

## **Query No. 9**

**Subject:** *Accounting for unspent CSR spending as per Revised DPE Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises.*<sup>1</sup>

### **A. Facts of the Case**

1. The querist is a Government company within the meaning of section 2(45) of the Companies Act, 2013. The shares of the company are listed with recognised stock exchanges. The company is engaged in the business of refining of crude oil and marketing of petroleum products. It has two refineries and lube blending/filling plants. The company also has depots, installation and LPG plants across India, besides having administrative offices at Delhi, Chennai, Kolkata, Mumbai and other major cities.

2. The querist has stated that as per the provisions of section 135 and relevant rules, etc. under the Companies Act, 2013, Board of Directors of a company has to ensure that the company spends, in each financial year, at least 2% of the average net profits of the company, made during the three immediately preceding financial years, in pursuance of its corporate social responsibility (CSR) policy. If the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134 of the Companies Act, 2013, specify the reasons for not spending the amount. Further, paragraph 1.5.3 of the erstwhile DPE Guidelines<sup>2</sup> (effective till 31.3.2014), applicable to all the central public sector enterprises, inter alia, stated as follows:

“The budget allocated for CSR and Sustainability activities/projects planned for each financial year is expected to be spent within that year. If due to some reason, the budget of a year remains unutilised, the same would not lapse. Instead, it would be carried forward to the next year for expenditure on CSR and Sustainability activities, which were planned for implementation in the previous year, but could not be completed due to some reason. However, the public sector enterprise shall have to disclose reasons for not being able to spend the entire budget on CSR and Sustainability activities as planned for that year, and shall make every endeavour to spend the unutilized budget of any year within the next two financial years. In case the CPSEs are unable to spend the unutilized budget within the next two financial years, the unspent amount would be transferred to a ‘Sustainability Fund’ to be used for CSR and Sustainability activities. This ‘Sustainability Fund’ would be created separately. Implementation mechanism in this context is also being formulated separately.”

3. The querist has further stated that in the financial year 2014-15, Rs. 76.01 crore is required to be spent by the company towards CSR expenses. However, the company has spent Rs. 33.95 crore (including payables of Rs 7.28 crore as on 31<sup>st</sup> Mar 15). The company had made

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<sup>1</sup> Opinion finalised by the Committee on 7.7.2016.

<sup>2</sup> These Guidelines were subsequently superseded by the Revised Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises, which are effective from 1.4.2014.

the provision of Rs. 42.06 crore for the unspent amount in line with an earlier opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI), published as Query No. 8 of Volume XXXIV of the Compendium of Opinions, which provides guidance in a similar case. Further, the company made the following disclosures in line with the Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities, issued by the ICAI:

“Disclosure in respect of Expenditure on Corporate Social Responsibility Activities

(Rs. in crore)

a) Amount required to be spent by the company during the year	76.01
b) Amount spent during the year (on purpose other than construction/ acquisition of assets controlled by the company) #	33.95 *
c) Provision created for balance amount	42.06

# the above expenditure includes contribution to funds, expenses through registered trusts / registered society or company established under section 8 of the Act and direct expenses by the company.

\* including payables of Rs. 7.28 crore as on 31.03.2015.”

4. *Points raised by Government Auditor*

During the audit of the financial year 2014-15, Government auditor has raised query stating that provision created for unspent amount on CSR expenditure is not in line with the interim guidance of the Corporate Laws and Corporate Governance Committee of the ICAI i.e., Frequently Asked Questions (FAQs)<sup>3</sup> on the provisions of Corporate Social Responsibility under Section 135 of the Companies Act 2013 and Rules thereon, which, inter alia, states (vide Issue no. 7) that “any such shortfall is not required to be provided for in the books of accounts”.

