Part 2: CSR Accounting, Impact assessment and communication strategies

Dr.V.V.L.N. Sastry

Jurist & Financial Economist

M.E, M.B.A, FCMA (CIMA), CMA, CGMA, CPA, CACA, MSc (Economic Policy), LL.M, Ph.D.

Post Doctorate in Economics.

Legal Perspective of CSR

- In India the scope of CSR is dealt under Section 135 of Companies Act 2013 read with Schedule VII and Companies (Corporate Social Responsibility policy) Rules 2014 are the special provisions under the new company law regime.

- Section 135 of Companies Act 2013 states every company having Net profit of Rs 5 crores or more or Net worth of Rs 500 crores or more or Turnover of Rs 1000 crores or more, comes under CSR.

- The figures pertaining to Net profit, Net worth, Turnover, shall be based on audited financial statement pertaining to previous financial year.

- If any one criteria is satisfied then CSR comes into play. Every Company includes holding or subsidiary and a foreign company having its branch office or project office in India which satisfies any one criteria, also needs to comply with the same.

Legal Perspective of CSR

- It also includes Section 8 Company as defined under Companies Act shall also comply with corporate social responsibility if fulfils any one criteria. It also clearly stated that merely because holding company satisfies the CSR conditions and the subsidiary does not then for subsidiary CSR it is not applicable.
- If CSR becomes applicable then CSR committee has to be constituted with three or more directors (including at least one independent director). On the other hand if Company is not required to appoint an independent director then CSR committee shall be formed with 2 or more directors.
- Every company shall spend in every financial year at least two percent of the average net profit of the company made during the three immediately preceding financial year (or where company has not completed the period of three financial years since its incorporation during such immediately previous financial years) by giving preference to local area and the area which it operates.
- If the company spends an amount in excess of the prescribed criteria it may be set off such excess amount against the requirement to spend for such number of succeeding financial years and in such a manner as can prescribed. If the company decides not to carry forward such excess spend in full or in part the same to the extent not carry forward to recognize as expense.
- Where the amount to be spent by a Company does not exceed 50 lakhs then the requirement of the CSR shall not be applicable and functions shall be discharged by the board. The board shall approve disclose CSR policy and ensure undertaking of CSR activities and spending of amount.

Legal Perspective of CSR

- It shall transfer unspent amount within 30 days from the end of financial year to ‘unspent CSR A/c opened for that financial year. The same shall be spend within 3 financial years from date of transfer if the same is not spend then transfer the same to a fund specified in schedule VII within 30 days from date of completion of the 3rd financial year.
- The CSR activities shall be undertaken by the company as per CSR policy and shall undertake through company established under section 8 or trust or society established by the company or central government.
- Merely incurring CSR expenditure at concessional rates or activities in the ordinary course of business cannot be constituted as CSR expenditure.
- It is also clarified that CSR programs or activities that benefit only the employees and families not considered as CSR activities.
- Contribution of any amount directly or indirectly to political party not considered as CSR activity.
- Expenditure made in kind cannot qualify as CSR spend. To book an expenditure towards CSR now 2% of total expenditure for that FY or 50 lakhs, whichever is higher.
- If a company default in complying 135(5), 135(6) the company shall be liable for a penalty of twice the amount required to be transferred by the company to the fund or unspent CSR responsibility or one core which is less.
- In addition to every officer who in default shall be liable for a penalty of one tenth amount required to be transferred by the company to such fund specified in schedule VII, or the unspent Corporate social responsibility account as case may be or two lakhs which is less.

Auditing Perspective of CSR

As per Clause (xx) of CARO 2020 the auditor shall check

- Whether, in respect of other than ongoing projects, the company has transferred unspent amount to a Fund specified in Schedule VII to the Companies Act within a period of six months of the expiry of the financial year in compliance with second proviso to sub-section (5) of section 135 of the said Act;
- Whether any amount remaining unspent under sub-section (5) of section 135 of the Companies Act, pursuant to any ongoing project, has been transferred to special account in compliance with the provision of sub-section (6) of section 135 of the said Act;

