

GN (A) 34

**Guidance Note on
Accounting for Expenditure on
Corporate Social Responsibility Activities**



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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(Issued May 15, 2015)



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Foreword

In today's times, the society expects the businesses to fulfil their corporate social responsibility, thereby contributing to the overall development of the society in a more pragmatic and cohesive way. It is an accepted fact that corporate houses also have a major role to play in the equitable sustenance of the society at large and the onus on them to contribute towards all-round development of the society, environment, etc., which generally is termed as corporate social responsibility (CSR). This, hitherto, being a voluntary activity on the part of few corporate houses to discharge their social obligation has now been given a more onerous responsibility with the introduction of provisions governing the expenditure on CSR activities, in the new Companies Act, 2013 (the Act). The provisions related to corporate social responsibility in the Act have already become effective from April 1, 2014.

Realising the need to provide guidance on accounting for expenditure on corporate social responsibility activities, the Council of the Institute, through its Research Committee, has issued the 'Guidance Note on Accounting for Expenditure on CSR Activities' which comes into effect from the date of its issuance. The Guidance Note also consist of relevant sections of the Companies Act, 2013, Companies (Corporate Social Responsibility) Rules, 2014, as well as various notifications and circulars issued by the MCA with regard to CSR for ease of reference of members and others. Pending finalisation of the Guidance Note, as it was under discussion with the relevant authorities, the Corporate Laws & Corporate Governance Committee had issued 'Frequently Asked Questions on the provisions of Corporate Social Responsibility under Section 135 of the Companies Act 2013 and Rules thereon' which, inter alia, provided an interim guidance with regard to certain accounting issues. On issuance of this Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities, the FAQs related to areas covered by the Guidance Note stand withdrawn.

I would like to congratulate CA. Subodh K. Agrawal, Past President and Chairman, Research Committee, CA. Sanjiv K. Chaudhary, Vice Chairman, Research Committee, CA. V. Murali, Former Chairman, Research Committee and its other members and my colleagues on the Council who have contributed immensely towards bringing out this publication.

I am confident that this Guidance Note will be immensely useful to the members of the Institute as well as to others concerned.

June 2, 2015
New Delhi

CA. Manoj Fadnis
President

Preface

The world over, it is now being realised that businesses, being an integral part of society, also have a critical and active role to play in the sustenance of the society at large which is its prime stakeholder. Corporate social responsibility (CSR) ordinarily refers to the voluntary endeavors undertaken by certain companies towards betterment of society and environment as a whole. Hitherto, in India, CSR activities have been carried out by few companies or business houses and not by all the corporate entities. India, being a welfare state, has become perhaps the first country to mandate CSR activities through a statutory provision in the new Companies Act, 2013 (the Act), thus making it mandatory for certain classes of companies. Accordingly, it is expected that the number of companies carrying on CSR activities will greatly increase, as a consequence of the CSR requirements in the Act.

Since incurrance of CSR expenditure has accounting implications, the Research Committee of the Institute undertook the project to provide uniform guidance on accounting for expenditure on CSR activities in accordance with the generally accepted accounting principles in India. This Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities has been formulated after detailed discussions with various stakeholders.

I would like to place on record my deep appreciation for the contribution provided in the formulation of this draft by my esteemed colleagues on the Council, noting specially the contribution made by CA. V. Murali, immediate past Chairman, Research Committee and my other colleagues on the Research Committee.

I hope that this endeavour of the Research Committee will prove to be of immense value in establishing sound accounting principles and provide guidance to industry, members and others.

June 1, 2015
New Delhi

CA. Subodh K. Agrawal
Chairman, Research Committee

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**Guidance Note on Accounting for
Expenditure on Corporate Social
Responsibility Activities**
(Issued May 15, 2015)

(The Council of the Institute of Chartered Accountants of India (ICAI) has issued this **Guidance Note on Accounting for Expenditure on Corporate Social Responsibility Activities** which comes into effect from the date of its issuance.)

Introduction

1. Section 135 of the Companies Act, 2013 (the Act), requires the Board of Directors of every company having a net worth of Rupees 500 crore or more, or turnover of Rupees 1,000 crore or more or a net profit of Rupees 5 crore or more, during any financial year, to ensure that the company spends in every financial year at least 2% of the average net profits of the company made during the three immediately preceding financial years on Corporate Social Responsibility (CSR) in pursuance of its policy in this regard. The Act requires such companies to constitute a Corporate Social Responsibility Committee which shall formulate and recommend to the Board a Corporate Social Responsibility Policy which shall indicate the CSR activities to be undertaken by the company as specified in Schedule VII to the Act.

Objective

2. The objective of this Guidance Note is to provide guidance on recognition, measurement, presentation and disclosure of expenditure on activities relating to corporate social responsibility.

Scope

3. What constitutes CSR activities is specified in Schedule VII to the Act. Reference is also invited to the circular issued by the Ministry of Corporate Affairs (MCA) No. 21/2014 and Notification dated October 24, 2014. Accordingly, the Guidance Note does not deal with identification of activities that constitute CSR activities but only provides guidance on accounting for expenditure on CSR activities in line with the requirements of the generally accepted accounting principles including the applicable Accounting Standards.

Definitions

4. For the purpose of this Guidance Note, the definitions mentioned at sl. nos. (a) to (f) are reproduced from the Companies Act, 2013, and the Companies (Corporate Social Responsibility Policy) Rules, 2014 and in the event of any change in the Act or the Rules made thereunder, these definitions shall stand automatically revised/modified to that extent:

- (a) *Any financial year*: "Any financial year" referred under sub-section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014, implies 'any of the three preceding financial years'. (Clarification vide MCA General Circular No. 21/2014)
- (b) *Average Net Profit*: "Average Net Profit" is the amount as calculated in accordance with the provisions of Section 198 of the Companies Act, 2013.
- (c) *Financial Year*: "Financial Year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that on an application made by a company or body corporate, which is a holding company or a subsidiary of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:

Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause;

- (d) *Net Profit*: "Net Profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:-
- (i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
 - (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be re-calculated in accordance with the provisions of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

- (e) *Net worth*: "Net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;
- (f) *Turnover*: "Turnover" means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year;
- (g) *Spend* : The term 'spend' in accounting parlance generally means the liabilities incurred during the relevant accounting period.