5. *The company’s view*

As per section 135 (5) of the Companies Act, 2013 and as mentioned in the Guidelines on Corporate Social Responsibility and Sustainability For Central Public Sector Enterprises, issued by the Department of Public Enterprises (DPE) on 21st October, 2014 (hereinafter referred to as the ‘Revised DPE Guidelines’), which are effective from 1.4.2014, the Board of every company to which CSR provisions are applicable, 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, in pursuance of its Corporate Social Responsibility Policy. Further, if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of Section 134, specify the reasons for not spending the amount. The DPE guidelines in paragraph 2.4 (iv) also state that in case of CPSEs mere reporting and explaining the reasons for not spending this amount in a particular year would not suffice and the unspent CSR amount in a particular year would not lapse. It would instead be carried forward to the next year for utilization for the purpose for which it was allocated. There is an

<sup>3</sup> The FAQs on certain issues covered by the Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities were subsequently superseded by the said Guidance Note on its issuance on May 15, 2015.

earlier opinion, issued by the Expert Advisory Committee (EAC) of the ICAI (published as Query No. 8 of Volume XXXIV of the Compendium of Opinions) on a similar query wherein EAC has opined that the company should provide for the unspent amount of CSR and sustainability development (SD) as provision in its accounts since the company is obligated to spend the remaining amount in subsequent periods. Accordingly, taking guidance from the subject opinion, the provision towards unspent CSR amount for F.Y. 2014-15 was created in the accounts as there is an obligation on the company on the reporting date to spend the balance CSR amounts and the same will not lapse. Further, the company has made the necessary disclosures as per the guidance referred to in paragraph 4 above.

## **B. Query**

6. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the accounting treatment followed by the company, i.e., creating provision towards unspent CSR amount is correct.
- (ii) If not, what will be the accounting treatment for the unspent amount in view of the fact that the unspent amount shall have to be carried forward and spent in subsequent years in line with the DPE Guidelines?
- (iii) What are the disclosure requirements of the unspent amount by the company?

## **C. Points considered by the Committee**

7. The Committee, while expressing the opinion, has restricted itself to the issues raised in paragraph 6 above and has not examined any other issue arising from the Facts of the Case, such as, determination of the amount to be earmarked for CSR activities, legal interpretation of DPE Guidelines, what qualifies as CSR expenditure, etc. At the outset, the Committee notes from the Revised DPE Guidelines that the Guidelines supplement the CSR requirements as envisaged in the Companies Act, 2013 and Companies (Corporate Social Responsibility Policy) Rules, 2014 (hereinafter referred to as CSR Rules) and, therefore, CPSEs have been advised to follow the CSR Rules together with the Guidelines. Accordingly, it is understood that these DPE guidelines are additionally required to be followed by the CPSEs. Further, since the company seems to be already following the requirements of DPE Guidelines as the querist has also referred to the DPE Guidelines while arguing for creation of provision by the company in the extant case, the Committee, without interpreting DPE Guidelines presumes that the company is required to follow these Guidelines. Accordingly, the Committee has examined the extant issue in the context of DPE Guidelines. Further, the Committee notes that the querist has raised the issue for financial year 2014-15 and has also referred to the requirements of FAQs issued by the Corporate Laws and Corporate Governance Committee, which provided an interim guidance and on issuance of the Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities on May 15, 2015, by the ICAI, the FAQs related to areas covered by the Guidance Note stand withdrawn from that date. The Committee also notes that the Guidance Note as well as FAQs provide that considering the requirements of the Companies Act, no provision for the unspent amount is required to be made in the financial statements. However, the Committee notes that both the FAQs as well as the Guidance Note cover only the

requirements of the Companies Act 2013 and CSR Rules, whereas in the extant case, the company is also required to follow DPE Guidelines in addition to the requirements of the Companies Act, 2013. Accordingly, the issue in the extant case is being examined in the context of DPE Guidelines.

8. The Committee further notes the following paragraphs of the revised DPE Guidelines:

“2.4 (i) It is *mandatory* for all profit making CPSEs to undertake CSR activities as per the provisions of the Act and the CSR Rules. Even the CPSEs which are not covered under the eligibility criteria based on threshold limits of net-worth, turnover, or net profit as specified by Section 135 (1) of the Act, but which made profit in the preceding year, would also be required to take up CSR activities as specified in the Act and the CSR Rules, and such CPSEs would be expected to spend at least 2% of the profit made in the preceding year on CSR activities.

...

