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CSR

NORMS AND PRACTICES

CSR FUND UTILISATION AND REGULATORY INSIGHTS

VOLUME I ISSUE 3

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1. INTRODUCTION

The trajectory of philanthropy in India has been shaped by its unique history, cultural ethos, and ethical frameworks derived from religious and philosophical traditions. Wealth has long been regarded not merely as a personal possession but as a resource carrying responsibilities toward society, to be used ethically, purposefully, and for the welfare of deserving recipients. In modern times, the Companies Act, 2013, and the associated CSR Rules have formalized this principle, making it mandatory for companies meeting defined thresholds to allocate a portion of their profits to social causes. These statutory obligations bring with them a range of practical, operational, and regulatory considerations that companies must navigate carefully.

The CSR Norms and Practices series continues its exploration of Corporate Social Responsibility under the Companies Act, 2013. Building on the discussion in Issue 2, which focused on the eligibility and scope of CSR expenditure, Issue 3, titled CSR Fund Utilisation and Regulatory Insights, examines further the challenges and complexities that arise once CSR funds are to be spent, providing guidance on how companies can approach these matters in a structured and compliant manner.

While the law prescribes the quantum and nature of CSR spending, practical questions emerge in situations not explicitly covered by the basic framework. This issue aims to provide clarity on some nuanced aspects of CSR expenditure. By offering guidance on operational and regulatory considerations, Issue 3 equips companies and practitioners with an understanding to navigate their obligations thoughtfully, ensuring that CSR is not merely a compliance requirement but a meaningful contribution to India's social development.

2. CSR FUND TREATMENT

2.1 UNSPENT CSR AMOUNT

In Issue 2 of this series, we introduced the concept of unspent CSR amounts and discussed the statutory expectations under the Companies Act, 2013. Continuing that discussion, a practical question often raised by companies and auditors alike:

Is a provision for unspent CSR amount required to be created in the books of accounts?

Section 135(5) of the Companies Act, 2013, requires the Board of every eligible company to ensure that at least 2% of the average net profits of the preceding three financial years is spent on CSR activities in each financial year. The proviso to this section further states that if a company fails to spend such an amount, the Board shall, in its report, specify the reasons for not spending it.

In light of this provision, no accounting liability arises merely on account of unspent CSR amounts. Accordingly, a provision for the shortfall between the amount required to be spent and the amount actually spent at the year-end should not be created in the financial statements.

However, where a company has already undertaken a CSR activity and incurred a liability, for example, by entering into a contractual obligation with an implementing agency then, in line with generally accepted accounting principles, a provision must be recognised in the financial statements to the extent that the CSR activity has been completed during the reporting period.

2.2 EXCESS CSR AMOUNT

If a company spends more than the requirement provided under section 135, the excess amount can be set off against the mandatory 2% CSR expenditure up to the immediately succeeding three financial years subject to compliance with the conditions stipulated under rule 7(3) of the Companies (CSR Policy) Rules, 2014.

> ***Rule 7(3) of the Companies (CSR Policy) Rules, 2014:***
>
> ***Where a company spends an amount in excess of requirement provided under sub-section (5) of section 135 , such excess amount may be set off against the requirement to spend under sub-section (5) of section 135 up to immediate succeeding three financial years subject to the conditions that –***
>
> ***(i) the excess amount available for set off shall not include the surplus arising out of the CSR activities, if any, in pursuance of sub-rule (2) of this rule.***
>
> ***(ii) the Board of the company shall pass a resolution to that effect.***

For instance – If the company spends ₹1.20 crore against the obligation of ₹1 crore in FY 2024–25, the excess amount of ₹20 lakh may be set off against future CSR obligations within the next three financial years (i.e., up to FY 2027–28), subject to a resolution passed by the Board to that effect.

Note – This position became applicable from 22nd January, 2021 and had a prospective effect. Thus, no carry forward was allowed for the excess amount spent, if any, in financial years prior to FY 2020-21.