5. Rule 4 of the Companies (Corporate Social Responsibility Policy) Rules, 2014, requires that the CSR activities that shall be undertaken by the companies for the purpose of Section 135 of the Act shall exclude activities undertaken in pursuance of its 'normal course of business'. The Rules also specify that CSR projects or programmes or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with the requirements of the Act. Such programmes or projects or activities, that are carried out as a pre-condition for setting up a business, or as part of a contractual obligation undertaken by the company or in accordance with any other Act, or as a part of the requirement in this regard by the relevant authorities cannot be considered as a CSR activity within the meaning of the Act. Similarly, the requirements under relevant regulations or otherwise prescribed by the concerned regulators as a necessary part of running of the business, would be considered to be the activities undertaken in the 'normal course of business' of the company and, therefore, would not be considered CSR activities.

Recognition and Measurement of CSR Expenditure in Financial Statements

Whether Provision for Unspent Amount required to be created?

6. Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy". A proviso to this Section states that "if the company fails to spend such amount, the Board shall, in its report ... specify the reasons for not spending the amount".

7. Further, Rule 8(1) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, prescribes that the Board Report of a company under these Rules shall include an Annual Report on CSR, containing particulars specified in the Annexure to the said Rules, which provide a format in this regard.

8. The above provisions of the Act clearly lay down that the expenditure on CSR activities is to be disclosed only in the Board's Report in accordance with the Rules made thereunder. In view of this, no provision for the amount

which is not spent, i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period, may be made in the financial statements. The proviso to section 135 (5) of the Act, makes it clear that if the specified amount is not spent by the company during the year, the Directors' Report should disclose the reasons for not spending the amount. However, if a company has already undertaken certain CSR activity for which a liability has been incurred by entering into a contractual obligation, then in accordance with the generally accepted principles of accounting, a provision for the amount representing the extent to which the CSR activity was completed during the year, needs to be recognised in the financial statements.

9. Where a company spends more than that required under law, a question arises as to whether the excess amount 'spent' can be carried forward to be adjusted against amounts to be spent on CSR activities in future period. Since '2% of average net profits of immediately preceding three years' is the minimum amount which is required to be spent under section 135 (5) of the Act, the excess amount can not be carried forward for set off against the CSR expenditure required to be spent in future.

Other Considerations in Recognition and Measurement

10. A company may decide to undertake its CSR activities approved by the CSR Committee with a view to discharge its CSR obligation as arising under section 135 of the Act in the following three ways:

- (a) making a contribution to the funds as specified in Schedule VII to the Act;
or
- (b) through a registered trust or a registered society or a company established under section 8 of the Act (or section 25 of the Companies Act, 1956) by the company, either singly or along with its holding or subsidiary or associate company or along with any other company or holding or subsidiary or associate company of such other company, or otherwise ; or
- (c) in any other way in accordance with the Companies (Corporate Social Responsibility Policy) Rules, 2014, e.g. on its own

11. 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 amount is spent in the manner as specified in paragraph 10 (b) above the same will also be treated as expense for the year by charging off to the statement of profit and loss. The accounting for expenditure incurred by the company otherwise e.g. on its own would be accounted for in accordance with the principles of accounting as explained hereinafter.

CSR activities carried out by the company covered under paragraph 10 (c)

12. In cases, where an expenditure of revenue nature is incurred on any of the activities mentioned in Schedule VII to the Act by the company on its own, the same should be charged as an expense to the statement of profit and loss. In case the expenditure incurred by the company is of such nature which may give rise to an 'asset', a question may arise as to whether such an 'asset' should be recognised by the company in its balance sheet. In this context, it would be relevant to note the definition of the term 'asset' as per the Framework for Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India. As per the Framework, an 'asset' is a "resource controlled by an enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise". Hence, in cases where the control of the 'asset' is transferred by the company, e.g., a school building is transferred to a Gram Panchayat for running and maintaining the school, it should not be recognised as 'asset' in its books and such expenditure would need to be charged to the statement of profit and loss as and when incurred. In other cases, where the company retains the control of the 'asset' then it would need to be examined whether any future economic benefits accrue to the company. Invariably future economic benefits from a 'CSR asset' would not flow to the company as any surplus from CSR cannot be included by the company in business profits in view of Rule 6(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014.

13. In some cases, a company may supply goods manufactured by it or render services as CSR activities. In such cases, the expenditure incurred should be recognised when the control on the goods manufactured by it is transferred or the allowable services are rendered by the employees. The goods manufactured by the company should be valued in accordance with the principles prescribed in Accounting Standard (AS) 2, *Valuation of Inventories*. The services rendered should be measured at cost. Indirect

taxes (like excise duty, service tax, VAT or other applicable taxes) on the goods and services so contributed will also form part of the CSR expenditure.

14. Where a company receives a grant from others for carrying out CSR activities, the CSR expenditure should be measured net of the grant.

