR spend
Following activities are not eligible for the CSR spend:

a. Normal course of business activities
b. Direct/indirect contribution to any political party
c. Only for the benefit of the employees and their families
d. One-off events
e. Regulatory expenses
f. Activities undertaken outside India.

Treatment of CSR expenditure in the financial statements
The amount of contribution made towards CSR would generally, be treated as an expense and charged to the statement of profit and loss, unless it gives rise to an asset. According to the GN on CSR, an asset would be recognised on the basis of an evaluation of control over the asset and accrual of future economic benefits to the company. Based on GN on CSR, it seems that a company would be unlikely to demonstrate either the control or future economic benefits criteria for the CSR assets.

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 BoD may carry forward any unspent amount out of the minimum required CSR expenditure to the next FY. 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.

It is important to note that under Ind AS, Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, requires recognition of a provision when all the following conditions are being met:

a. An entity has a present obligation (legal or constructive) as a result of a past event
b. It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
c. A reliable estimate could be made of the amount of obligation.

Based on the requirements of Ind AS 37 and the 2013 Act, ITFG in its clarifications bulletin 8\(^3\) clarified that the provision for any shortfall in the amount that was expected to be spent on the CSR activities as per the 2013 Act and the amount actually spent at the end of a reporting period, may not be required in the Ind AS financial statements. However, if a company has already undertaken certain CSR activity for which an obligation has been created, for example, by entering into a contractual obligation, or either a constructive obligation has arisen during the year, then in accordance with Ind AS 37, a provision for the amount of such CSR obligation, should be recognised in the Ind AS financial statements.

Key tax benefits of CSR expenditure
As per the Finance Act 2014, expenditure on CSR does not form part of the business expenditure. However, spending on certain activities such as 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).

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

- Financial statements: Disclose the amount of expenditure incurred on CSR by way of a note to the statement of profit and loss.
  
  The GN on CSR require expenditures on CSR activities to be presented as a separate line item under the term ‘CSR expenditure’ in the statement of profit and loss. Additionally, a note containing the break-up of various heads of expenses relating to the item CSR expenditure should be provided.
  
  If a company has made a provision for unspent CSR amount then it should be presented as per the requirements of the Schedule III to the 2013 Act. The movements in the provision during the year should also be shown separately.
  
  Additionally, a company should also disclose RPTs e.g. contribution to a trust controlled by the company in relation to CSR expenditure.

- Cash flow statement: Disclose in the notes to cash flow statement the expenditure incurred on CSR provisions.

- BoD’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).

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If the CSR policy is being made available on the company’s website, then the company could provide the salient features of the CSR policy and any change therein briefly in the BoD’s report and should indicate the web address at which the complete policy is available.

Regulation 34(2)(f) of the Listing Regulations requires mandatory submission of Business Responsibility Report (BRR) for top 500 listed companies based on market capitalisation (calculated as on 31 March of every year) along with the annual report.

The BRR should describe the initiatives taken by the said listed entities from an environmental, social and governance perspective, in the format as specified by SEBI from time to time.

Additionally, the listed entities other than the top 500 listed entities and listed entities which have listed their specified securities on the SME exchange, could include these BRRs on a voluntary basis in the specified format.

Companies should formulate the CSR policy and effectively monitor the compliance with the CSR requirements.

- The CSR activities mentioned in Schedule VII of the 2013 Act are broad-based and intended to cover wide range of activities. Many more can be covered by the companies.

  Additionally, the Companies (Amendment) Act, 2017 provides discretion to the companies to spend the CSR amount in the areas other than their local area of business or industry.

- The CSR expenditure does not specifically qualifies for exemptions under the Income Tax Act, 1961. However, certain activities forming part of Schedule VII of the 2013 Act are covered under tax exemptions.

- Reasons for not spending the amount set aside for CSR in a FY also need to be disclosed in the BoD’s report.

- Companies conducting CSR through a Section 8 company, trust or society (established by it) should carefully evaluate if such a company, trust or society would be consolidated in its CFS.