3. SURPLUS FROM CSR ACTIVITIES

3.1 WHAT IS SURPLUS FROM CSR ACTIVITIES?

It refers to any income or gains that arise in the course of implementing CSR projects. This may include interest earned by the implementing agency on CSR funds provided, revenue generated through CSR-linked initiatives, proceeds from the sale or disposal of materials used in CSR projects, or similar incidental earnings.

3.2 ALLOCATION AND COMPLIANCE REQUIREMENTS FOR SURPLUS

Such surplus is not to be treated as business profit and cannot be diverted toward general business purposes, dividend distribution, or investment in unrelated activities. The law mandates that any income generated from CSR spending must be reapplied exclusively for CSR objectives, thereby reinforcing the principle that funds earmarked for social responsibility continue to serve that very purpose.

Rule 7(2) of the Companies (CSR Policy) Rules, 2014:

Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

Importantly, the surplus does not reduce the company's mandatory CSR obligation of 2% of average net profits. For instance, if a company has a CSR obligation of ₹30,00,000 and a surplus of ₹2,00,000 arises from CSR activities, the statutory 2% spend of ₹30,00,000 is still required. The surplus is in addition to this mandated expenditure and must be ploughed back into CSR activities or transferred to the Unspent CSR Account or a Fund specified in Schedule VII within six months of the financial year-end.

Companies have several options for applying these surpluses, depending on their CSR strategy and community needs. For example, they may expand or scale up ongoing CSR projects by channelling the additional resources or initiate new CSR initiatives, such as healthcare, education, or livelihood programs in underserved areas.

3.3 ACCOUNTING TREATMENT

A question often arises as to whether surplus generated from CSR activities should be recognised in the company's statement of profit and loss. Paragraph 5 of Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, states that all items of income recognised during a period should generally be included in determining net profit or loss unless specifically exempted by an Accounting Standard. For accounting purposes, the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India defines 'income' as "an increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in liabilities that result in increases in equity, other than contributions from equity participants". Since surplus arising from CSR activities is not derived from transactions with owners, it qualifies as 'income' only for accounting purposes. However, as it cannot form part of the company's business profits, such surplus should be immediately recognised as a liability for CSR expenditure in the balance sheet and simultaneously recorded as an expense in the statement of profit and loss. This ensures that the surplus is allocated solely for CSR purposes and does not reduce the company's mandatory CSR obligation of 2% of the average net profits of the three preceding financial years as required under its CSR Policy.

4. DISCHARGING CSR OBLIGATION

Companies can fulfil their CSR obligations under Section 135 of the Companies Act, 2013, through multiple avenues, each with specific accounting treatment:

- **Contribution to Schedule VII Funds:**

Contributions made to any fund specified in Schedule VII of the Act (e.g., PM CARES Fund, Clean Ganga Fund) are treated as CSR expenses for the year and should be charged directly to the statement of profit and loss.

- **Spending through Registered Entities:**

CSR expenditure routed through a registered trust, society, or a Section 8 company, either individually, jointly with holding, subsidiary, or associate companies, or in collaboration with other companies, also qualifies as an expense for the year and must be recorded in the statement of profit and loss.

- **Direct CSR Implementation by the Company:**

When the company itself undertakes CSR activities that fall under Schedule VII, the related expenditure of a revenue nature should be charged to the statement of profit and loss. Any surplus arising from these activities must be applied exclusively to CSR purposes and cannot be treated as business profit or used for any other purpose.

- **CSR Grants from Third Parties:**

If a company receives grants to implement CSR initiatives, the CSR expenditure should be recorded net of the grant received.

5. GEOGRAPHICAL LOCATION OF CSR SPENDING

The first proviso to Section 135(5) of the Companies Act, 2013, stipulates that companies shall give preference to the local area and areas surrounding their operations for undertaking CSR activities. However, the practical application of this provision warrants careful consideration, particularly in light of evolving business models and the nature of certain eligible CSR activities.

Section 135(5) of the Companies Act, 2013

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Certain activities enumerated in Schedule VII, such as support for war widows and their dependents, preservation of national heritage and culture, and similar initiatives, inherently transcend geographical limitations and hold relevance across the entire nation. These activities, by their very nature, cannot be confined to a specific locality.