Recognition of Income Earned from CSR Projects/ Programmes or During the Course of Conduct of CSR Activities

15. Rule 6 (2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, requires that “the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company”. The term ‘surplus’ ordinarily means excess of income over expenditure pertaining to an entity or an activity. Thus, in respect of a CSR project or programme or activity, it needs to be determined whether any surplus is arising therefrom. A question would arise as to whether such surplus should be recognised in the statement of profit and loss of the company. It may be noted that paragraph 5 of Accounting Standard (AS) 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*, inter alia, requires that all items of income which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise. As to whether the surplus from CSR activities can be considered as ‘income’, the *Framework for Preparation and Presentation of Financial Statements* issued by the Institute of Chartered Accountants of India, defines ‘income’ as “increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants”. Since the surplus arising from CSR activities is not arising from a transaction with the owners, it would be considered as ‘income’ for accounting purposes. In view of the aforesaid requirement any surplus arising out of CSR project or programme or activities shall be recognised in the statement of profit and loss and since this surplus can not be a part of business profits of the company, the same should immediately be recognised as liability for CSR expenditure in the balance sheet and recognised as a charge to the statement of profit and loss. Accordingly, such surplus would not form part of the minimum ‘2% of the average net profits of the company made during the three immediately preceding financial years in pursuance of its Corporate Social Responsibility Policy’ .

Presentation and Disclosure in Financial Statements

16. Item 5 (A)(k) of the General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of profit and loss. From the perspective of better financial reporting and still be in line with the requirements of Schedule III in this regard, it is recommended that all expenditure on CSR activities, that qualify to be recognised as expense in accordance with paragraphs 10-14 above should be recognised as a separate line item as 'CSR expenditure' in the statement of profit and loss. Further, the relevant note should disclose the break-up of various heads of expenses included in the line item 'CSR expenditure'.

17. The notes to accounts relating to CSR expenditure should also contain the following:

- (a) Gross amount required to be spent by the company during the year.
- (b) Amount spent during the year on:

		In cash	Yet to be paid in cash	Total
(i)	Construction/acquisition of any asset			
(ii)	On purposes other than (i) above			

The above disclosure, to the extent relevant, may also be made in the notes to the cash flow statement, where applicable.

- (c) Details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per Accounting Standard (AS) 18, *Related Party Disclosures*.
- (d) Where a provision is made in accordance with paragraph 8 above the same should be presented as per the requirements of Schedule III to the Companies Act, 2013. Further, movements in the provision during the year should be shown separately.

Appendix 1

Section 135 of the Companies Act, 2013-Corporate Social Responsibility

- (1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.
- (2) The Board's report under sub-section (3) of Section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
- (3) The Corporate Social Responsibility Committee shall,—
 - (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
 - (b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
 - (c) monitor the Corporate Social Responsibility Policy of the company from time to time.
- (4) The Board of every company referred to in sub-section (1) shall,—
 - (a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
 - (b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.
- (5) The Board of every company referred to in sub-section (1), 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:

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:

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.

Explanation.—For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of Section 198.

Appendix 2

Section 198 of the Companies Act , 2013 – Calculation of Profits

(1) In computing the net profits of a company in any financial year for the purpose of section 197,—

- (a) credit shall be given for the sums specified in sub-section (2), and credit shall not be given for those specified in sub-section (3); and
- (b) the sums specified in sub-section (4) shall be deducted, and those specified in sub-section (5) shall not be deducted.

(2) In making the computation aforesaid, credit shall be given for the bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs.

(3) In making the computation aforesaid, credit shall not be given for the following sums, namely:—

- (a) profits, by way of premium on shares or debentures of the company, which are issued or sold by the company;
- (b) profits on sales by the company of forfeited shares;
- (c) profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;
- (d) profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written-down value;

- (e) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

(4) In making the computation aforesaid, the following sums shall be deducted, namely:—

- (a) all the usual working charges;
- (b) directors' remuneration;
- (c) bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
- (d) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;

- (e) any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
- (f) interest on debentures issued by the company;
- (g) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
- (h) interest on unsecured loans and advances;
- (i) expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;
- (j) outgoings inclusive of contributions made under section 181;
- (k) depreciation to the extent specified in section 123;
- (l) the excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;
- (m) any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;
- (n) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in clause (m);
- (o) debts considered bad and written off or adjusted during the year of account.

(5) In making the computation aforesaid, the following sums shall not be deducted, namely:—

- (a) income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (d) and (e) of sub-section (4);
- (b) any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (m) of sub-section (4);
- (c) loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;
- (d) any change in carrying amount of an asset or of a liability recognised in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Appendix 3

Schedule VII to the Companies Act, 2013 (See sections 135)

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:—

- (i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation¹ including contribution to the Swachh Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;
- (ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects;
- (iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
- (iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water² including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;
- (v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
- (vi) measures for the benefit of armed forces veteran, war widows and their dependents;
- (vii) training to promote rural sports nationally recognised sports, Paralympic sports and Olympic sports;

¹ Inserted vide Notification G.S.R. 741 (E) dated 24.10.2014

² Inserted vide Notification G.S.R. 741 (E) dated 24.10.2014

- (viii) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- (ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- (x) rural development projects;
- (xi) ³slum area development

Explanation.—For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.

³ Inserted vide Notification G.S.R 568 (E) dated 06.08.2014

Appendix 4

Rules for CSR under Section 135 of Chapter IX (after incorporating Amendments upto May, 2015)

New Delhi, dated 27th February, 2014

G.S.R. 129 (E).- In exercise of the powers conferred under section 135 and sub-sections (1) and (2) of section 469 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following rules, namely: -

1. **Short title and commencement.** –
 - (1) These rules may be called the Companies (Corporate Social Responsibility Policy) Rules, 2014;
 - (2) They shall come into force on the 1st day of April, 2014.
2. **Definitions.**-
 - (1) In these rules, unless the context otherwise requires;
 - (a) "Act" means the Companies Act, 2013;
 - (b) "Annexure" means the Annexure appended to these rules;
 - (c) "Corporate Social Responsibility (CSR)" means and includes but is not limited to:-
 - (i) Projects or programs relating to activities specified in Schedule VII to the Act; or
 - (ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.
 - (d) "CSR Committee" means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act;
 - (e) "CSR Policy" relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company;

- (f) "Net profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :-
- (i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and
 - (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be re-calculated in accordance with the provisions of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (l) of section 381 read with section 198 of the Act.