Accounting Perspective on CSR

- CSR in cash

  CSR expenditure A/c DR

  To Bank/cash
- CSR in kind

  CSR expenditure A/c DR

  To purchase /cost of goods consumed
- CSR spends in excess of the amount

  CSR expenditure A/c DR

  To Cash/Purchase/good consumed

  To CSR to be deposited in fund
- CSR not fully spend for an ongoing project

  CSR expenditure A/c DR

  To Cash /Purchase /good consumed

  To CSR to be ongoing project
- CSR when spent in excess in advance

  CSR expenditure A/c DR

  CSR pre-spent A/c DR

  To Cash /purchase /good consumed

Income Tax Perspective on CSR

- CSR expenditure which is of the nature described in Section 30 to Section 36 of Income-Tax Act(''IT ACT") shall be allowed as a deduction provided that utilized for the purpose meant. If CSR expenditure is of nature under section 37 then no deduction shall be allowed.
- The expenditure incurred for CSR is allowed as deduction and no disallowance can be invoked. The donation which made under to CM relief fund is allowable as deduction. (Security Printing Minting Corporation vs. Add CIT (ITA NO 272/del/2019)(AY 2014-15).(Delhi ITAT)
- On account of Covid 19 Pandemic the donation were given to PM cares fund and state disaster management authority the same is not allowed as a deduction while computing business income but the same is allowed as a deduction under 80G of IT ACT.
- Donation to chief minister relief fund or state relief fund do not qualify as CSR expenditure.
- The requirement for Section 37(1) and 80 G are different but notwithstanding two are mutually exclusive. Thus these are overlapping areas between the donations given by the assessee and the business expenditure incurred by the assesse. In other words though there are certain amount though in the nature of donations and nonetheless the amounts may be deductible under section 37(1) as well.
- Companies which are governed by Minimum alternative tax may not have direct impact on account of CSR expenditure since such expenditure is allowable as deduction while computing book profit. However such CSR expenditure may impact the carry forward of MAT credit in the hands of such companies.

GST Implications on CSR

- To claim Input tax credit on corporate social responsibility relating to inwards supplies fundamental check has to be made as to whether expenses incurred in further course of business and whether it is blocked under section 17(5) of CGST act 2017.
- Based on case law of Essel Propack limited vs Commissioner of CGST it was held that CSR expenses are those incurred in the furtherance of business.
- ITC can be taken on CSR expenses if expenses do not fall under Blocked entity as laid under Section 17(5) as laid that work contract services when supplied for construction of immovable property (other than Plant machinery) except where it is an input service for further supply of work contract service.
- CSR, in India, is not just a moral responsibility but a structured mandate with clear legal, accounting, and tax implications. By understanding its multifaceted nature, companies can better align their business goals with broader societal and environmental objectives.

Accounting of Corporate Social Responsibility (CSR) expenses

The Accounting Standards Board of ICAI has released FAQs on accounting for expenses of CSR pursuant to the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021. These FAQs addressed the recent amendments to the accounting of CSR expenses.

Question: On January 22, 2021, the Ministry of Corporate Affairs notified the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021. Pursuant to the amendment rules, companies are required to spend the required amount (2% of average net profits of the company made during the three immediately preceding financial years) in every financial year for Corporate Social Responsibility (CSR) activities as prescribed under schedule VII or transfer the unspent amount of ongoing projects in a special account called Unspent CSR Account within 30 days of the end of financial year for use within a period of three financial years from the date of such transfer (with the balance unspent out of such account at the end of the three financial years to be transferred to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year); or transfer unspent amount not relating to ongoing projects to such funds as mentioned in Schedule VII like Clean Ganga Fund or PMNRF etc. within 6 months of the end of financial year.

What is the effect of these amendments on the accounting of amounts to be incurred towards CSR?

Accounting of Corporate Social Responsibility (CSR) expenses

Response: Section 135 of the Companies Act, 2013 lays down the requirements pertaining to CSR of a company.