Further, the emergence of Information and Communication Technology (ICT) and the rise of new-age business models have added complexity to the interpretation of local area. E-commerce platforms, business process outsourcing firms, aggregator companies, and digital service providers often operate through distributed networks with no single identifiable operational base. For such entities, determining a defined local area becomes inherently challenging, if not impractical.

It is essential to view the local area preference within the broader legislative intent of the Act. The underlying objective of India's CSR framework is to align corporate initiatives with national development priorities and to mobilize corporate resources toward achieving the Sustainable Development Goals (SDGs). Adopted by the United Nations in 2015, the SDGs represent a universal agenda to eradicate poverty, safeguard the environment, and ensure shared prosperity for all by 2030. These 17 interconnected goals recognize that progress in one domain influences outcomes in others, and that sustainable development must harmonize social, economic, and environmental dimensions. Nations across the world have committed to prioritizing those who are most marginalized, with the SDGs specifically designed to eliminate poverty, hunger, disease, and gender-based discrimination. Achieving these goals requires collective effort, drawing upon innovation, expertise, technology, and financial resources from all sectors of society.

In this context, the preference for local areas should be understood as a guiding principle rather than an absolute obligation. It is directional in nature, intended to encourage companies to engage meaningfully with the communities in their immediate vicinity. However, it does not preclude companies from undertaking CSR activities that address broader national concerns or contribute to nationwide developmental objectives. Companies are expected to exercise informed judgment, balancing local engagement with the imperative of advancing national priorities and the SDGs, thereby ensuring that their CSR efforts create meaningful and sustainable impact.

6. CSR AND GOVERNMENT SCHEMES

A common area of confusion relates to whether CSR funds can be directly utilized to finance Government schemes. The regulatory position on this matter is clear, CSR funds cannot be used to fill resource gaps in Government schemes.

The CSR framework under the Companies Act, 2013, is designed to position corporate entities as collaborative partners in India's social development journey, rather than as alternative funding sources for State obligations. The legislative intent is to harness corporate innovation, management expertise, and operational efficiency in addressing social challenges, bringing a distinct approach to the delivery of public goods that complements, but does not substitute, governmental efforts.

Corporates have consistently demonstrated solidarity with the Government during periods of crisis, contributing to the nation's social and economic resilience. However, this partnership must be understood within the proper regulatory boundaries. While certain activities listed in Schedule VII of the Act, such as combating hunger and malnutrition, advancing healthcare and sanitation, ensuring environmental sustainability, supporting research and development in science and technology, and conserving natural resources align closely with Government priorities and programmes, the manner of contribution matters significantly.

The Act permits specific, earmarked contributions to designated funds established by the Central Government, including the Swachh Bharat Kosh (for sanitation promotion), the Clean Ganga Fund (for river rejuvenation), and contributions toward research and development projects in science, technology, engineering, and medicine that are funded by Central or State Governments, Public Sector Undertakings, or their agencies. These are explicitly recognized as eligible CSR expenditure because they represent targeted contributions to specified national initiatives, rather than general budgetary support.

What is not permissible is the direct channelling of CSR funds into existing Government schemes to address their budgetary shortfalls. CSR is intended to enable companies to conceptualize, design, and execute independent interventions that address social needs creatively and efficiently. Companies must exercise autonomy in project selection, implementation strategy, and beneficiary identification, subject, of course, to the provisions of the Companies (CSR Policy) Rules, 2014.

Thus, while a company cannot simply fund a Government scheme, it is entirely permissible, and indeed encouraged for the Board of an eligible company to undertake similar activities independently. For instance, if a Government scheme focuses on skill development in rural areas, a company may design and implement its own skill development programme targeting similar or overlapping beneficiaries, utilizing its own resources, management systems, and delivery mechanisms. The distinction lies in corporate ownership and execution of the initiative, ensuring that CSR remains a channel for private sector innovation in public welfare.

7. EMPLOYEE VOLUNTEERING IN CSR

Employee time and effort contributed toward CSR activities cannot be monetized or recognized as CSR expenditure. This position is grounded in Section 135(5) of the Companies Act, 2013, which mandates that companies “spend” a specified percentage of their average net profits on CSR activities. The term spend refers to actual financial outlay, the disbursement of funds toward CSR projects. Employee participation, while valuable, does not constitute monetary expenditure and therefore cannot be counted toward meeting the statutory CSR obligation.

