***Query No. 30***

***Subject:*** ***Accounting for unspent expenditure towards Corporate Social Responsibility and Sustainability activities as per Revised DPE Guidelines.***[1]

## A. Facts of the Case

1. A public sector company is engaged in the field of power equipment manufacture. The company has manufacturing units, power sector regions, service centers and regional offices besides project sites spread all over India and abroad. Shares of the company are listed at National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). The turnover of the company was Rs. 50,156 crore in the year 2012-13. The company had an employee strength of 48,399 Nos. as on 31.03.2013.

2. The querist has raised the extant query in the context of Department of Public Enterprise (DPE) Guidelines (Revised) on Corporate Social Responsibility (CSR) and Sustainability for Central Public Sector Enterprises (CPSEs), which are effective from April 01, 2013 (hereinafter referred to as 'revised DPE Guidelines'):

Paragraph 1.5.1 of the revised DPE Guidelines states, "Every year, each CPSE shall with the approval of its Board of Directors make a budgetary allocation for CSR and Sustainability activities / projects for the year. The budgetary allocation will be based on the profitability of the company. More specifically, it will *be determined by the Profit After Tax (PAT) of the company in the previous year* as shown hereunder:

| PAT of CPSE in the previous year | Range of budgetary allocation for CSR and Sustainability activities (as % of PAT in previous year) |
|---|---|
| (i) Less than Rs. 100 Crore | 3%-5% |
| (ii) Rs. 100 Crore to Rs. 500 Crore | 2%-3% |
| (iii) Rs. 500 Crore and above | 1%-2% |

Further, paragraph 1.5.3 of the revised DPE Guidelines states, "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

[1] Opinion finalised by the Committee on 11.4.2014.

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."
(Emphasis supplied by the querist.)

3. Policy of the company relating to the unspent expenditure towards Corporate Social Responsibility and Sustainability Development (SD) is as below:

> DPE guidelines on CSR were adopted by the Board in its 427th meeting held on 23.07.2010 wherein it was decided that CSR budget for financial year 2010-11 would be 0.5% of profit after tax (PAT).

The querist has stated that any unspent amount at the end of the year is provided for and shown as 'short-term provision' in the accounts of the company.

*4. Point raised by Government Audit:*

During the audit of annual accounts for the year 2012-13, the Government audit has raised a query stating that unspent amount related to CSR & SD should be shown as CSR & SD reserve under 'Reserves & Surplus' instead of provision for CSR activities.

*5. The company's views:*

*As evident from revised DPE guidelines referred to in paragraph 2 above, there is a clear mandate for spending on CSR activities of the specified amount and time limit for incurring this expenditure is also clearly specified. Though penalty, in financial terms, is not prescribed for not incurring the specified expenditure during the year, companies have to disclose reasons for not being able to spend the entire budget on CSR and Sustainability activities as planned for that year.* (Emphasis supplied by the querist.)

This obligatory nature is further evident in section 135(5) of the Companies Act, 2013 (implementation date yet to be notified)[2] which states:

> "The Board of every company 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…

[2] Subsequent to the submission of query by the querist, implementation date of section 135(5) was notified by the Ministry of Corporate Affairs vide Notification dated 27th February, 2014, as per which, it came into force from 1st April, 2014.

… Provided further that 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."

Moreover, the provision for carry forward of the unspent balance also exists in the proposed draft Corporate Social Responsibility Rules[3]. It clearly means that the unspent balance of amount specified for CSR cannot lapse or be used for any other purpose.

In the opinion of the querist, based on these facts, treatment of unspent amount of CSR as provision is in line with Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', as it is fulfilling all the following three pre-requisites of recognition as provision:

(i) There is a *present obligation to spend on CSR activities as a result of past event of earning of profits* as is clear from the intention of DPE in its revised Guidelines and also New Companies Act, 2013:

*The amount to be spent in the year is based on the past event of earning of profit, i.e., PAT for the last year and it is a present obligation as on the balance sheet date and it is independent of the future action of the company (i.e., future conduct of its business;*

(ii) *Outflow of resources will be certainly required* to settle the obligation:

*The outflow for the amount specified for CSR is certainly required to take place in the specified period to settle this statutory obligation and there is no realistic alternative available to the company to settle this. Compromising on a lower level of performance can not be a realistic alternative to avoid the obligation in this context;* and

(iii) *A reliable estimate can be made* of the amount of obligation:

*Amount of CSR obligation as specified by DPE can be estimated accurately as it is based on a known figure i.e. PAT of the last year.*

(Emphasis supplied by the querist.)