- **Section 135(1) lays down requirement for constituting a CSR committee by a company which meets either of the three criteria viz., net worth, turnover and net profit in the immediately preceding financial year.**
- **Section 135(4) requires the Board of Directors of a company to ensure that the activities as included in CSR Policy of the company are undertaken by the company.**
- **Section 135(5) requires the Board of Directors of every company referred to in sub-section (1) to 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 or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its CSR Policy. Every company to which Section 135 is applicable is required to spend a minimum amount on CSR activities during the financial year and if not spent, an explanation by the Board of Directors specifying the reasons for not spending such amount in that financial year is to be given, in the Directors report.**
- **The amendment to section 135 on 22nd Jan 2021, now requires companies to additionally deal with the unspent amount as at the end of the financial year in a stipulated manner by transferring the same to specified accounts (Unspent CSR Account or Fund specified in Schedule VII, as applicable) depending upon the fact whether such unspent amount relates to ongoing project(s) or not.**

Accounting of Corporate Social Responsibility (CSR) expenses

Specific penal provisions have also been inserted by the amendment if the company makes default in complying with the minimum amount required to be spent on CSR activities or the treatment of the unspent amount, if any

The issue is analysed below with reference to Companies (Indian Accounting Standards) Rules, 2015: Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, defines liability and obligating event and explains past event as under:

Liability: "A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Obligating event: "An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation."

Past event: "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 entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

Accounting of Corporate Social Responsibility (CSR) expenses

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

The obligating event arises as the CSR activities (spend/incur) are undertaken during the financial year in accordance with the CSR Policy and CSR projects approved by the Board of Directors of the company, and on the determination of the unspent amount as at the end of the financial year whether relating to ongoing projects or not, duly considering the following requirements of Section 135:

"the spend of two percent of average net profits of immediately preceding three years, represents the measurement basis for determining the minimum amount to be spent on CSR activities during the financial year";

the "unspent amount":
of ongoing projects is to be transferred to a special account called Unspent CSR Account within 30 days of the end of financial year (emphasis supplied) for use within a period of three financial years from the date of such transfer (with the balance unspent out of such account at the end of the three financial years to be transferred to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year); and

Accounting of Corporate Social Responsibility (CSR) expenses

not relating to ongoing projects is to be transferred to such funds as mentioned in Schedule VII like Clean Ganga Fund or PMNRF etc. within 6 months of the end of financial year (emphasis supplied)
Thus, the obligating events requiring recognition of CSR expenditure (and a liability, as applicable) occur as follows:

(a) during the financial year, when carrying on CSR activities (spending/incurring);
(b) at end of the financial year, to the extent of the "unspent amount" relating to:
(i) ongoing projects and
(ii) other than ongoing projects.

Accordingly, CSR expenditure would be recognised as expense in the statement of profit or loss as and when such expenditure is incurred on the CSR activities undertaken as per the Board approved CSR Policy and CSR projects during the financial year. For the "unspent amount", a legal obligation arises to transfer to specified accounts depending upon the fact whether such unspent amount relates to ongoing projects or not. Therefore, liability needs to be recognised for such "unspent amount" as at the end of the financial year as per para 17(a) of Ind AS 37.

Accounting of Corporate Social Responsibility (CSR) expenses

Further as per Ind AS 34, Interim Financial Statements, CSR obligation will be recognised based on the principles for recognition of the same in annual financial statements.

Provisions relevant for the instant issue under AS 29, Provisions Contingent Liabilities and Contingent Assets, and AS 25, Interim Financial Statements, are similar to Ind AS 37 and Ind AS 34, respectively. Accordingly, conclusions drawn above equally apply under Companies (Accounting Standards) Rule, 2006 also.

CSR expenses need to be treated as non-cost items: ICAI (Institute of Cost Accountants of India)

- Companies need to treat expenses related to CSR activities as non-cost items and separately disclose transactions in this regard where related parties are involved, according to cost accountants ICAI.

- In a detailed exposure draft of guidance note on Treatment of Costs Relating to CSR Activities (2016), it has said that cost auditors should ensure that corporate social responsibility expenses are treated properly and not wrongfully claimed as product or service costs.

- Under the Companies Act, 2013, certain class of profitable entities are required to shell out at least two per cent of their three-year annual average net profit towards Corporate Social Responsibility (CSR) activities.

- The provision came into force from April 1, 2014. According to the Institute of Cost Accountants of India (ICAI), all expenses relating to CSR activities "whether incurred up to the statutory limit of two per cent... or more, shall be treated as non-cost items and reflected separately in the profit reconciliation statement".