- (2) Words and expressions used and not defined in these rules but defined in the Act shall have the same meanings respectively assigned to them in the Act.

3. Corporate Social Responsibility. -

- (1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfills the criteria specified in sub-section (l) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

- (2) Every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to -

- (a) constitute a CSR Committee; and
- (b) comply with the provisions contained in sub-section (2) to (5) of the said section, till such time it meets the criteria specified in sub-section (1) of section 135

4. CSR Activities.-

- (1) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.
- (2) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through a registered trust or a registered society or a company established under Section 8 of the Act by the company, either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company, or otherwise:⁴

Provided that-

- (i) if such trust, society or company is not established by the company either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company⁵, it shall have an established track record of three years in undertaking similar programs or projects.
- (ii) the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.
- (3) A company may also collaborate with other companies for undertaking projects or programs 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 programs in accordance with these rules.
- (4) Subject to provisions of sub-section (5) of section 135 of the Act, the CSR projects or programs or activities undertaken in India only shall amount to CSR expenditure.

⁴ Substituted vide Amendment in Rules, G.S.R. 43 (E), dated 19.01.2015

⁵ Substituted vide Amendment in Rules, G.S.R. 43 (E), dated 19.01.2015

- (5) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.
- (6) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure ⁶including expenditure on administrative overheads, shall not exceed five percent of total CSR expenditure of the company in one financial year.
- (7) Contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

5. CSR Committees.-

1. The companies mentioned in the rule 3 shall constitute CSR Committee as under:-
 - (i) an unlisted public company or a private company covered under sub-section (1) of section 135 which is not required to appoint an independent director pursuant to subsection (4) of section 149 of the Act, shall have its CSR Committee without such director;
 - (ii) a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;
 - (iii) with respect to a foreign company covered under these rules, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Act and another person shall be nominated by the foreign company.
- (2) The CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

6. CSR Policy.-

- (1) The CSR Policy of the company shall, inter-alia, include the following, namely -

⁶ Inserted vide Amendment in Rules, G.S.R. 644 (E), dated 12.09.2014

- (a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and
- (b) monitoring process of such projects or programs:

Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Provided further that the Board of Directors shall ensure that activities included by a company in its Corporate Social Responsibility Policy are related to the activities included in Schedule VII of the Act.

- (2) The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

7. CSR Expenditure- CSR expenditure shall include all expenditure including contribution to corpus, for projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

8. CSR Reporting-

- (1) The Board's Report of a company covered under these rules pertaining to a financial year commencing on or after the 1st day of April, 2014 shall include an annual report on CSR containing particulars specified in Annexure.
- (2) In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR.

9. Display of CSR activities on its website -

The Board of Directors of the company shall, after taking into account the recommendations of CSR Committee, approve the CSR Policy for the company and disclose contents of such policy in its report and the same shall be displayed on the company's website, if any, as per the particulars specified in the Annexure.

ANNEXURE

FORMAT FOR THE ANNUAL REPORT ON CSR ACTIVITIES TO BE INCLUDED IN THE BOARD'S REPORT

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The Composition of the CSR Committee.
3. Average net profit of the company for last three financial years.
4. Prescribed CSR Expenditure (two per cent. Of the amount as in item 3 above)
5. Details of CSR spent during the financial year.
 - (a) Total amount to be spent for the financial year;
 - (b) Amount unspent, if any;
 - (c) Manner in which the amount spent during the financial year is detailed below.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S. No.	CSR Project or activity identified	Sector in which the Project is covered	Projects or programs (1) Local area or other (2) Specify the State and district where projects or programs was undertaken	Amount outlay (budget) project or programs wise	Amount spent on the projects or programs Sub -heads: (1) Direct expenditure on projects or programs. 2.Overheads:	Cumulative expenditure upto to the reporting period	Amount spent: Direct or through implementing agency
1							
2							
3							
	TOTAL						

*Give details of implementing agency:

6. In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

Sd/- (Chief Executive Officer or Managing Director or Director)	Sd/- (Chairman CSR Committee)	Sd/- (Person specified under clause (d) of sub-section (1) of section 380 of the Act) (wherever applicable)
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Appendix 5

Summary of Circulars issued by the Ministry of Corporate Affairs related to CSR

S. No	General Circular No.	Date	Description
1.	General Circular No. 21/2014	18.06.2014	<p>Clarification with regard to provisions of Corporate Social Responsibility under Section 135 of the Companies Act, 2013:-</p> <ul style="list-style-type: none"> • <i>Clarification with respect to CSR is as under:-</i> <ul style="list-style-type: none"> ➤ The statutory provision and provisions of CSR Rules, 2014, is to ensure that while activities undertaken in pursuance of the CSR policy must be relatable to Schedule VII of the Companies Act, 2013, the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad based and are intended to cover a wide range of activities as mentioned in the Annexure:- ➤ CSR activities should be undertaken by the companies in project/programme mode [as referred in Rule 4(1) of Companies CSR Rules, 2014]. <i>(One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be</i>

