Accounting for Unspent Expenditure towards Corporate Social Responsibility

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company (hereinafter referred to as 'the company'), a Government of India enterprise, is engaged in the business of transmission of power from the generating units in central sector to various State Electricity Boards.

2. The querist has stated that the Guidelines on Corporate Social Responsibility (CSR) for Central Public Sector Enterprises (CPSEs), issued by the Department of Public Enterprises (DPE) on 9th April, 2010, provides that each CPSE has to mandatorily create CSR budget through a board resolution as a percentage of net profit of the previous financial year. The above guidelines also provide that amount allocated for CSR activities should be transferred to a CSR fund, which will accumulate - as in the case of non-lapsable pool- for the North East. In this regard, the querist has referred to clause 5.4 of the Guidelines on Corporate Social Responsibility for Central Public Sector Enterprises dated 09/04/2010, issued by the Department of Public Enterprises (a copy of which has been supplied by the querist for the perusal of the Committee).

3. In accordance with the above guidelines, in the financial year (F.Y.) 2011-12, 1% of profit after tax (PAT) of the previous year was earmarked to CSR activities (after approval of the Board of Directors).

4. The querist has also stated that upto the F.Y. 2010-11, actual expenditure incurred on CSR activities was charged to the statement of profit and loss and the difference between 1% of PAT of previous year and actual expenditure (hereinafter called as 'unspent expenditure') was appropriated through the statement of profit and loss to CSR reserve.

5. During the F.Y. 2011-12, it was considered that unspent expenditure is not in the nature of reserve to be created by appropriation of profit but is an obligation to be incurred. As such, it is in the nature of provision rather than reserve fund. Accordingly, provision was made for the unspent expenditure for the year as well as unspent expenditure as at the beginning of the year. The above accounting treatment was based on distinction between a provision and a reserve as discussed in 'Metal Box Co. India Ltd. v. Their Workmen (1969)'. The relevant text as reproduced by the querist is as below:

   "An amount set aside out of profits and other surpluses, not designated to meet a liability, contingency commitment or diminution in value of assets known to etxist at the date of balance sheet is a reserve but an amount set aside of profits and other surpluses to provide for any known liability of which the amount cannot be determined with substantial accuracy is a provision"

6. Moreover, according to the querist, as per Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', ***"a provision is a liability which can be measured only by using a substantial degree of estimation".*** Liability is defined as ***"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". Thus, "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."***

7. During the audit under section 619(4) of the Companies Act, 1956, the Comptroller and Auditor General of India (C&AG) observed that the above practice of the company is not in line with the DPE's guidelines. The C&AG was of the view

that unspent expenditure should be transferred to CSR reserve under 'Reserves and Surplus' instead of provision for CSR through charge to the profit and loss account. The observation was dropped on assurance that the matter will be referred to the Expert Advisory Committee of the Institute of Chartered Accountants of India.

B. Query

8. On the basis of the above, the querist has sought the opinion of the Committee on the following issues:

(i) whether the unspent expenditure should be charged to the profit and loss account and provision be created for the same.

or

(ii) the unspent expenditure be appropriated through the profit and loss account to CSR reserve.

or

(iii) to adopt any other accounting treatment.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting for unspent expenditure towards Corporate Social Responsibility (CSR), viz., whether it should be recognised as a provision or reserve or should be treated in any other way. The Committee has, therefore, considered only this issue 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, etc.

10. The Committee notes the definitions of 'provision', 'liability', 'obligating event', 'present obligation' and paragraphs 14, 16, 17 and 18 of AS 29, notified under the Companies (Accounting Standards) Rules, 2006 as follows:

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

"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."

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

"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."

"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.

17. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.

18. It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation to the extent that the enterprise is obliged to rectify damage already caused. In contrast,

because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised."

11. The Committee further notes the following features of the DPE Guidelines:
    (i) The CSR *budget* will be mandatorily created through a Board Resolution as a percentage of net profit in the manner specified in the guidelines. (Clause 5.1 of DPE Guidelines)
    (ii) Loss-making companies are not mandated to earmark specific funding for CSR activities. (Clause 5.2 of DPE Guidelines)
    (iii) The CSR *budget* should be fixed for each financial year. This funding will not lapse. It will be transferred to a *CSR Fund,* which will accumulate - as in the case of non-lapsable pool – for the North East. (Clause 5.4 of DPE Guidelines)
    (iv) The implementation of CSR guidelines will form a part of the Memorandum of Understanding that is signed each year between CPSEs and Government. (Clause 8.4 of DPE Guidelines)
    (v) In MoU Guidelines from 2010-11 onwards, 5 marks have been earmarked out of the non-financial parameters for CSR activities… . (Clause 8.6 of DPE Guidelines)

From the above, the Committee notes that as per the DPE Guidelines, there is a mandate for creation of a budget/fund and not to spend on CSR activities as a percentage of profits, which would only form a basis for evaluation of the performance of an enterprise. However, there is no mandate on the amount of expenditure, which has to be necessarily incurred by an enterprise during a period of its operation. Thus, there is a mandate only on the creation of a budget or fund rather than an obligation to incur expenditure during a period. Further, neither there is any time limit for incurring the expenditure out of CSR fund nor any penalty is prescribed for non-incurrence of such expenditure. The Committee also notes that as per the provisions of AS 29, a provision should be recognised when there is a present obligation involving incurrence of expenditure, arising from a past event that leaves no realistic alternative apart from settling that obligation and that obligation exist independently of an enterprise's further actions. Since as per DPE Guidelines, there is no such obligation on the enterprise, provision should not be recognised. Accordingly, the Committee is of the view that the requirement in the DPE Guidelines for creation of a CSR budget can be met through creation of a reserve as an appropriation of profits rather than creating a provision as per AS 29.

12. On the basis of the above, the Committee is of the view that in the extant case, it is not appropriate to recognise a provision in respect of unspent expenditure on CSR activities. However, a CSR reserve may be created as an appropriation of profits.

D. Opinion

13. On the basis of the above, the Committee is of the opinion that the unspent expenditure should not be recognised as a provision. However, a reserve may be created as an appropriation of profits, as discussed in paragraphs 11 and 12 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on February 7, 2013. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty volumes. A CD of Compendium of Opinions containing thirty volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.org.