CSR expenses need to be treated as non-cost items: ICAI (Institute of Cost Accountants of India)

- Similarly, all incomes generated out of assets created under CSR projects, programmes and activities, whether recognised as revenue in the profit and loss statement or not, should be treated as non-cost items and shown separately.

- "The cost auditor has to be extra careful in such situations and check such expenses (or incomes) to ensure their proper treatment in the cost statements. The cost auditor should also bring such deviations to the notice of the Audit Committee or Board, as the case may be."

- On whether excess amount spent on CSR activities under the law can be considered as cost, ICAI has said, "the entire amount is to be shown as non-cost item in the cost statements".

Accounting treatment of Corporate Social Responsibility expenditure

Schedule VII to the company's bill, 2013 specifies a list of CSR activities. The accounting of CSR activities will be done as under:

- In case a contribution is made to a fund specified in Schedule VII to the Act, the same would be treated as an expense for the year and charged to the statement of profit and loss.

- In case the company incurs any expenditure on any of the activities as per schedule VII on its own, the company needs to analyse the nature of the expenditure keeping in mind the "Framework for Preparation and Presentation of Financial Statements issued by ICAI.

- In case the company incurs any expenditure on any of the activities as per schedule VII is of revenue nature, the same should be charged as an expense to the statement of profit or loss.

- In case the company incurs any expenditure which give rise to an asset, the company need to analyse whether the expenditure qualifies the definition of the term asset as per the Framework i.e. whether it has control over the asset and derives future economic benefits from it.

Impact Assessment on Corporate Financial Performance

- The debate on the relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) has been ongoing (Alexander & Buchholz, Citation1978).

- Yet empirical results concerning the nature of the relationship are equivocal. Some studies detect a positive relationship, while various others find negative, no or even curvilinear (e.g., U-shaped) relationships.

- Despite this diversity, based on their meta-analyses, Margolis, Elfenbein, and Walsh (Citation2007) and Orlitzky, Schmidt, and Rynes (Citation2003) conclude that a positive relationship is more common than other types.

Corporate social responsibility and financial performance relationship: measurement approaches

- **Classical economists argue that a company's only responsibility is to increase value for its shareholders (Friedman, Citation1970). In line with this view, the key objective of most companies, especially in the private sector, is to grow profits. However, achieving this objective should not cause negative side effects for other stakeholders and society as a whole.**

- **Businesses make up part of society and depend on it to attain their economic goals (Crane, McWilliams, Matten, Moon, & Siegel, Citation2008).**

- **A recently emerged stakeholder theory argues that the better a firm manages its relationships with its stakeholders, the more successful it will be over time (Barnett & Salomon, Citation2012). Although all stakeholders can potentially affect firm performance, the mechanisms differ. Market constituents (e.g., employees, customers, suppliers, creditors) can directly trigger a shortfall in economic rents by making unfavourable economic choices (Delmas & Toffel, Citation2008).**

- **Non-market constituents (e.g., the general public, the media, NGOs) indirectly exert their influences by conveying information (Henriques & Sadorsky, Citation1999). Despite the different transmission mechanisms, the dissatisfaction of any stakeholder group can potentially affect economic rents and even compromise a company's future (Clarkson, Citation1995).**

- **In effect, socially responsible corporate action is increasingly argued to be a prerequisite for protecting the bottom line and boosting shareholder value (Epstein & Rejc-Buhovac, 2014).**

The nature of the CSR–CFP relationship identified in the empirical literature

Nature of the CSR&CFP relationship	Representative references
Positive	Al-Tuwaijri et al., 2004; Burnett & Hansen, 2008; Erhemjamts et al., 2013; Rodgers et al., 2013
Negative	Baird, Geylani, & Roberts, 2012; Peng & Yang, 2014
No relationship	Alexander & Buchholz, 1978; Aupperle et al., 1985; Soana, 2011; Sun, Salama, Hussainey, & Habbash, 2010; McWilliams & Siegel, 2000
U-shaped/inverted U-shaped	Barnett & Salomon, 2012; Bowman & Haire, 1975

CSR dimensions included in major reputation indices.