			<p><i>qualified as part of CSR expenditure).</i></p> <ul style="list-style-type: none"> ➤ <i>Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc) would not count as CSR expenditure under the Companies Act.</i> ➤ <i>Salary paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/ hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.</i> ➤ <i>"Any Financial year" referred under Sub-Section (1) of Section 135 of the Act read with Rule 3(2) of Companies CSR Rule, 2014 implies 'any of the three preceding financial years'.</i> ➤ <i>Expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per Section 135 of the Act.</i> ➤ <i>'Registered Trust' (as referred in Rule 4(2) of the Companies CSR Rules, 2014) would include Trusts registered under Income Tax Act, 1956 for those states</i>
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			<p><i>where registration of Trust is not mandatory.</i></p> <p>➤ <i>Contribution to Corpus of a Trust/ Society/Section 8 Companies etc. will qualify as CSR expenditure as long as (a) the Trust/Society/ Section 8 companies etc. is created exclusively for undertaking CSR activities or (b) where the corpus is created exclusively for a purpose directly relatable to a subject covered in Schedule VII of the Act.</i></p>
2.	General Circular No. 36/2014	17.09.2014	<p>Clarification with regard to provisions of Corporate Social Responsibility (CSR) under Section 135 of the Companies Act, 2013:-</p> <ul style="list-style-type: none"> • In continuation of the General Circular No. 21 of 2014 dated 18.06.2014 the following clarifications are hereby issued: <ul style="list-style-type: none"> (i) Rule 4(6) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 as notified on 27.02.2014 has been amended by notification dated 12.09.2014; and (ii) Consequently, clarification (iv) in General Circular No. 21 of 2014 dated 18.06.2014, stands omitted i.e., <p><i>Salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into CSR project cost as part of the CSR expenditure.'</i></p>

**ANNEXURE REFERRED TO AT PARA (i) OF GENERAL CIRCULAR NO.
21/2014 DATED 18.06.2014**

Sl. No.	Additional items requested to be included in Schedule VII or to be clarified as already being covered under Schedule VII of the Act	Whether covered under Schedule VII of the Act
1.	<p>Promotion of Road Safety through CSR:</p> <p>(i) (a) Promotions of Education, "Educating the Masses and Promotion of Road Safety awareness in all facets of road usage,</p> <p>(b) Drivers' training,</p> <p>(c) Training to enforcement personnel,</p> <p>(d) Safety traffic engineering and awareness through print, audio and visual media" should be included.</p> <p>(ii) Social Business Projects: "giving medical and Legal aid, treatment to road accident victims" should be included.</p>	<p>(a) Schedule VII (ii) under "promoting education".</p> <p>(b) For drivers training etc. Schedule VII (ii) under "vocational skills".</p> <p>(c) It is establishment functions of Government (cannot be covered).</p> <p>(d) Schedule VII (ii) under "promoting education".</p> <p>(ii) Schedule VII (i) under 'promoting health care including preventive health care.'</p>
2.	Provisions for aids and appliances to the differently-able persons- 'Request for inclusion	Schedule VII (i) under 'promoting health care including preventive health care.'
3.	The company contemplates of setting up ARTIIC (Applied Research Training and Innovation Centre) at Nasik. Centre will cover the following aspects as CSR initiatives for the benefit of the predominately rural farming	<p>Item no. (ii) of Schedule VII under the head of "promoting education" and "vocational skills" and "rural development".</p> <p>(a) "Vocational skill" livelihood enhancement projects.</p>

	<p>community:</p> <p>(a) Capacity building for farmers covering best sustainable farm management practices.</p> <p>(b) Training Agriculture Labour on skill development.</p> <p>(c) Doing our own research on the field for individual crops to find out the most cost optimum and Agri-ecological sustainable farm practices. (Applied research) with a focus on water management.</p> <p>(d) To do Product Life Cycle analysis from the soil conservation point of view.</p>	<p>(b) "Vocational skill"</p> <p>(c) 'Ecological balance', 'maintaining quality of soil, air and water'.</p> <p>(d) "Conservation of natural resource" and 'maintaining quality of soil, air and water'.</p>
4.	<p>To make "Consumer Protection Services" eligible under CSR. (Reference received by Dr. V.G. Patel, Chairman of Consumer Education and Research Centre).</p> <p>(i) Providing effective consumer grievance redressal mechanism.</p> <p>(ii) Protecting consumer's health and safety, sustainable consumption, consumer service, support and complaint resolution.</p> <p>(iii) Consumer protection activities.</p> <p>(iv) Consumer Rights to be mandated.</p> <p>(v) all consumer protection programs and activities" on the same lines as Rural Development, Education etc.</p>	<p>Consumer education and awareness can be covered under Schedule VII (ii) "promoting education".</p>

5.	<p>(a) Donations to IIM [A] for conservation of buildings and renovation of classrooms would qualify as "promoting education" and hence eligible for compliance of companies with Corporate Social Responsibility.</p> <p>(b) Donations to IIMA for conservation of buildings and renovation of classrooms would qualify as "protection of national heritage, art and culture, including restoration of buildings and sites of historical importance" and hence eligible for compliance of companies with CSR.</p>	<p>Conservation and renovation of school buildings and classrooms relates to CSR activities under Schedule VII as "promoting education".</p>
6.	<p>Non Academic Technopark TBI not located within an academic Institution but approved and supported by Department of Science and Technology.</p>	<p>Schedule VII (ii) under "promoting education", if approved by Department of Science and Technology.</p>
7.	<p>Disaster Relief</p>	<p>Disaster relief can cover wide range of activities that can be appropriately shown under various items listed in Schedule VII. For example,</p> <ul style="list-style-type: none"> (i) medical aid can be covered under 'promoting health care including preventive health care.' (ii) food supply can be covered under eradicating hunger, poverty and malnutrition. (iii) supply of clean water can be covered under 'sanitation and

