Technical Guide on Audit of Non-Banking Financial Companies (Revised 2023 Edition)

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

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FOREWORD

Non-Banking Financial Companies (NBFCs) are an important segment of the Indian financial sector. NBFCs cater to the funding requirements of organized as well as unorganized sector like small scale industries, small entrepreneurs, people in self-employment, etc. The diversified range of services provided by the NBFCs and large quantum of public finance involved in NBFCs require more disciplined environment of financial reporting by NBFCs. In view of this, the Reserve Bank of India, from time to time prescribes and updates regulatory framework for NBFCs to bring discipline broadly in the registration and functioning of NBFCs. The Auditing and Assurance Standards Board (AASB) of ICAI reviews the framework issued by RBI and identifies the peculiarities related to statutory audit that need to be addressed.

In 2010, the AASB of ICAI issued the "*Technical Guide on Audit of Non-Banking Financial Companies*" to provide detailed guidance to the members regarding audit of NBFCs. The Technical Guide was last revised in 2016. I am happy to note that the AASB has now brought out this Revised 2023 Edition of the "*Technical Guide on Audit of Non-Banking Financial Companies*" which is quite comprehensive in its coverage, dealing with various aspects of audit of NBFCs.

I wish to place my appreciation for CA. (Dr.) Sanjeev Kumar Singhal, Chairman, CA. Vishal Doshi, Vice Chairman and other members of the Auditing and Assurance Standards Board for their efforts in bringing this publication to enhance the knowledge and skills of members conducting audits of NBFCs.

I am confident that the members would find this Technical Guide immensely useful in their professional assignments.

September 5, 2023 **CA. Aniket Sunil Talati**
New Delhi President, ICAI

PREFACE

Non-banking financial companies (NBFCs) are playing an important role in the Indian financial sector. Due to their importance in the Indian financial sector, NBFCs are recognized as being complementary to the banking sector. However, there are several instances of misuse of public funds, irregularities in functioning, bankruptcies etc. in NBFCs. Therefore, the role of statutory audit of NBFCs is very important to bring discipline in functioning of NBFCs.

In 2010, the Auditing and Assurance Standards Board of ICAI issued the "Technical Guide on Audit of Non-Banking Financial Companies" to provide detailed guidance to the members on various aspects of audit of NBFCs. The Technical Guide was last revised in 2016. Since 2016, several developments have taken place impacting NBFCs e.g. applicability of Indian Accounting Standards to certain categories of NBFCs, issuance of number of master directions, circulars, guidelines, notifications relating to NBFCs. In light of these developments, the Auditing and Assurance Standards Board decided to revise the Technical Guide.

It gives us immense pleasure to place in hands of the members, this Revised 2023 edition of the "Technical Guide on Audit of Non-Banking Financial Companies". The Technical Guide deals with various aspects of audit of NBFCs such as introduction of NBFCs, points for consideration in audit of NBFCs, financial reporting framework, auditing framework, areas of audit concern, operations of NBFCs, governance etc. For the benefit of the members, the Appendices to the Technical Guide contain illustrative templates of audit report / certificate, illustrative audit checklist, illustrative list of master directions, circulars, RBI notifications, illustrative disclosure norms for NBFCs, illustrative list of returns to be submitted by NBFCs etc.

We would like to thank CA. Aniket Sunil Talati, President, ICAI and CA. Ranjeet Kumar Agarwal, Vice-President, ICAI for their guidance and support in various endeavours of the Board.

We wish to place on record our sincere gratitude to CA. A. Jayashankar and his team comprising CA. Bhavesh Gohil, CA.

Kapil Gupta and CA. Karishma Mavani for their contribution in revising the Technical Guide for the benefit of the members.

We wish to place on record high appreciation of all Board members and special invitees to the Board viz. CA. Chandrashekhar Vasant Chitale, CA. Durgesh Kabra, CA. Dheeraj Kumar Khandelwal, CA. Purushottamlal Khandelwal, CA. Mangesh Pandurang Kinare, CA. Priti Paras Savla, CA. Piyush Sohanrajji Chhajed, CA. Dayaniwas Sharma, CA. Sridhar Muppala, CA. Sripriya Kumar, CA. (Dr.) Debashis Mitra (Past President, ICAI), CA. Rohit Ruwatia Agarwal, CA. Abhay Kumar Chhajed, CA. Anuj Goyal, CA. Gyan Chandra Misra, CA. Prakash Sharma, CA. (Ms.) Kemisha Soni, CA.(Dr.) Raj Chawla, CA. Hans Raj Chugh, CA. Pramod Jain, CA. Charanjot Singh Nanda, Shri Deepak Kapoor, Adv. Vijay Kumar Jhalani, CA. Sekar G., CA. Gaurav Rawat, CA. Ashok Kumar Pandey, CA. Geeta Dhingra, CA. Ganesh B, CA. Shrikant Narayan Dandavate, CA. D N Agrawal, CA. Pankaj Khullar, CA. Viren Bhanuchandra Shah, CA. Dhananjay Gokhale, CA. Amit Mitra, CA. Sandeep Sharma, CA. Lalit Kumar, CA. Parveen Kumar, CA. Sumant Chadha, CA. Rajesh Mody, CA. Rajeev Saxena, Shri Atma Sah, CA. Aniruddha Godbole, CA. Ridhima Dubey, CA. Avinash Aggarwal, CA. Narender Singhania, CA. Gulshan Grover, CA. Anurag Totuka, CA. Rahul Aggarwal, CA. Bhuwanesh Kumar Thakur, CA. Naresh Aggarwal, CA. Tanmay Gupta, CA. Deepa Agarwal, CA. Pallav Gupta, Ms. Yogita Jadhav, Shri Raushan Kumar, Shri Rambabu Gorli, CA. Ramkumar Pandey and Shri Nethaji Bhudevan for their suggestions in finalising the Technical Guide. We also appreciate the contribution made by CA. Megha Saxena, Secretary, AASB and staff members of AASB in finalising the Technical Guide.