MSCI KLD 400 social index	Fortune magazine Most admirable	Vigeo index	Dow Jones Sustainability Index
1. Environment	1. Innovation	1. Human resources	ECONOMIC DIMENSIONS
2. Community and Society	2. People management	2. Environment	1. Corporate governance
3. Employees and Supply Chain	3. Use of corporate assets	3. Corporate governance	2. Risk and crisis management
4. Customers	4. Social responsibility	4. Community involvement	3. Codes of conduct/compliance/anti-corruption and bribery
5. Governance and Ethics	5. Quality of management	5. Business behaviour	4. Industry-specific criteria
	6. Financial soundness	6. Human rights	ENVIRONMENTAL DIMENSIONS
	7. Long-term investment value		5. Environmental reporting
	8. Quality of products/services		6. Industry-specific criteria
	9. Global competitiveness		SOCIAL DIMENSIONS
			7. Human-capital development
			8. Talent attraction and retention
			9. Labour practice indicators
			10. Corporate citizenship/philanthropy
			11. Social reporting
			12. Industry-specific criteria

CSR indices' geographic coverage.

Index	Index coverage (sub-indices)
MSCI KLD 400	USA only
Fortune magazine most admirable	1. USA's most admirable companies 2. World's most admirable companies
Dow Jones Sustainability Index (DJSI)	1. DJSI world – Dow Jones Sustainability World – Dow Jones Sustainability World Enlarged – Dow Jones Sustainability Emerging Markets 2. DJSI Regions – Dow Jones Sustainability Asia/Pacific – Dow Jones Sustainability Europe – Dow Jones Sustainability North America 3. DJSI Countries – Dow Jones Sustainability Australia – Dow Jones Sustainability Canada Select 25 – Dow Jones Sustainability Korea – Dow Jones Sustainability Korea Capped 25% – Dow Jones Sustainability Chile
Vigeo ratings	1. The Euronext Vigeo Indices – Euronext Vigeo World 120, Euronext Vigeo Europe 120, Euronext Vigeo Eurozone 120, Euronext Vigeo EM 70, Euronext Vigeo US 50, Euronext Vigeo France 20, Euronext Vigeo United Kingdom 20 and Euronext Vigeo Benelux 20 2. The Ethibel Sustainability Indices (ESI) – ESI Excellence Global and ESI Excellence Europe

Source: MSCI ESG Indexes (n.d.); RebecoSam Sustainability investing, 2016; Vigeo Eiris Rating (n.d.); Fortune, The World's Most Admired Companies (n.d.).

Commonly used indicators for CFP

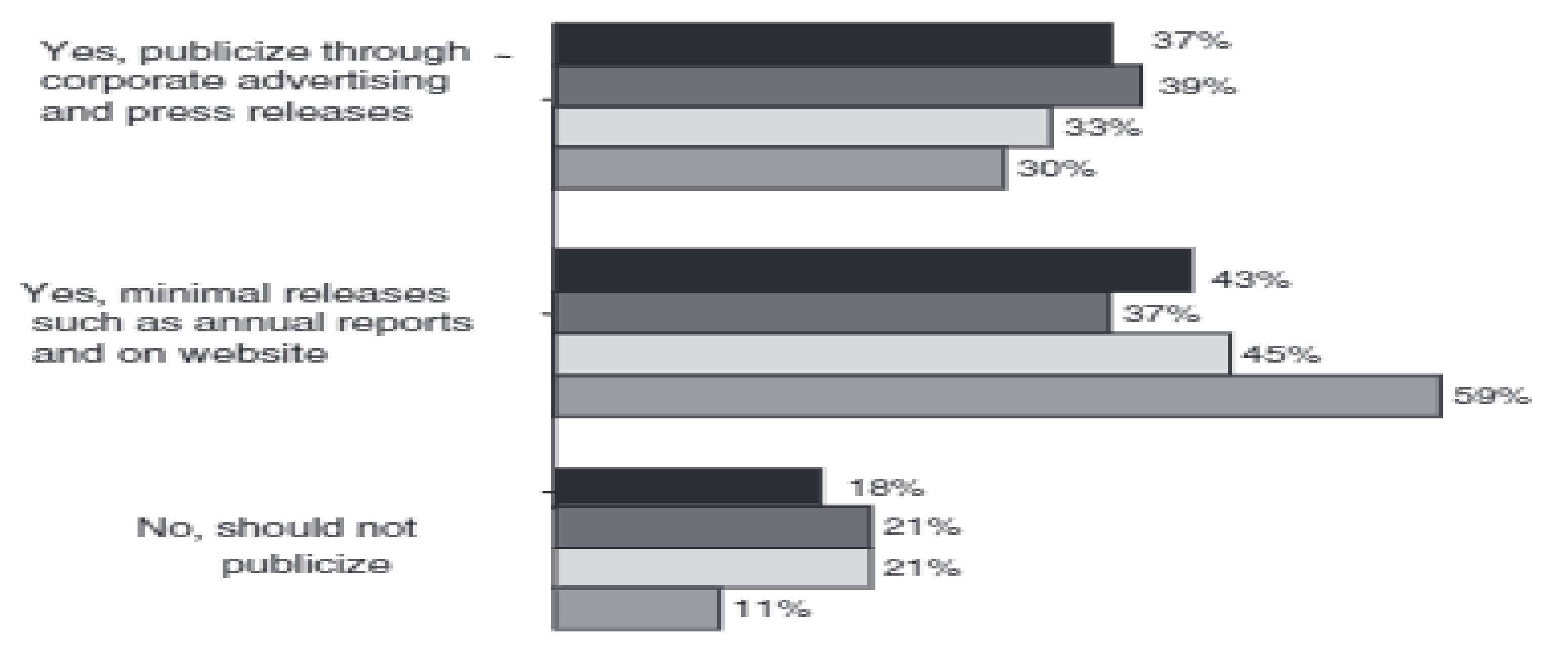
Accounting-based	Market-based	Accounting- and market-based
ROA – return on assets	Stock returns	Tobin's Q
ROE – return on equity	Market value of a company	MVA – market value added
ROCE – return on capital employed	Change in stock returns	
ROS – return on sales		
Net operating income		
Net income		
Zmijewski score		