		making available safe drinking water'.
8.	Trauma care around highways in case of road accidents.	Under 'health care'.
9.	Clarity on "rural development projects"	Any project meant for the development of rural India will be covered under this.
10.	Supplementing of Govt. schemes like mid-day meal by corporates through additional nutrition would qualify under Schedule VII.	Yes. Under Schedule VII, item no. (i) under 'poverty and malnutrition'.
11.	Research and Studies in the areas specified in Schedule VII.	Yes, under the respective areas of items defined in Schedule VII. Otherwise under 'promoting education'.
12.	Capacity building of government officials and elected representatives - both in the area of PPPs and urban infrastructure.	No.
13.	Sustainable urban development and urban public transport systems	Not covered.
14.	Enabling access to, or improving the delivery of, public health systems be considered under the head "preventive healthcare" or "measures for reducing inequalities faced by socially & economically backward groups"?	Can be covered under both the heads of "healthcare" or "measures for reducing inequalities faced by socially & economically backward groups", depending on the context.
15.	Likewise, could slum re-development or EWS housing be covered under "measures for reducing inequalities faced by socially & economically backward groups"?	Yes.

16.	Renewable energy projects	Under 'Environmental sustainability, ecological balance and conservation of natural resources',
17.	<p>(i) Are the initiatives mentioned in Schedule VII exhaustive?</p> <p>(ii) In case a company wants to undertake initiatives for the beneficiaries mentioned in Schedule VII, but the activity is not included in Schedule VII, then will it count (as per 2(c)(ii) of the Final Rules, they will count)?</p>	(i) & (ii) Schedule VII is to be liberally interpreted so as to capture the essence of subjects enumerated in the schedule.
18.	US-India Physicians Exchange Program-broadly speaking, this would be program that provides for the professional exchange of physicians between India and the United States.	No.



Guidance Note on Accounting for Derivative Contracts

Key Highlights

May 2015

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Guidance Note on Accounting for Derivative Contracts - Key Highlights

Introduction

The Accounting Standards 30, 31 issued in 2007 and Accounting Standard 32 issued in 2008, which deal with financial instruments were made recommendatory from the date of their issue and to be made mandatory from specified dates. Owing to the Global situation and various issues raised in respect of the treatment of financial instruments, ICAI withdrew the recommendatory as well as mandatory status of AS 30, AS 31 and AS 32 in March 2011 on account of proposed revision of International Accounting Standard 39 by the IASB on whose principles the AS 30 was based on. Currently, the relevant regulation that concerns accounting for foreign currency transactions and foreign exchange forward contracts is AS 11. However, AS 11 does not cover contracts used to hedge highly probable forecast transactions and firm commitments. In order to bring the uniformity on accounting for derivative, the ICAI has issued the Guidance Note on accounting for derivative contracts. This Guidance Note provides the guidance on recognition, measurement, presentation and disclosure for derivative contracts so as to bring uniformity in their accounting and presentation in the financial statements. This Guidance Note however does not cover foreign exchange forward contracts which are within the scope of AS 11. This Guidance Note will apply to all entities that do not apply Indian Accounting Standards (IND AS).

Applicability

This Guidance Note becomes applicable for accounting periods beginning on or after 1st April, 2016; its earlier application, is encouraged. From the date this Guidance Note comes into effect the following Announcements issued by the Council of the ICAI stand withdrawn:

- i. Applicability of Accounting Standard (AS) 11 (revised 2003), The Effects of Changes in Foreign Exchange Rates, in respect of exchange differences arising on a forward exchange contract entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction issued on the basis of the decision of the Council at its meeting held on June 24-26, 2004
- ii. Disclosures regarding Derivative Instruments published in 'The Chartered Accountant', December 2005 (pp 927).
- iii. Accounting for Derivatives published in 'The Chartered Accountant', May 2008 (pp.1945).
- iv. Application of AS 30, Financial Instruments: Recognition and Measurement published in 'The Chartered Accountant', April 2011 (pp.1575) to the extent of the guidance covered for accounting for derivatives within the scope of this Guidance Note.

Scope

This Guidance Note thus applies to the following derivative contracts:

- Foreign exchange forward contracts outside the scope of AS 11
- Other foreign currency derivative contracts such as cross currency interest rate swaps, foreign currency futures, options and swaps, not covered in scope of AS 11
- Other derivative contracts such as traded equity index futures, traded equity index options, traded stock futures and option contracts
- Commodity derivative contracts

Guidance Note on Accounting for Derivative Contracts - Key Highlights

This Guidance Note is not applicable to:

- Foreign exchange forward contracts covered by AS 11
- Foreign exchange forward contracts or covered by regulations specific to a sector or specified set of entities.
- Macro hedging and accounting for non derivative financial assets/liabilities which are designated as hedging instruments since its objective is to provide guidance on accounting for derivative contracts only and not hedge accounting in its entirety.

Examples of contracts within the scope of AS 11 and thus not covered within the scope of this Guidance Note include:

- Foreign currency forward or future contract entered into to hedge the payment of a monetary asset or a monetary liability recognised on balance sheet, e.g., a debtor, creditor, loan, borrowing etc.
- A currency swap contract (principal only; no interest rate element) that hedges the repayment of the principal of a foreign currency loan.

Accounting of derivatives

The Guidance Note includes definitions of various terms such as derivative, firm commitment; forecast transaction, hedging instrument, hedged item, hedge effectiveness, hedge ratio.

The key principles, on which the accounting for derivatives are based, are as follows:

- i. All derivative contracts should be recognized on the balance sheet date and measured at fair value.
- ii. If any entity is not using hedge accounting as described in Guidance Note, it should account for its derivatives at fair value with changes in fair value being recognized in the statement of Profit and Loss.
- iii. If an entity decides to apply hedge accounting as described in this Guidance Note, it should be able to clearly identify
 - its risk management objective,
 - the risk that it is hedging,
 - how it will measure the derivative instrument if its risk management objective is being
- iv. An entity may decide to use hedge accounting for certain derivative contracts and for derivatives not included as part of hedge accounting, it will apply the principles at (i) and (ii) above.
- v. Adequate disclosures of accounting policies, risk management objectives and hedging activities should be made in its financial statements.