We are confident that the Technical Guide would be well received by the members and other interested readers.

CA. Vishal Doshi	**CA. (Dr.) Sanjeev Kumar Singhal**
Vice Chairman, AASB	Chairman, AASB

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Chapter 1
Introduction

1.1 Non-banking financial companies or NBFCs, play an important part of the Indian economy. The areas in which these entities play an important role traditionally include equipment leasing, hire-purchase, making loans and investments. Given the nature of these companies, through Chapter III-B of the RBI Act, 1934, the Reserve Bank of India ("RBI" or the "Bank") was entrusted with the regulation and supervision with the following objectives:

- to ensure healthy growth of the financial companies;
- to ensure that these companies function as a part of the financial system within the policy framework, in such a manner that their existence and functioning do not lead to systemic aberrations; and
- to sustain the quality of surveillance and supervision exercised by the Bank over the NBFCs by keeping pace with the developments that take place in this sector of the financial system.

What is an NBFC?

1.2 A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 or under the Companies Act, 2013 and is engaged in the business of giving loans and advances, acquisition of shares/stock/ bonds/debentures/securities issued by other companies, Government or Local Authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

1.3 Section 45-I(f) of RBI Act, 1934 defines non-banking financial company as:

(i) a financial institution which is a company;

(ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;

(iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

Need for registration of NBFC

1.4 Section 45-IA of the RBI Act, 1934 provides that a non-banking financial company shall not commence or carry on business of a non-banking financial institution without –

(a) obtaining a certificate of registration issued under Chapter III-B of the said Act; and

(b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify.

The Bank may notify different amounts of net owned fund for different categories of non-banking financial companies. (Proviso to section 45-IA of the said Act).

1.5 RBI has prescribed that NBFCs should have a minimum net owned funds of Rs. 2 crores. RBI vide its Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs circular RBI/2021-22/112 DOR.CRE.REC.No.60/ 03.10.001/2021-22 dated October 22, 2021 has directed that the present mandatory net owned funds of NBFCs are to be increased in phased manner to Rs. 10 crores by the year 2027.

However, for NBFC-Peer to Peer, NBFC-Accounts Aggregator, and NBFCs with no public funds and no customer interface, the net owned funds shall continue to be Rs. 2 crore. The aforesaid circular further clarifies that there is no change in the existing regulatory minimum net owned funds for NBFCs – Infrastructure Development Fund (Rs. 300 crores), Infrastructure Finance

Company (Rs. 300 crores), Mortgage Guarantee Companies (Rs. 100 crores), HFC (Rs. 20 crores) and SPD (Rs. 150 crores or Rs. 250 crores depending upon whether SPDs take up only core activities or also take up non-core activities.)

Determination of NBFC activity

1.6 Reserve Bank of India *vide* its press release dated 8th April,1999 has announced that "in order to identify a particular company as a non-banking financial company (NBFC), it will consider both, the assets and the income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as an NBFC if its financial assets are more than 50 per cent of its total assets (netted off by intangible assets) and income from financial assets should be more than 50 per cent of the gross income. Both these tests are required to be satisfied as the determinant factor for principal business of a company."

Meaning of Business of a non-banking financial institution

1.7 Section 45-I(a) of the RBI Act, 1934 provides:

"Business of a non-banking financial institution" means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f).

Clause (f) defines an NBFC (Refer Paragraph 1.3 above).

Meaning of Financial Institution

1.8 Section 45-I(c) of the RBI Act, 1934 provides:

"financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:

(i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;

(ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;

(iii) letting or delivering of any goods to a hirer under a hire purchase agreement as defined in clause (c) of section 2 of the Hire Purchase Act, 1972;

(iv) the carrying on of any class of insurance business;

(v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;

(vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business

(a) agricultural operations; or

(aa) industrial activity; or

(b) the purchase or sale of any goods (other than securities) or the providing of any services; or

(c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation- For the purposes of this clause, "industrial activity" means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964.

Effect of Non-registration

1.9 If any person contravenes the provisions of sub-section (1) of section 45-IA of the RBI Act, 1934 regarding commencing or carrying on any business of an NBFC without registering with the RBI, such person shall be punishable with imprisonment for a term which shall not be less than one year, but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to twenty five lakh rupees (sub section (4A) of Section 58B of the RBI Act, 1934).

1.10 Section 58C of the RBI Act, 1934 provides as follows:

(1) “Where a person committing a contravention or default referred to in section 58B is a company, every person who at the time the contravention or default was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the contravention or default and shall be liable to be proceeded against and punished accordingly:

Provided that nothing contained in this sub-section shall render any such person liable to punishment if he proves that the contravention or default was committed without his knowledge or that he had exercised all due diligence to prevent the contravention or default.”

(2) "Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the same was committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary, or other officer or employee of the company, such director, manager, secretary, other officer or employee shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly."

Power to take action against auditors

1.11 A new section 45MAA was inserted in the RBI Act, 1934 by the Finance Act, 2019, bestowing powers to RBI for taking action against erring auditors. Where any auditor fails to comply with any direction given or order made by the Bank under section 45MA of the aforesaid Act, the Bank, may, if satisfied, remove or debar the auditor from exercising the duties as auditor of any of the Bank regulated entities for a maximum period of three years, at a time.

Regulatory Environment

1.12 NBFCs, like banks, are subject to the prudential norms, capital adequacy norms, rules and regulations formulated by the Reserve Bank of India, which is the principal regulator for the financing and NBFC sector in India.