**B. Query**

6. Based on the above facts, the querist has sought the opinion of the Expert Advisory Committee (EAC) as to whether in line with the Revised DPE Guidelines, the company can continue its practice to provide unspent amount of CSR/SD in accounts and carry forward the same in the next year as 'short term provision' till final cash outflow takes place.

[3] Subsequent to the submission of query by the querist, the Companies (Corporate Social Responsibility Policy) Rules, 2014, was notified by the Ministry of Corporate Affairs vide Notification dated 27th February, 2014, which came into force from 1st April, 2014.

## C. Points considered by the Committee

7. The Committee notes from the Facts of the Case that the basic issue raised in the query relates to accounting for unspent amount of expenditure required to be made for CSR and SD activities as per the above-mentioned revised DPE Guidelines that are effective from April 1, 2013. 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 and SD activities, legal interpretation of DPE Guidelines, disclosure of CSR and SD fund, etc. The Committee has also not considered the issue in the context of the Companies Act, 2013.

8. 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 <u>provision</u> is a liability which can be measured only by using a substantial degree of estimation.***
>
> ***10.2 A <u>liability</u> 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 <u>obligating event</u> is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation."***
>
> ***"10.6 <u>Present obligation</u> - 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."

9. The Committee further notes paragraph 1.5.3 of the revised DPE Guidelines:

**"1.5.3** 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 unutilised budget* of any year within the next two financial years. In case the CPSEs are unable to spend the unutilised 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." (Emphasis supplied by the Committee.)

From the above, the Committee notes that as per the DPE Guidelines, the enterprises are required not only to make budget allocation for CSR and Sustainability activities but are also expected to spend it within that year. If due to some reason, the budget of a year remains unutilised, the same would not lapse and would be carried forward to the next two years and finally, the unspent amount would be transferred to a 'Sustainability Fund' to be used for CSR and Sustainability activities. Further, the Committee notes that the enterprise shall have to disclose reasons for not being able to spend the entire budget on CSR and Sustainability activities as planned for a year and shall make every endeavour to spend the unutilised budget. Thus, the Committee is of the view that as per the revised DPE Guidelines, there is a mandate not only on budget allocation but also to spend on CSR and Sustainability activities within a specified period.

10. The Committee also 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. Since as per the revised DPE Guidelines, the company is required to spend certain amount on CSR and Sustainability activities within a specified period and since, the unspent amount would not lapse and would be transferred to a 'Sustainability Fund' which can be used only for CSR and Sustainability activities as per the implementation mechanism specified by DPE, the Committee is of the view that in order to act in an equitable manner, the company has no realistic alternative apart from spending that amount on the CSR and Sustainability activities. Thus, it is more likely than not that the company would be required to spend the specified amount on CSR and Sustainability activities, which creates a present obligation on the company. 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 2013-14, the company would be correct in recognising a provision in respect of unspent expenditure on CSR and Sustainability activities.

11. With regard to disclosure of unspent amount of CSR & SD as short-term provision, the Committee is of the view that the company may classify the same as short-term provision under the head 'current liabilities' provided it meets the definition of 'current liabilities' as per the requirements of the revised Schedule VI to the Companies Act, 1956. In this regard, the Committee notes clause 3 of 'General Instructions for preparation of Balance Sheet' to Revised Schedule VI to the Companies Act, 1956 as follows:

> "3. A liability shall be classified as current when it satisfies any of the following criteria:
>
> (a) it is expected to be settled in the company's normal operating cycle;
> (b) it is held primarily for the purpose of being traded;
> (c) it is due to be settled within twelve months after the reporting date; or
> (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.
>
> All other liabilities shall be classified as non-current."

From the above, the Committee is of the view that to the extent the liability for CSR and SD is due to be settled within twelve months, the same should be disclosed as 'short-term provision' under the head 'current liability', otherwise, the same should be classified as 'non-current liability'.

## D. Opinion

12. On the basis of the above, the Committee is of the opinion that in the financial year 2013-14, the company should provide for the unspent amount of CSR & SD as provision in its accounts. With regard to disclosure, the Committee is of opinion that to the extent, the liability for CSR and SD is due to be settled within twelve months, the same should be disclosed as 'short-term provision' under the head 'current liability' otherwise it should be classified as 'non-current liability', as discussed in paragraph 11 above.