8. COLLABORATION WITH OTHER CORPORATES

Under Rule 4(4) of the Companies (CSR Policy) Rules, 2014, companies are permitted to collaborate with one another to implement CSR projects or programs. Such collaboration must be structured in a way that the CSR Committees of each participating company can report separately on the activities, in compliance with the reporting requirements under the Rules.

Rule 4(4) of The Companies (Corporate Social Responsibility Policy) Rules, 2014:

A company may also collaborate with other companies for undertaking projects or programmes or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programmes in accordance with these rules.

This provision allows companies, including holding and subsidiary companies, to jointly execute CSR initiatives, enabling them to pool resources, expertise, and operational capabilities. Importantly, it also allows companies with small CSR funds to participate in meaningful CSR activities by contributing jointly with other companies, ensuring that even limited resources can be leveraged to create significant social impact.

While the Act and the Rules do not prescribe detailed modalities for joint execution, companies are expected to establish clear agreements on governance, roles, responsibilities, and reporting. Proper planning and coordination ensure that collaborative CSR projects remain transparent, effective, and fully compliant with regulatory requirements.

9. WHEN A COMPANY CEASES TO COME UNDER CSR CRITERIA

A company that does not meet the CSR applicability thresholds in the immediately preceding financial year i.e., net worth of ₹500 crore or more, turnover of ₹1000 crore or more, or net profit of ₹5 crore or more, is not required to comply with CSR provisions for the current financial year.

This clarity comes after the deletion of Rule 3(2) of The Companies (Corporate Social Responsibility Policy) Rules, 2014 in September 2022, which previously created ambiguity regarding the duration for which CSR obligations remained applicable. Earlier, even if a company did not meet the criteria in a given year, it could not automatically discontinue CSR activities unless the criteria were unmet for three consecutive years. Post-2022 amendment, CSR applicability is now assessed solely based on the immediately preceding financial year, allowing companies to adjust their CSR planning accordingly.

Hence, CSR obligations are to be evaluated on a year-to-year basis. If a company meets the thresholds in the preceding year, it must comply; if not, it is exempt for that year. This approach simplifies compliance, aligns CSR spending with current financial realities, and enables companies to focus on initiatives strategically and responsibly.

10. CSR SPENDING AND VOLUNTARY CONTRIBUTIONS

Section 181, notified on 12th September 2013, allows a company's Board of Directors to voluntarily contribute to bona fide charitable and other funds. If the contribution in any financial year exceeds five percent of the company's average net profits for the preceding three years, prior approval from the company in a general meeting is required. In contrast, Section 135 mandates Corporate Social Responsibility (CSR) expenditure for companies meeting specified financial thresholds, with structured governance, reporting, and compliance requirements.

Similar to voluntary contributions under Section 181, CSR spending also cannot be claimed as a business expense for tax purposes, as clarified by the Finance Act, 2014 through Explanation 2 to Section 37(1) of the Income Tax Act, 1961. Essentially, while Section 181 governs voluntary charitable giving, Section 135 establishes a mandatory framework for corporate participation in social development.

11. CONCLUSION

CSR under the Companies Act, 2013 is a well-defined statutory obligation, specifying not only the quantum of expenditure but also the reporting, governance, and compliance responsibilities of companies. A clear understanding of key aspects, such as treatment of unspent amounts, handling of excess expenditure, allocation of surpluses, and collaborative projects enables companies to navigate their CSR obligations with certainty and avoid regulatory ambiguities. The law provides flexibility in planning and executing CSR, yet maintains accountability by ensuring that funds are spent purposefully and in line with Schedule VII activities. When implemented thoughtfully within this legal framework, CSR not only fulfills statutory requirements but also creates meaningful, measurable impact for society, reinforcing the principle that corporate resources carry social responsibility.

Someone is sitting in the shade today because someone planted a tree a long time ago.

Warren Buffett

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