1.13 It is to be noted that provisions of Chapter V of the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014 are not applicable to NBFCs which are registered with RBI. NBFCs are required to follow guidelines issued by the RBI for acceptance of deposits.

1.14 The RBI Act, 1934 was amended in 1997 authorising the Reserve Bank to determine policies, and issue directions to NBFCs regarding income recognition, accounting standards, NPAs, capital adequacy etc. In addition to above, the listed NBFCs are required to adhere to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred as LODR Regulations 2015).

1.15 RBI being the regulatory authority for NBFCs, issues circulars from time to time monitoring the activities of NBFCs. The ambit of regulation includes the type of activities that can be carried out by NBFC, prudential norms for income recognition, classification of their lending as well as periodic submission of returns and reports to RBI.

1.16 Presently, the RBI has in place, Master directions, Master circulars comprising guidelines and prudential norms on income recognition, asset classification, capital adequacy etc. to be complied by NBFCs. Apart from this, RBI issues notifications as and when any amendment or fresh direction is required to be issued to NBFCs for compliance.

1.17 NBFCs are required to submit various periodical returns to RBI under extant guidelines. Please refer the **Appendix D** to this Technical Guide for list of various returns to be submitted by an NBFC.

1.18 A list of relevant regulatory requirements (Master directions and circulars) that need to be considered by the auditor are given in the **Appendix F** to this Technical Guide. The auditor should check the relevant link for full text of the directions/ circulars and related updates from RBI.

Types of NBFCs- Compliance and Regulatory perspective

1.19 NBFCs may be categorised based on:

(a) Nature of activities

(b) Systemic significance

(c) Holding or non-holding of deposits

(a) Nature of activities

1.20 Currently, NBFCs registered with RBI are being classified as:

- **Investment and Credit Company (ICC)** – RBI vide its notification RBI/2018-19/130 DNBR (PD) CC.No.097 /03.10.001/ 2018-19 dated 22 February 2019- Harmonisation of different categories of NBFCs, has decided to merge three categories of NBFCs viz. Asset Finance Companies (AFC), Loan Companies (LCs) and Investment Companies (ICs) into a new category called NBFC - Investment and Credit Company (NBFC-ICC).This was done in order to provide NBFCs with greater operational flexibility. Harmonisation of different categories of NBFCs into fewer ones shall be carried out based on the principle of regulation by activity rather than regulation by entity.

- **Infrastructure Finance Companies -** This category of NBFCs deploys a minimum of three-fourths of their total assets in infrastructure loans. The net owned funds of this category of NBFCs should be a minimum of Rs. 300 crores and they should have a minimum credit rating of 'A' or equivalent by any accredited rating agencies and the Capital to Risk-Weighted Assets Ratio (CRAR) is 15% (with a minimum Tier I Capital of 10%).

- **Core Investment Company (CIC)** are NBFCs which carry on the business of acquisition of shares and securities in group companies and satisfies four conditions stated in the Core Investment Companies (Reserve Bank) Directions, 2016 (updated as on December 29, 2022). issued by RBI. Refer Master Directions in **Appendix F** to this Technical Guide**.**

- **Infrastructure Debt Fund - Non-Banking Financial Company (IDF-NBFC) -** IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, especially insurance and pension funds can invest through units and bonds issued by the IDFs. Infrastructure Debt Funds (IDFs) are funds set up to facilitate the flow of long-term debt into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust based IDF would normally be a Mutual Fund (MF) while a company based IDF would normally be an NBFC.

- **Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) -** An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Companies Act, 1956 or under Section 8 of the Companies Act, 2013) that fulfils the following conditions: (a) Minimum net owned funds of Rs. 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum Net owned funds requirement shall stand at Rs. 2 crore). (b) Not less than 75% of its total assets are in the nature of “microfinance loans” as defined in the Non-Banking Financial Company–Non Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 (Updated as on June 20, 2023). RBI has come out with regulatory framework for MFIs uniformly applicable to all regulated lenders in the microfinance space including scheduled commercial banks, small finance banks and NBFC-Investment and Credit Companies vide Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022 (Updated as on July 25, 2022).

- **Non-Banking Financial Company - Factor -** This category was introduced in 2012 pursuant to notification of Factoring Regulation Act, 2011 by the Central Government. NBFC-Factor means an NBFC as defined in section 45-I(f) of the RBI Act, 1934 which has its principal business as factoring business and its financial assets in the factoring business constitute at least 50% of its total assets and the income derived from factoring business is not less than 50% of its gross income.

- **Mortgage Guarantee Companies -** These are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned funds is Rs. 100 crores. Other conditions as prescribed in the Master Direction -Mortgage Guarantee Companies (Reserve Bank) Directions, 2016 (Updated as on December 29, 2022) are to be fulfilled for registration with RBI under this category.
- **NBFC – Non operative Financial Holding Company (NOFHC) -** It is a financial institution through which promoter/ promoter groups will be permitted to set up a new bank. It is a wholly owned NOFHC which will hold the bank as well as other financial services companies regulated by the RBI or other financial regulators to the extent permissible under the applicable regulatory prescriptions.
- **Non-Banking Financial Company** – **Peer to Peer Lending - NBFC** –Peer to Peer Lending platform (NBFC-P2P) is a type of Non-Banking Financial Company which carries on the business of providing services of loan facilitation to willing lenders and borrowers through online platform. This type of Non-Banking Financial Company is not allowed to accept deposits or lend on its own. It is to moderate the interactions between lenders and borrowers. NBFC-P2P provides services of matching the right lender with the right borrower through the due diligence on electronic platform (e-platform). It provides other ancillary services like services of loan recovery services, credit assessment services, profile verification and other related services. The detailed directions for NBFC-P2P are given in the Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 (Updated December 29, 2022).

