KNAV & CO. LLP

Chartered Accountants

ACCOUNTING & ASSURANCE UPDATE
INDIA

MAY 2021

1. Corpoarate social responsibility ('CSR')

a. Accounting treatment for CSR expenses incurred during the year and unspent as at year end

Consequent to notification of Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 on 22nd January 2021, any unspent amount towards CSR activities is required to be treated as under:

i. In case of ongoing projects, unspent amount is required to be transferred to a special account called Unspent CSR Account within 30 days of the end of the financial year, for use within a period of 3 financial years from the date of such transfer. If there is a balance unspent amount out of such account at the end of the 3rd financial year, it is to be transferred to a Fund specified in Schedule VII of the Companies Act, 2013 ('the Act'), within a period of 30 days from the date of completion of the 3rd financial year.
ii. In case of activities which are not towards ongoing projects, the unspent amount has to be transferred to such funds as mentioned in Schedule VII of the Act like Clean Ganga Fund or PMNRF, etc. within 6 months of the end of the financial year.
iii. Penal provisions have been prescribed for non-compliances with respect to above provisions.

In view of the above, questions were raised as regards whether there will be obligating event which will necessitate the provision in the books of account for the CSR amount to be spend during the year and unspent amount as at year end. Prior to the above amendments, there was no obligation to spend the whole amount and only disclosure was required in the Board of Director's report giving the reason for not spending the full amount, hence there were not much of accounting challenges.

The Institute of Chartered Accountants of India (ICAI) has recently issued an FAQ clarifying the accounting treatment for CSR. As per the FAQ, considering the definitions of Liability, Obligating Event and Past Event given in Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*, there is an obligating event for the (a) 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 (b) on the determination of the unspent amount as at the end of the financial year whether relating to ongoing projects or not.

In view of above, CSR expenditure has to 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. Also, liability has to be recognised for the unspent amount at the end of the financial year. 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. This will be relevant for quarterly results of listed companies. The above principles will also apply to companies which are not required to prepare accounts as per Ind AS.

b. Amount spent for Covid-19- Coverage under CSR

Based on the various circulars/clarifications issued the Ministry of Corporate Affairs (MCA) recently and in earlier months, amounts spent towards following activities are considered as contribution towards CSR activities:

i. Various activities related to Covid-19 under item nos. (i) and (xii) of Schedule VII of the Act relating to promotion of healthcare, including preventive healthcare and sanitation, disaster management
ii. Carrying out awareness campaigns/programmes or public outreach campaigns on COVID-19 Vaccination programme
iii. Setting up of makeshift hospitals and temporary COVID Care facilities

iv. Creating health infrastructure for COVID care
v. Establishment of medical oxygen generation and storage plants
vi. Manufacturing and supply of Oxygen concentrators, ventilators, cylinders and other medical equipment for countering COVID-19' or similar such activities
vii. Specified research and development project public fund universities and certain organisation engaged in conducting research in science, technology, engineering, and medicine.

2. New criteria for applicability of Accounting Standards (AS) to non-corporate entities

For the purpose of applicability of Accounting Standards, the criteria for applicability of AS/Ind AS is prescribed by the Companies Act, 2013. Whereas for non-corporate entities, criteria for applicability of AS is prescribed by ICAI. Till now, the ICAI had categorised non-corporate entities into 3 levels based on which it is determined whether they have to comply with all AS or there are full or partial exemptions from applicability of AS.

ICAI has now classified non-corporate entities into 4 levels. Level I entities are large size entities, Level II entities are medium size entities, Level III entities are small size entities and Level IV entities are micro entities. Level IV, Level III and Level II entities are referred to as Micro, Small and Medium size entities respectively.

These amendments will also reduce the difficulties faced by non-corporate entities falling under existing levels as they will be provided with partial or full relaxation or exemption by getting categorised into descending levels. Level I entities are required to comply in full with all the Accounting Standards.

The above scheme is applicable for accounting periods commencing on or after 1st April 2020.

For the detailed announcement, refer: https://resource.cdn.icai.org/64269asb51535.pdf

3. Expert advisory opinion

Background:

