



Deviation from Accounting Standards permissible subject to compliance with appropriate disclosure requirements

Background

Hindalco Industries Limited ('HIL' or 'the Company'), is the flagship company of Aditya Birla Group. To establish a wider footprint on the global scene, the Company has made a number of acquisitions in the past - one of the notable ones being that of Novelis Inc. in 2007.

The global economic meltdown, especially in the commodity space, had an adverse impact on HIL's domestic and overseas operations. A consequence of which, as foreseen by HIL, may be an impairment / diminution in the value of assets / investments of HIL and its subsidiaries.

Hence, the Company undertook a Scheme of Arrangement between HIL and its shareholders ('the Scheme') to adjust such impairment / diminution in the value of assets / investments and various other costs relating to organic and inorganic growth projects against a special reserve created under the Scheme, such that the financial statements reflect the true operating performance of the Company.

Salient features of the Scheme of Arrangement

- The Scheme was a financial restructuring exercise proposed by HIL under Sections 391 to 394 of the Companies Act.

- The Scheme proposed to transfer the Securities Premium Account balance as on 31 March 2008 and further additions up to 31 December 2008 to “Business Reconstruction Reserve Account” (‘BRR’).
- Under the Scheme, BRR would be utilized by the Company to adjust the following prescribed expenses:
 - Impairment, amortisation and / or write-off of goodwill and other intangible assets, if any, arising on preparation of consolidated accounts of HIL;
 - Interest and other financial charges paid / payable on borrowings for acquisitions made by HIL or any of its subsidiaries and interest and other financial charges paid / payable upon refinancing of such borrowings;
 - Impairment of assets / investments / intangibles in the financial statements of HIL and / or any of its subsidiaries;
 - Diminution in the value of investments in subsidiary companies in the financial statements of HIL and / or any of its subsidiaries;
 - Costs associated with exiting projects / divisions in part and / or whole by HIL or any of its subsidiaries and financial costs associated with delay in projects;
 - Consultants / law firms fees and / or any fees payable towards professional services (say due diligence) in connection with financing / refinancing acquisitions.
- The aforesaid expenses would be adjusted against BRR in the standalone and consolidated profit & loss account of HIL from 1 April 2008 and thereafter for subsequent financial years on an ongoing basis.
- Consequential capital reduction by virtue of transfer of balance from Securities Premium Account to BRR was undertaken as an integral part of the Scheme.

Key arguments before the Bombay High Court

The High Court had two primary questions for consideration before itself:

- Whether deviation from Accounting Standards is permissible?

The High Court discussed the provisions of Section 211(3A) and (3B) of the Companies Act, 1956 ('the Act'). The High Court held that deviation from Accounting Standards is not prohibited but is regulated by the provisions of Section 211 of the Act. In case of deviation, the profit and loss account and balance sheet of the company shall state:

- disclosure of deviation from Accounting Standards;
- reasons thereof; and
- financial effects, if any.

The High Court was further guided by the 'Preface to Statements of Accounting Standards' (revised December 2004)¹ issued by the Institute of Chartered Accountants of India which reiterate the same position.

- Can the High Court interfere with the commercial wisdom and business decision approved by majority of shareholders in the Scheme?

The Scheme provided discretion to the Board of Directors of the Company to adjust expenses on an ongoing basis, without any time limit and such proposition had been approved by an overwhelming majority of shareholders.

The Regional Director in its report to the High Court had recommended a time limit on the adjustment of the expenses against BRR. The High Court held that there was no provision in any law or public policy by which the Company was constrained to adjust / write off all expenses within a prescribed time frame. In absence on any tangible reason and prejudice being caused to stakeholders / creditors there was no justification for such a restriction.

¹ Announcement on Disclosures in cases where a High Court/Tribunal makes an order sanctioning an accounting treatment which is different from that prescribed by an Accounting Standard

The High Court relying on judicial precedents², observed that accepting such proposition would imply that it would interfere with the commercial wisdom or business decision of the shareholders, who have approved the Scheme by an overwhelming majority and thereby bestowed complete confidence in the prudent discretion of the Board of Directors of the Company.

Conclusion

- Section 391 to 394 of the Act permits companies to enter into arrangements with its shareholders and / or creditors. The scope of aforesaid Sections is wide enough to accommodate innovative restructuring schemes. Further, the High Court would sanction such schemes undertaken by companies despite deviation from Accounting Standards wherein the same is:
 - approved by the majority of the shareholders of the Company; and
 - not prejudicial to the interests of the creditors and public.
- In addition, the High Court under Sections 391-394 does not restrict the implementation of provisions of the Scheme to a particular date or time period. It permits the shareholders and Board of Directors to apply their prudent discretion to implement the provisions of the Scheme.

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² Zee Telefilms Ltd, 124 Comp Cases 102 (2005) (Bom), Hyderabad Industries Ltd 55 SCL 1 (2004) (AP), Parrys Confectionery Ltd. 122 Comp Cases 900 (2004) (Mad)

**For further information about KPMG in India and our services,
please contact:**

Bangalore

Maruthi Infotech Centre, 11-12/1
Inner Ring Road
Koramangala, Bangalore 560071
Phone: + 91 80 3980 6000 Fax: +91 80 3980 6999

Chennai

KPMG House
No.10, Mahatma Gandhi Road,
Nungambakkam High Road,
Chennai 600034
Phone: +91 44 39145000 Fax: +91 44 39145999

Delhi

DLF Cyber City, Building no. 10, Block B, Phase II
Gurgaon, Haryana 122 002
Phone: +91 124 307 4000 Fax: +91 124 254 9195

Hyderabad

KPMG, 8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad - 500 034
Phone: +91 40 66305000/23350060 Fax: + 91 40 6630 5299

Kolkata

KPMG Infinity Benchmark
Plot No. G-1, 10th floor Block - EP & GP,
Sector – V, Salt Lake City
Kolkata - 700091
Phone: +91 33 4403 4000 Fax: +91 33 4403 4199

Mumbai

KPMG House, Kamala Mills Compound, 448 Senapati Bapat Marg
Lower Parel, Mumbai 400 013
Phone: +91 22 39896000 Fax: + 91 22 39836000

Pune

703, 7th Floor Godrej Castlemaine, Next to Ruby Hall Clinic,
Bund Garden Road, Pune 411001
Phone: +91 20 30585764/65 Fax: +91 20 3058 5775

Kochi

4/F, Palal Towers, M. G. Road,
Ravipuram, Kochi 682016
Phone: +91 (484) 305 9000 Fax: +91 (484) 305 9001