(b) Systemic Significance

1.21 NBFCs-Non Deposit taking companies (shortly referred to as NBFC-ND) shall be categorized into two broad categories *viz.,*

(a) NBFCs-ND companies (those with assets of less than Rs. 500 crore) and

(b) NBFCs-ND-Systemically Important(SI) companies (those with assets of Rs. 500 crore and above).

Scale based categorisation

1.22 RBI has come out with a scale based regulatory framework for NBFC which is applicable from October 1, 2022. Regulatory structure for NBFCs now comprise of four layers based on their size, activity, and perceived riskiness. All references to NBFC-ND shall mean NBFC-Base Layer and all references to NBFC-Deposit taking(NBFC-D) and NBFC-ND-SI shall mean NBFC-Middle Layer or NBFC-Upper Layer, as the case may be. These are elaborated in paragraph 2.22 of this Technical Guide.

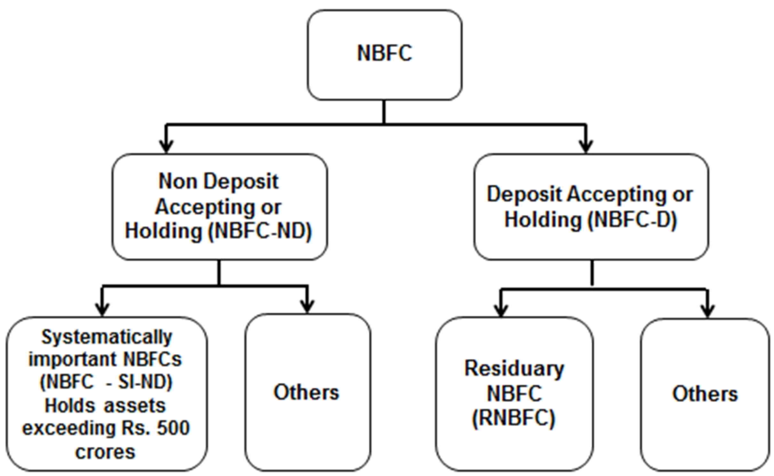
Link to RBI Notification:
https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0#F5

1.23 As per RBI regulations, NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the two categories mentioned above. Regulations as applicable to the two categories will be applicable to each of the NBFC-ND within the group. Regulations also require statutory auditors to certify the asset size of all the NBFCs in the Group. However, NBFC-D, within the group, if any, will be governed under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Direction 2016 and Non-Banking Financial Company - Systemically Important Non Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 as applicable to deposit taking NBFCs. "Companies in the group", shall mean an arrangement involving two or more entities related to each other through any of the following relationships: Subsidiary – parent (defined in terms of AS

21), Joint venture (defined in terms of AS 27), Associate (defined in terms of AS 23), Promoter-promotee (as provided in the SEBI (Acquisition of Shares and Takeover) Regulations, 1997) for listed companies, a related party (defined in terms of AS 18), Common brand name, and investment in equity shares of 20 % and above.

(c) Holding or Non-holding of Deposits

1.24 NBFCs may be further classified into those accepting deposits or those not accepting deposits.



1.25 Core Investment Companies, Infrastructure Debt Fund NBFC and NBFC – Micro Finance Institution (other than Companies Act, 1956 - Section 25 companies and Companies Act, 2013 - Section 8 companies), are non-deposit holding Companies.

Others

Housing Finance Companies

1.26 National Housing Bank set up by the Government of India is the Apex authority regulating the housing finance companies. Master Direction Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021 deals with matters relating to acceptance of deposits by housing finance companies, prudential norms for income recognition, accounting standards, asset classification, impairment allowance on financial instruments under Ind AS 109, “Financial Instruments” or provision for bad and doubtful assets under notified accounting standards (AS), capital adequacy and concentration of credit/ investments to be observed by the housing finance companies and matters to be included in the auditor’s report by the auditors of such housing finance companies and matters ancillary and incidental thereto and amended the said directions from time to time. These directions are primarily similar to directions prescribed by RBI for NBFCs.

Scope of the Technical Guide

1.27 The Technical Guide is applicable to audit of all kinds of NBFCs. The purpose of this Technical Guide is to provide practical assistance to auditors primarily in relation to RBI requirements and to promote good practice in applying Standards on Auditing (SAs) to the audit of NBFC’s financial statements.

1.28 The Technical Guide is not, however, intended to be an exhaustive listing of the procedures and practices to be used in such an audit. In conducting an audit in accordance with SAs, the auditor is required to comply with all the relevant requirements of all the applicable SAs. Further, this Technical Guide may not be applicable where there is a specific requirement imposed by the regulatory authorities governing the NBFCs/ investment companies.

1.29 The Technical Guide attempts to address the assertions made in respect of financing activities in the NBFC’s financial statements. The approach in this Technical Guide is based on the elements of the financial statements as well as the nature of activity of the NBFCs. However, when obtaining audit evidence to support the financial statements assertions, the auditors should carry out procedures based on the types of activities the NBFC carries out and the way in which those activities affect the financial statements assertions.

The auditor should also refer to RBI Master Directions, Circulars and other guidelines for further understanding of the requirements of audit of NBFCs.

Chapter 2
Audit of NBFCs – Points for Consideration

2.1 NBFCs are required to register based on the kind of activity to be undertaken by them. Consequent to the recent directions issued by the RBI, with effect from October 1, 2022, regulatory structure for NBFCs now comprise of four layers based on their size, activity, and perceived riskiness. NBFCs in the lowest layer shall be known as NBFC - Base Layer (NBFC-BL). NBFCs in middle layer and upper layer shall be known as NBFC - Middle Layer (NBFC-ML) and NBFC - Upper Layer (NBFC-UL) respectively. The Top Layer is ideally expected to be empty and will be known as NBFC - Top Layer (NBFC-TL).