This Guidance Note requires that all derivatives are recognized on the balance sheet and measured at fair value since a derivative contract represents a contractual right or an obligation

Fair value in the context of derivative contracts represents the 'exit price' i.e. the price that would be paid to transfer a liability or the price that would be received when transferring an asset to a knowledgeable, willing

Guidance Note on Accounting for Derivative Contracts - Key Highlights

counterparty. The fair value would also incorporate the effect of credit risk associated with the fulfillment of future obligations. The extent and availability of collateral should be factored in while arriving at the fair value of a derivative contract.

Synthetic Accounting not permitted

The Guidance Note does not permit synthetic accounting, i.e. accounting of combining a derivative and the underlying asset together as a single package. For instance, if any entity has a foreign currency borrowing that it has hedged by entering into a cross currency interest rate swap, it would require the entity to recognise the loan liability separately from the cross currency interest rate swap and not treat them as a package (synthetic accounting) as INR loan. Alternatively, if any entity has borrowed in terms of INR which it swaps with foreign currency borrowing it would not treat such a loan as a foreign currency borrowing.

Hedge Accounting

Designation of Derivative Contract as a Hedging Instrument

Designation of derivative contract as a hedging instrument is optional. Once designated, the entity needs to:

- Identify its risk management objective
- Demonstrate how the derivative contract helps meet that risk management objective
- specify how the entity plans to measure the fair value of the derivative instrument if the derivative contract is effective in meeting its risk management objective (including the relevant hedge ratio)
- Document risk management assessment at inception of the hedging relationship and subsequently at every reporting period
- demonstrate in cases of hedging a future cash flow that the cash flows are highly probable of occurring
- conclude that the risk that is being hedged could impact the statement of profit and loss
- adequately disclose its accounting policies, risk management objectives and hedging activities as required by this Guidance Note in its financial statements

If not classified as hedging instrument?

In case a derivative contract is not classified as a hedging instrument because it does not meet the required criteria or an entity decides against such designation, it will be measured at fair value and changes in fair value will be recognized immediately in the statement of profit and loss.

Designation for a partial term?

It is clarified that derivatives cannot be designated for a partial term of the derivative instrument. A derivative may be used in a hedging relationship relating to a portion of a non-financial item as long as the hedged portion is clearly identifiable and capable of being measured reliably.

Indian scenario

Large number of derivative contracts undertaken in the Over-the-counter (OTC) market and banks, are required by RBI to determine whether all or some of the above criteria are met before permitting an entity to enter into such a contract. Certain derivative instruments that are traded on stock exchanges such as foreign exchange futures contracts or equity options / equity futures do not have such requirements and in those cases, in particular, it will be important to demonstrate compliance with the above criteria before hedge accounting can be applied.

Why Hedge Accounting?

Hedge Accounting may be required due to accounting mismatches in:

- Measurement – Non-derivative financial instruments are NOT measured at fair value with changes being recognized in the statement of profit and loss whereas all derivatives, which commonly are used as hedging instruments, are measured at fair value.
- Recognition – unsettled or forecast transactions that may be hedged are not recognized in the balance sheet and are included in the profit and loss statement only in the future accounting period, whereas all derivatives are recognized at inception.

Some examples of such measurement mismatch include:

- Hedge of interest rate risk on fixed rate debt instruments that are not held with the intention of trading
- Derivative undertaken to hedge the price risk associated with recognised inventory.

Example of such recognition mismatch include hedge of a contracted or expected but not yet recognised sale, purchase or financing transaction in a foreign currency and future committed variable interest payments.

In order that the statement of profit and loss reflects the effect of the hedge properly, it is necessary to match the recognition of gains and losses on the hedging instrument and those on the hedged item. Matching can be achieved in principle by delaying the recording of certain gains and losses on the hedging instrument or by accelerating the recording of certain gains and losses on the hedged item in the statement of profit and loss. Both of these techniques are used while applying hedge accounting, depending on the nature of the hedging relationship.

Guidance Note on Accounting for Derivative Contracts - Key Highlights

Types of Hedge Accounting

The Guidance Note Recognizes three types of hedges and lays down accounting and measurement principles relating to:

- Fair value hedge accounting model – applied when hedging the risk of a fair value change of assets and liabilities already recognised in the balance sheet, or a firm commitment that is not yet recognised. When applying this method, the hedging instrument is measured at fair value with changes in fair value recognised in the statement of profit and loss.
- Cash flow hedge accounting model – applied when hedging the risk of changes in highly probable future cash flows or a firm commitment in a foreign currency. Under this method, the hedging instrument is measured at fair value, but any gain or loss that is determined to be an effective hedge is recognised in equity, e.g., cash flow hedge reserve.
- Hedge of a Net Investment in a foreign operation. The foreign exchange gains and losses on a net investment in a non-integral foreign operation are recognised directly in equity.

Documentation and Hedge effectiveness testing

The Guidance Note provides for elaborate documentation of hedge relationship at inception of a hedge which include entity's risk management objective and clear identification of the hedged item and the hedging instrument.

The entity should assess whether a hedging relationship meets the hedge effectiveness requirement. At a minimum, an entity should perform the ongoing assessment at each reporting date or when there is a significant change in the circumstances that affect hedge effectiveness requirement, whichever comes first. The Guidance note does not prescribe bright line tests for effectiveness assessment, instead requires disclosure of the entities risk management objectives and measures for assessing, if those objectives are met. This guidance note prohibits voluntary hedge de-designation if risk management objectives and hedging instruments are unchanged.