Source: Authors' summary based on the literature review.

Advantages and drawbacks of alternative measurement approaches

Measurement approach	Advantages	Drawbacks
For CSR		
- Indices	Data availability & comparability, multidimensionality recognised	Non-scientific, limited firm coverage (geography, size, industry)
- Content analysis	Flexibility for researcher	Researcher subjectivity, data non-disclosure, impressions management
- Questionnaire surveys	Flexibility for researcher	Researcher subjectivity, measurement error, non-response
- One-dimensional measures	Data availability & comparability	Theoretical invalidity
For CFP		
- Accounting-based indicators	Data availability & comparability	Historical data
- Market-based indicators	Contemporaneous data	Data only available for listed firms, also include systematic factors

CSR communication strategies – how companies should communicate – Danish survey results.



CSR - three communication strategies

Three CSR communication strategies

	The stakeholder information strategy	The stakeholder response strategy	The stakeholder involvement strategy
Communication ideal: (Grunig & Hunt 1984)	Public information, one-way communication	Two-way asymmetric communication	Two-way symmetric communication
Communication ideal: sense-making and sensegiving:	Sensegiving	Sensemaking ⇩ Sensegiving	Sensemaking ⇳ Sensegiving – in iterative progressive processes
Stakeholders:	Request more information on corporate CSR efforts	Must be reassured that the company is ethical and socially responsible	Co-construct corporate CSR efforts
Stakeholder role:	Stakeholder influence: support or oppose	Stakeholders respond to corporate actions	Stakeholders are involved, participate and suggest corporate actions
Identification of CSR focus:	Decided by top management	Decided by top management. Investigated in feedback via opinion polls, dialogue, networks and partnerships	Negotiated concurrently in interaction with stakeholders
Strategic communication task:	Inform stakeholders about favourable corporate CSR decisions and actions	Demonstrate to stakeholders how the company integrates their concerns	Invite and establish frequent, systematic and pro-active dialogue with stakeholders, i.e. opinion makers, corporate critics, the media, etc.
Corporate communication department's task:	Design appealing concept message	Identify relevant stakeholders	Build relationships
Third-party endorsement of CSR initiatives:	Unnecessary	Integrated element of surveys, rankings and opinion polls	Stakeholders are themselves involved in corporate CSR messages

End of Part-2

Thanks for your patient listening!

Now the floor is open for Q&A???

Part 3 on 31st October