The regulatory requirement may vary depending upon the category to which the NBFC belongs. It is therefore important for the auditor to understand the nature of the business environment. This would help the auditor to plan and conduct audit in an efficient manner. For instance, in the case of an NBFC accepting public deposits, the audit objectives may include procedures to confirm compliance with regulatory requirements in respect of public deposits accepted by the NBFC.

Exemptions

2.2 Following categories have been granted total / partial exemption from the applicability of provisions of Chapter III-B of the RBI Act, 1934 and the directions issued thereunder (Master Direction - Exemptions from the provisions of RBI Act, 1934 dated August 25, 2016) (Updated as on April 01, 2022):

i. **Housing Finance Institutions:** The Bank has exempted a non-banking financial company which is a housing finance institution as defined in Section 2(d) of the National Housing Bank Act, 1987 from the provisions of sections 45-IA, 45-IB and 45-IC in Chapter III-B of the RBI Act, 1934 regarding registration, maintenance of percentage of assets and reserve fund. Such company needs registration under the National

Housing Bank Act, 1987 as a Housing Finance Company. Auditor should consider the directions issued by the National Housing Bank Act, 1987 for compliance requirements.

ii. **Merchant Banking company:** A merchant banking company has been exempted from the provisions of Section 45-IA - Requirement of registration and net owned fund, Section 45-IB - Maintenance of percentage of assets and Section 45-IC - Reserve Fund of the RBI Act, 1934, Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company – Non- Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 subject to compliance with the following conditions:

(a) It is registered with the Securities and Exchange Board of India as a Merchant Banker under Section 12 of the Securities and Exchange Board of India Act, 1992 and is carrying on the business of merchant banker in accordance with the Securities and Exchange Board of India Merchant Banking (Rules) 1992 and Securities and Exchange Board of India Merchant Banking (Regulations) 1992;

(b) acquires securities only as a part of its merchant banking business;

(c) does not carry on any other financial activity referred to in Section 45-I(c) of the RBI Act, 1934; and

(d) does not accept or hold public deposits as defined in sub-paragraph (xiii) of paragraph 3 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

iii. **Micro Finance Companies:** Sections 45-IA, 45-IB and 45-IC of the RBI Act, 1934 shall not apply to any non-banking financial company which is:

(a) providing only microfinance loans as defined under the Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022, provided the monthly loan obligations of a household does not exceed 50 per cent of the monthly household income; and

(b) licensed under Section 25 of the Companies Act, 1956 or section 8 of the Companies Act, 2013; and

(c) not accepting public deposits as defined under Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; and

(d) having asset size of less than Rs.100 crore.

iv. **Mutual Benefit Companies:** Sections 45-IA, 45-IB and 45-IC of the RBI Act, 1934 shall not apply to any non-banking financial company which being a mutual benefit company as defined in paragraph 3(x) of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 (updated as on May 02, 2022). A “mutual benefit company” means a company not notified under section 620A of the Companies Act, 1956 or section 406 of the Companies Act, 2013 and carrying on the business of a non-banking financial institution, -

(a) on 9th January 1997; and

(b) having the aggregate of net owned funds and preferential share capital of not less than ten lakhs of rupees; and

(c) has applied for issue of certificate of registration to the Bank on or before 9th July 1997; and

(d) is complying with the requirements contained in the relevant provisions of the Directions issued under Section 637A of the Companies Act, 1956 applicable to Nidhi Companies by the Central Government or the Nidhi Rules, 2014 under the Companies Act, 2013.

v. **Government Companies:** A Government Company is a company as defined in Clause (45) of Section 2 of the

Companies Act, 2013 i.e. in which not less than 51% of the paid up capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is subsidiary of such Government Company as thus defined.

Sections 45-IB and 45-IC of the RBI Act, 1934, shall not apply to any non-banking financial company as defined in section 45-I(f) of the RBI Act, 1934 being a Government company as defined in clause (45) of section 2 of the Companies Act, 2013 and exemption is valid for a phased period as under:

Section 45 IB	Maintenance of percentage of assets – 15% of the outstanding deposits	March 31, 2019 – 5% of outstanding deposits March 31, 2020 – 10% of outstanding deposits March 31, 2021 – 12% of outstanding deposits March 31, 2022 – 15% of outstanding deposits
Section 45 IC	Reserve Fund	March 31, 2019

vi. **Venture Capital Fund Companies:** Section 45-IA and Section 45-IC of the RBI Act, 1934; Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998; and Notification No. DFC.119 / DG(SPT)-98 dated January 31, 1998 shall not apply to a non-banking financial company, which is a venture capital fund company holding a certificate of registration obtained under Section 12 of the Securities and Exchange Board of India Act, 1992 and not holding or accepting public deposits as defined in paragraph 2(1)(xii) of the Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998.

vii. **Insurance/Stock Exchange/Stock Broker/Sub-Broker:** For the above referred companies, if they are not holding or accepting public deposits as defined in sub-paragraph (xiii) of paragraph 3 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, the provisions of Sections 45-IA, 45-IB, 45-IC, 45MB and 45MC of the RBI Act, 1934 shall not apply. Further, such companies shall be exempt from the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

(a) Insurance Companies are companies doing the business of insurance, holding a valid certificate of registration issued under Section 3 of the Insurance Act, 1938;

(b) Stock exchanges are those recognised under Section 4 of the Securities Contracts (Regulation) Act, 1956; and

(c) Stock broker/ sub broker - doing the business of a stock-broker or sub-broker holding a valid certificate of registration obtained under Section 12 of the Securities and Exchange Board of India Act, 1992.

viii. Other Companies:

Nidhi Companies and Chit Companies: The provisions of Sections 45-IA, 45-IB and 45-IC of the RBI Act, 1934 shall not apply to any non-banking financial company notified under Section 620A of the Companies Act, 1956 or Section 406 of the Companies Act, 2013, known as Nidhi Companies; and doing the business of chits, as defined in clause (b) of Section 2 of the Chit Funds Act, 1982.