Hedge ineffectiveness

It also does not prescribe a single method of how ineffectiveness measurement should be conducted other than to require an entity to consider how ineffectiveness could affect a hedging relationship and require immediate recognition of such ineffectiveness. Hedge ineffectiveness is measured based on the actual performance of the hedging instrument and the hedged item, by comparing the changes in their values in currency unit amounts.

Examples of situations where ineffectiveness is to be recognised are:

- in a cash flow hedge, when the forecasted hedged transaction is no longer probable of occurring
- in a fair value hedge, when the hedging instrument is no longer considered to be an effective hedge of the hedging instrument; and
- in any hedge relationship, if the risk management objective is changed or no longer expected to be met.

If recognition is ineffective, the Hedge Accounting need not be discontinued if the risk management objective and criteria set out by the entity for the specific hedge relationship continues to be met.

Termination of Hedge Accounting / Reclassification of Hedge Reserve

Voluntary termination is prohibited unless the management objective of the entity, as was originally defined at the inception, is no longer met.

Hedge accounting is discontinued prospectively in the following cases:

- Termination a hedging instrument prior to its maturity / contractual term,
- In case of hedges of highly probable forecast transactions or commitments, if the forecasted transaction is no longer 'highly' probable of occurring, but still probable of occurring

The amount previously recognised in the hedge reserve is reclassified into the statement of profit and loss only in the period when the hedged item impacts earnings.

In case of hedges of forecast transactions, if the forecasted transaction is no longer probable of occurring, then hedge accounting is discontinued and all amounts recognised in the hedge reserve are recognised immediately in the statement of profit and loss.

Presentation in the financial statements

- Derivatives that are intended for trading or speculative purposes should be reflected as current assets and liabilities.
- Derivatives that are hedges of recognized assets or liabilities should be classified as current or non-current based on the classification of the hedged item.
- Derivatives that are hedges of forecasted transactions and firm commitments should classified as current or non-current based on the settlement date / maturity dates of the derivative contracts.
- Derivatives that have periodic or multiple settlements such as interest rate swaps should not be bifurcated into current and non-current elements. Their classification should be based on when a predominant portion of their cash flows are due for settlement as per their contractual terms.
- Netting off of assets and liabilities is not permitted except where basis adjustment is applied under cash flow hedges.
- Amounts recognised in the statement of profit and loss for derivatives not designated as hedges may be presented on a net basis.

Guidance Note on Accounting for Derivative Contracts - Key Highlights

Disclosures

Entities should disclose:

- Overall financial risk management objectives & policy
- Explanation on financial risks and approach towards managing financial risks
- Methodology used to arrive at the fair value of derivative contracts
- Extent of fair value gains/losses recognized in the statement of profit and loss and in equity
- Types of hedging instruments
- Extent of transactions that are hedged
- Description of the Hedge
- Description of the financial instruments designated as hedging instruments for the hedge and their fair values at the balance sheet date
- Nature of risks being hedged
- For hedges of forecast transactions, the periods in which the transactions are expected to occur, when they are expected to affect the statement of profit and loss, and a description of any forecast transactions that were originally hedged but now are no longer expected to occur
- Amount recognised as Hedge Reserve
- Amount recycled from the hedge reserve and reported in statement of profit and loss
- Amount recycled from hedge reserve and added to the initial measurement of the acquisition cost or other carrying amount of a non-financial asset or non-financial liability in a hedged forecast transaction
- Breakup of the balance in the hedge reserve between realised and unrealized components and a reconciliation of the opening balance to the closing balance for each reporting period

Transitional Provisions

This Guidance Note applies to all derivative contracts covered by it and are outstanding on the date this Guidance Note becomes effective. Any cumulative impact (net of taxes) should be recognized in reserves as a transition adjustment and disclosed separately. An entity is not permitted to follow hedge accounting as recommended in this Guidance Note retrospectively.

CHENNAI

48, Masilamani Road,
Balaji Nagar, Royapettah,
Chennai - 600014.
Phone: +91 - 044 - 28131 128/38/48
Fax: +91 - 28131 158

BENGALURU

Khivraj Mansions, 10/2 Kasturba Road,
Bangalore - 560001.
Phone: +91 - 080 - 22274 551/52
Fax: +91 - 22212437

VISAKHAPATNAM

1-88-19, Plot No: 135/4,
Sector 4, MVP Colony,
Visakhapatnam 530 017
Phone: (0891) 2755821 & 2755848,
Fax: (0891) 2755848

GUNTUR

10-3-21, 3rd Lane,
Sambasivapet, Guntur - 522001.
Phone: +91 - 863 - 2220347/2224924
Fax: +91 - 2220347

TANUKU

22-29/5 Gubbalavari Street,
Society Road, Tanuku - 534211.
Phone: +91 - 8819 - 221 234/224 911

HYDERABAD

No 403&404, Golden
Green Apartments,
Erra Manzil Colony,
Hyderabad - 500082.
Phone: +91 - 040 - 23370 002/04
Fax: 23379 988

GURGAON (New Delhi)

404, DLF City Court,
Sikandarpur, Mehrauli_Gurgaon Road
(MG Road), Gurgaon,
Haryana - 122002
Phone : +91 - 0124 - 4235 522

VIJAYAWADA

No 33-25-33/3, Govinda
Rajulu Naidu Street,
Surya Rao Pet,
Vijayawada - 520010.
Phone: +91 - 866 - 2444 592/93/94

KAKINADA

3-16C-40/1, 8th Road, Santhi Nagar,
Kakinada - 5330003.
Phone: +91 - 884 - 2374 402/04
Fax: +91 - 2374 402, 2363 656

ADONI

142/6, Sri Krishnadevaraya Colony,
Adoni - 518301.
Phone: +91 - 8512 - 253 447/222 377
Fax: +91 - 253 447

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