(iv) It would be *mandatory* for all CPSEs which meet the criteria as laid down in Section 135 (1) of the Act, to spend at least 2% of the average net profits of the three immediately preceding financial years in pursuance of their CSR activities as stipulated in the Act and the CSR Rules. This stipulated percentage of average net profits is to be spent every year in a manner specified in the Act and CSR Rules. *In case a company fails to spend such amount, it shall have to specify the reasons for not spending it. However, in case of CPSEs mere reporting and explaining the reasons for not spending this amount in a particular year would not suffice and the unspent CSR amount in a particular year would not lapse. It would instead be carried forward to the next year for utilization for the purpose for which it was allocated.*

(Emphasis supplied by the Committee.)

From the above, the Committee notes that as per the above DPE Guidelines, all central public sector enterprises are mandatorily required to undertake CSR activities and spend the prescribed amount on such activities in a financial year. If a company fails to spend such amount, it shall have to specify the reasons for not spending it and further that unspent CSR amount in a particular year would not lapse. It would instead be carried forward to the next year for utilization for the purpose for which it was allocated, viz., CSR activities. Thus, the Committee is of the view that as per the revised DPE Guidelines, there is a mandate on the CPSEs to spend on CSR activities within a specified period as the prescribed amount, if not spent in a financial year, will be carried forward and shall not lapse.

9. The Committee notes the definitions of the terms, ‘provision’, ‘liability’, ‘obligating event’, ‘present obligation’ and paragraphs 11, 14 and 16 of Accounting Standard (AS) 29, ‘Provisions, Contingent Liabilities and Contingent Assets’, notified under the Companies (Accounting Standards) Rules, 2006, as follows:

***“10.1 A provision is a liability which can be measured only by using a substantial degree of estimation.***

***10.2 A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.***

***10.3 An obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.”***

***“10.6 Present obligation - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.”***

***“11. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. Obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.”***

***“14. A provision should be recognised when:***

- (a) an enterprise has a present obligation 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 can be made of the amount of the obligation.***

***If these conditions are not met, no provision should be recognised.”***

***“16. 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 enterprise has no realistic alternative to settling the obligation created by the event.”***

From the above, the Committee notes that as per the provisions of AS 29, a provision should be recognised when there is a present obligation, i.e., more likely than not, involving incurrence of expenditure, arising from a past event that leaves no realistic alternative apart from settling that obligation and that the obligation exists independently of an enterprise’s future actions. In this context, Committee also notes that since DPE Guidelines are presumed to be followed by the company (in paragraph 7 above), which require the company to spend certain amount on CSR activities within a particular year and since as per the these Guidelines, the unspent amount would not lapse; rather the same would be carried forward only to next year to be used only for CSR activities, the Committee is of the view that as per DPE Guidelines, the company has no realistic alternative apart from spending that amount on the CSR activities. Thus, it creates a present obligation on the company to spend the specified amount on CSR activities. Accordingly, the company should make a provision for such an obligation as per the

requirements of AS 29. On the basis of the above, the Committee is of the view that in the extant case, in the financial year 2014-15, the company is correct in recognising a provision in respect of unspent expenditure on CSR activities.

10. With regard to disclosure of unspent amount of CSR, the Committee is of the view that apart from complying with the disclosure requirements as prescribed in the Companies Act, 2013 (Schedule III and section 135), Companies (Corporate Social Responsibility) Rules, 2014 and DPE Guidelines, the company should make disclosures in accordance with the disclosure requirements with regard to the provisions, as contained in AS 29.

#### **D. Opinion**

11. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 6 above:

- (i) The accounting treatment followed by the company, i.e., creating provision towards unspent CSR amount in the financial year 2014-15 is correct.
- (ii) Answer to this question does not arise in view of (i) above.
- (iii) As regards the disclosure requirements of the unspent amount by the company, the company should, apart from complying with the disclosure requirements as prescribed in the Companies Act, 2013 (Schedule III and section 135), Companies (Corporate Social Responsibility) Rules, 2014 and DPE Guidelines, make disclosures in accordance with the disclosure requirements with regard to the provisions, as contained in AS 29.

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