Securitisation and Reconstruction Companies: Securitisation company or Reconstruction company registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Mortgage Guarantee Companies: Mortgage Guarantee Companies notified as non-banking financial company in terms of Section 45I(f)(iii) of the RBI Act, 1934 with the prior approval of the Central Government, and a company registered with the Bank under the scheme for registration of Mortgage Guarantee Companies.

Both Securitisation and Reconstruction companies and Mortgage Guarantee Companies referred above are exempted from the provisions of Sections 45-IA, 45-IB and 45-IC of the RBI Act, 1934.

Alternative Investment Fund (AIF) Companies: i.e. a non-banking financial company, which is an Alternative Investment Fund holding a certificate of registration obtained under section 12 of the Securities and Exchange Board of India Act, 1992 and not holding or accepting public deposit as defined in sub-paragraph (xiii) of paragraph 3 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 (updated as on May 02, 2022).

Provisions of Section 45-IA and 45-IC of the RBI Act, 1934 shall not apply to such companies. Further, such companies shall be exempt from the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company – Non- Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

Exemption to Core Investment Companies

2.3 The RBI, while exempting Core Investment Companies (CIC) from the regulatory requirements, has brought the systemically important Core Investment Companies (CICs-ND-SI) into the ambit of regulatory framework. CIC with an asset size of Rs.100 crore or above are considered as CICs-ND-SI. It may be noted that a CIC is defined as an NBFC carrying on the business of acquisition of shares and securities which satisfy the following conditions as on the date of the last audited balance sheet:

(i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

(ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trusts only as sponsor constitute not less than 60% of its net assets (refer clause (xviii) of sub-para (1) of paragraph 3 of Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (updated as on December 29, 2022);

Provided that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

(iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment; and

(iv) it does not carry on any other financial activity referred to in Section 45-I(c) and Section 45-I(f) of the RBI Act, 1934 except:

a) investment in bank deposits, money market instruments, including money market mutual funds that make investments in debt/money market instruments with a maturity of up to 1 year, government securities and bonds or debentures issued by the group companies.

b) granting of loans to group companies.

c) guarantees issued on behalf of group companies.

2.4 In accordance with the Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (updated as on December 29, 2022), prudential regulations are applicable only to CIC having total assets of not less than Rs.100 crore either individually or in aggregate along with other CICs in the Group and which raises or holds public funds.

Systemically Important CIC

2.5 A Core Investment Company with an asset size of Rs.100 crore and above is called a Systemically Important CIC or CIC-ND-SI.

Registration of CIC

2.6 CICs with an asset size of less than Rs.100 crore, irrespective of whether accessing public funds or not and CICs with an asset size of Rs.100 crore and above and not accessing public funds are not required to register with the Bank under Section 45-IA of the RBI Act, 1934 in terms of Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (updated as on December 29, 2022) and will be termed as 'Unregistered CICs'. However, they have to approach RBI if they intend to access public funds.

A CIC (as defined above), on meeting the requirements referred in paragraph 2.4 above, shall be required to obtain a certificate of registration under section 45-IA of the RBI Act, 1934 irrespective of any advice in the past, issued by the RBI, to the contrary and shall be governed by the provisions of the RBI Act,1934 and directions issued by RBI from time to time. Every Core Investment Company shall apply to the RBI for grant of certificate of registration within a period of three months from the date of meeting the requirements of registration.

2.7 Every CIC exempted from registration requirement with RBI shall pass a Board Resolution that it will not, in the future, access public funds. If unregistered CICs with asset size above Rs. 100 crore access public funds without obtaining a certificate of registration from RBI, they will be seen as violating aforesaid Master Directions -Core Investment Companies (Reserve Bank) Directions, 2016.

2.8 All CICs investing in Joint Venture/Subsidiary/Representative Offices overseas in the financial sector are required to obtain prior approval from the RBI. A certificate of registration and compliance with all the regulations applicable to CIC is must if they are desirous of making overseas investment in the financial sector. In case the investment is in non-financial sector, the CICs are required to only report such investments within 30 days to RBI in the prescribed format and in the prescribed periodicity.

Group structure

2.9 The number of layers of CICs within a Group (including the parent CIC) shall be restricted to two, irrespective of the extent of direct or indirect holding/ control exercised by a CIC in the other CIC. If a CIC makes any direct/ indirect equity investment in another CIC, it will be deemed as a layer for the investing CIC. While the regulation shall be applicable from August 13, 2020, existing entities shall reorganise their business structure and adhere to this Guideline latest by March 31, 2023.

Capital Adequacy for CIC

2.10 Adjusted net worth of a CIC shall at no point of time be less than 30% of its aggregate risk weighted assets on balance sheet and risk adjusted value of off-balance sheet items as on the date of the last audited balance sheet as at the end of the financial year.

Leverage Ratio

2.11 The outside liabilities of a CIC shall at no point of time exceed 2.5 times its adjusted net worth as on the date of the last audited balance sheet as at the end of the financial year.

Exemptions to CIC

2.12 CIC maintaining the minimum capital and leverage ratio are exempted from maintenance of minimum net owned funds, CRAR and concentration limits. CIC with asset size of less than Rs.100 crores is exempted from registration with the RBI under RBI Act, 1934.