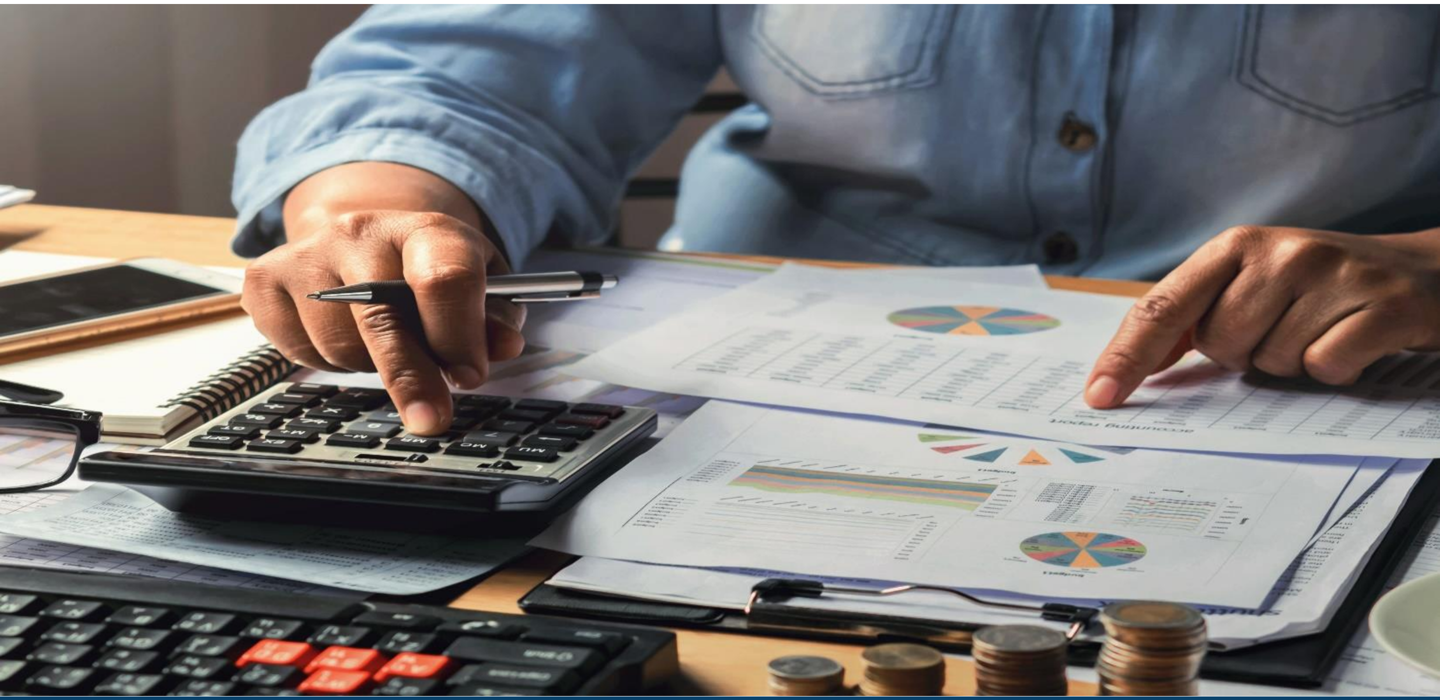
Expert advisory committee ('EAC') of ICAI has recently issued an opinion in case of disclosure of changes in inventory of scrap in the statement of profit and loss. As per the facts of the case, scrap is predominantly generated from the Company's manufacturing operations and it is not usable. It also does not have an active market and can be sold as scrap only. The scrap income is shown separately under 'Other Operational Income' and it includes scrap sale as well as increase/decrease in scrap stock i.e. difference of closing stock and opening stock of scrap.

Query: Whether the change in inventory of scrap can be shown as part of scrap income being disclosed under 'Other operational income' or whether it has to be disclosed under the item 'Changes in inventories of finished goods and work in progress'?

Key Principles applied by EAC & its conclusions:

- As per Ind AS 2- Inventories, there is no specific treatment prescribed for scrap whereas it prescribes what is joint product and by-product. In the opinion of the EAC, although the inventory of scrap is incidentally generated in the production/manufacturing process, since it is produced and sold in the 'normal course of business', these are of the nature of 'inventory' as per Ind AS 2. Hence, the accounting prescribed in respect of by-product in Ind AS 2 may be applied. This view is also supported by Accounting Standard 2 (applicable to non-Ind AS companies) which deals with the accounting for scrap.
- In respect of disclosure of changes in inventories of scrap in statement of profit & loss, there is no specific mention in Schedule III of the Act. The Guidance note (GN) of Schedule III has prescribed only disclosure for sale of manufacturing scrap as 'other operating revenue' under the head 'Revenue from operations'. It does not mention about the disclosure of 'change in the inventory of scrap' under this classification or any other classification.

- Drawing analogy from other items under ‘Revenue from operations’, viz., sale of goods and sale of services, the EAC is of the view that only sale of scrap should be disclosed under ‘other operating revenue’ and not the changes in inventory of scrap.
- Further, as per the GN, internally manufactured components that are sometimes sold without further processing and sometimes after further processing may be disclosed as ‘manufactured components’ for the purpose of classification of inventories (although there is no such classification prescribed under Schedule III). Drawing an analogy from this and since in the present case, the inventory of scrap can be accounted for as by-product inventory under Ind AS 2, the ‘change in the inventory of scrap’ should also be disclosed separately under the classification, ‘Changes in inventories of finished goods, work in progress and stock in trade’.
- The EAC is of the view that Schedule III permits the use of additional line items, heads, etc. in the presentation of Statement of Profit and Loss, if these are relevant to an understanding of the entity’s financial performance. Therefore, separate disclosure of ‘change in the inventory of scrap’ under the classification, ‘Changes in inventories of finished goods, work in progress and stock in trade’ is permissible under the requirements of Schedule III to the Act.



Contact

Samir Parmar
Associate Partner

samir.parmar@knavcpa.com

India office: 201/202, Naman Centre, G-Block, Bandra-Kurla Complex, Bandra (East), Mumbai – 400 051