2.13 Master Directions governing CIC do not require submission of auditor’s certificate on its NBFC activity, capital adequacy norms and concentration of credit/investment. They are only required to file DNBS12 return -Important Prudential Parameters on the basis of intimation from the RBI requiring submission. The return captures compliance with various prudential norms, e.g. Capital Adequacy, Asset Classification, Provisioning, net owned funds etc. for CIC-ND-SIs through XBRL portal.

Statutory Auditor's Certificate

2.14 Every CIC shall submit an annual certificate from its statutory auditors regarding compliance with the requirements of these directions within a period of one month from the date of finalisation of the balance-sheet. This is submitted through XBRL portal.

Understanding the nature of other NBFCs

2.15 The auditor may remember the following while understanding the category of NBFC:

- A loan company or an investment company shall have financial assets (as defined in RBI FAQs (Refer link - https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92) more than 50% of its total assets and financial income in excess of 50% of the total income from financial assets respectively.
- In the case of an asset finance company, the aggregate of financing real / physical assets supporting economic activity should be greater than 60% of total assets and the income arising therefrom should be greater than 60% of total income.
- For an infrastructure company, a minimum of 75% of the total assets are to be deployed in infrastructural loans and finance income should be greater than 50% of total income.
- In the case of a core investment company, the investments in shares and other securities should be 90% of the net assets of the company and investments in equity shares should constitute more than 60% of the net assets of such a company.
- In the case of a company having factoring business, income derived from factoring business should constitute more than 50% of its gross income.

The auditor should refer to the prudential norms Master Directions issued by RBI with regard to income recognition, provisioning, accounting for investments.

Capital Risk-Weighted Asset ratio (CRAR)

2.16 For deposit and non-deposit taking NBFCs, Capital to Risk Weighted Assets Ratio or CRAR (which includes Tier I capital of 10 per cent) is 15 per cent at present. Applicable

NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 per cent or more of their financial assets) shall maintain a minimum Tier I capital of 12 per cent.

Computation of CRAR (illustrative)

CRAR	$\text{CRAR} = \dfrac{\text{Total Capital Funds}}{\text{Risk-weighted Assets}}$ Total Capital Funds = Tier I Capital + Tier II Capital Weighted Risk Assets Assets and investments of the NBFC are given risk weights (e.g. Shares / debentures / bonds / commercial papers of all companies and units of all mutual funds are weighted 100%, whereas Bonds of public sector banks are 20% and Loans to staff are 0%)
Tier I	Equity + CCPS + reserves excluding revaluation reserves+ Perpetual debt instruments (upto 15% of Tier I of previous accounting year) - Accumulated Losses - NBFC investments – Investments in shares, debentures, bonds, Loans and deposits with subsidiaries and group companies exceeding 10% of owned funds un aggregate-book value of intangible assets
Tier II	OCPS / OCDs + hybrid debt + Subordinated debt + General Provision and loss reserves (subject to conditions) + Perpetual debt instruments (which is in excess of what qualifies for Tier I above) *To the extent aggregate does not exceed Tier I capital* + revaluation reserves at a discounted rate of 55%+hybrid debt capital instruments

While computing the owned funds and net owned funds, fair valuation gains and transition gains on implementation of Ind AS are not to be included. However, losses need to be considered. Refer paragraph 2.21 for details.

Risk Weighted Assets

2.17 **On Balance Sheet Assets:** The risk weighted assets shall be calculated as the weighted aggregate of funded items as detailed hereunder:

Weighted risk assets – weight	**Percentage**
(i) Cash and bank balances including fixed deposits and certificates of deposits with banks	0
(ii) Investments	
(a) Approved securities [Except at (c) below]	0
(b) Bonds of public sector banks	20
(c) Fixed deposits/certificates of deposits/ bonds of public financial institutions	100
(d) Shares of all companies and debentures/bonds/commercial papers of all companies and units of all mutual funds	100
(e) All assets covering PPP and post Commercial Operations Date (COD) infrastructure projects in existence over a year of commercial operation.	50
(iii) Current assets	
(a) Stock on hire (net book value)	100
(b) Inter-corporate loans/deposits	100
(c) Loans and advances fully secured against deposits held by the company itself	0
(d) Loans to staff	0
(e) Other secured loans and advances considered good (Except at (vi) below)	100

(f) Bills purchased/discounted	100
(g) Others (To be specified)	100
(iv) Fixed Assets (net of depreciation)	
(a) Assets leased out (net book value)	100
(b) Premises	100
(c) Furniture & Fixtures	100
(v) Other assets	
(a) Income tax deducted at source (net of provision)	0
(b) Advance tax paid (net of provision)	0
(c) Interest due on Government securities	0
(d) Others (to be specified)	100
(vi) Domestic sovereign	
(a) fund-based claims on the Central Government	0
(b) Direct loan/ credit/ overdraft exposure and investment in State Government securities	0
(c) Central Government guaranteed claims	0
(d) State Government guaranteed claims, which have not remained in default or which are in default for a period not more than 90 days	20
(e) State Government guaranteed claims, which have remained in default for a period of more than 90 days	100

Note:

The above computation is illustrative. Auditor should refer to the respective Master Directions for computing the risk weighted assets and the percentage as applicable to specific NBFC.

2.18 *Off Balance Sheet Items:*

Sr. No.	Instruments	Credit Conversion Factor
i.	Financial & other guarantees	100
ii.	Share/debenture underwriting obligations	50
iii.	Partly-paid shares/debentures	100
iv.	Bills discounted/rediscounted	100
v.	Lease contracts entered into but yet to be executed	100
vi.	Sale and repurchase agreement and asset sales with recourse, where the credit risk remains with the NBFC	100
vii.	Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain draw down	100
viii.	Lending of NBFC securities or posting of securities as collateral by NBFC, including instances where these arise out of repo style transactions	100

ix.	Other commitments (e.g., formal standby facilities and credit lines) with an original maturity of:		
	up to one year		20
	over one year		50
x.	Similar commitments that are unconditionally cancellable at any time by the NBFC without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness		0
xi.	Take-out Finance in the books of taking-over institution		
	(i)	Unconditional take-out finance	100
	(ii)	Conditional take-out finance	50
	Note: As the counter-party exposure will determine the risk weight, it will be 100 per cent in respect of all borrowers or zero per cent if covered by Government guarantee.		
xii.	Commitment to provide liquidity facility for securitization of standard asset transactions		100
xiii.	Second loss credit enhancement for securitization of standard asset transactions provided by third party		100
xiv.	Other contingent liabilities (To be specified)		50
xv.	Non-fund based claims on the Central Government		0

Note:

i. Cash margins/deposits shall be deducted before applying the conversion factor.

ii. Where the non-market related off-balance sheet item is an undrawn or partially undrawn fund-based facility, the amount of undrawn commitment to be included in calculating the off-balance sheet non-market related credit exposures is the maximum unused portion of the commitment that could be drawn during the remaining period to maturity. Any drawn portion of a commitment forms a part of NBFC's on-balance sheet credit exposure.

For example:

A term loan of Rs. 700 crore is sanctioned for a large project which can be drawn down in stages over a three year period. The terms of sanction allow draw down in three stages – Rs. 150 crore in Stage I, Rs. 200 crore in Stage II and Rs. 350 crore in Stage III, where the borrower needs the NBFC's explicit approval for draw down under Stages II and III after completion of certain formalities. If the borrower has drawn already Rs. 50 crore under Stage I, then the undrawn portion would be computed with reference to Stage I alone i.e., it will be Rs.100 crore. If Stage I is scheduled to be completed within one year, the CCF will be 20 percent and if it is more than one year then the applicable CCF will be 50 per cent.

2.19 *Market Related Off-Balance Sheet Items*

i. NBFCs should take into account all market related off-balance sheet items (OTC derivatives and securities financing transactions such as repo / reverse repo/ CBLO etc.) while calculating the risk weighted off-balance sheet credit exposures.

ii. The credit risk on market related off-balance sheet items is the cost to an NBFC of replacing the cash flow specified by the contract in the event of counterparty default. This would depend, among other things, upon the maturity of the contract and on the volatility of rates underlying the type of instrument.

Treatment of deferred tax assets (DTA) and deferred tax liabilities (DTL) for computation of capital

2.20 In computing the CRAR ratio, the following clarification of the RBI on the treatment of Deferred Tax Asset (DTA) and Deferred Tax Liability (DTL) should be kept in mind by the auditor:

- The balance in DTL account will not be eligible for inclusion in Tier I or Tier II capital adequacy purpose and the DTA being the intangible asset should be deducted from Tier I capital.
- DTL created by debit to opening balance of Revenue Reserves or to Profit and Loss Account for the current year should be included under "Others" of "Other Liabilities and Provisions."
- DTA created by credit to opening balance of Revenue Reserves or to Profit and Loss Account for the current year should be included under item "Others" of "Other Assets."
- Intangible assets and losses in the current period and those brought forward from previous periods should be deducted from Tier I capital.
- DTA computed as under should be deducted from Tier I capital:

  (i) DTA associated with accumulated losses; and

  (ii) The DTA (excluding DTA associated with accumulated losses) net of DTL.

  Where the DTL is in excess of the DTA (excluding DTA associated with accumulated losses), the excess shall neither be adjusted against item (i) nor added to Tier I capital.

2.21 Computation of Regulatory Capital and Regulatory Ratios on implementation of Ind AS

(Extract from the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking

Company (Reserve Bank) Directions, 2016 (updated as on June 20, 2023)

(a) In determining 'owned funds', 'net owned funds' and 'regulatory capital', NBFCs shall be guided by the following:

(i) Any net unrealised gains arising on fair valuation of financial instruments, including such gains arising on transition to Ind AS, should not be included in owned funds whereas all such net losses should be considered. In determining the net unrealised gains for reduction from owned funds, NBFCs should categorise financial assets measured at fair value into two categories viz.

   A. Investments in shares of other NBFCs and in shares, debentures, bonds, etc. in Group companies that are required to be reduced while determining Tier I Capital as defined in paragraph 2(xxxii) of these Directions; and

   B. Others

   While netting may be done within the aforementioned categories, net gains from one category should not be offset against losses in the other category. Unrealized gains/losses shall be considered net of the effect of taxation.

(ii) Any unrealised gains or losses recognised in equity due to (a) own credit risk and (b) cash flow hedge reserve shall be derecognised while determining owned funds.

(iii) The unrealised gain/loss on a derivative transaction undertaken for hedging may be offset against the unrealised loss/gain recognized in the capital (either through Profit or Loss or through Other Comprehensive Income) on the corresponding underlying hedged instrument. If after such offset and netting with unrealised gains/losses on other financial instruments, there are still net unrealised gains, the same should be excluded from regulatory capital.

(iv) Since unrealised gains on category A have been excluded in computation of owned fund, NBFCs shall reduce the lower of acquisition cost or fair value of investments/advances in subsidiaries/other group companies and other NBFCs while determining Tier I capital as specified in paragraph 2(xxxii) of the aforementioned Master Directions. Net unrealised gains on Category B (i.e. ‘Others’) to the extent they have been excluded in regulatory capital, shall also be reduced from risk weighted assets.

(v) Where NBFCs use fair value as deemed cost at the date of transition with respect to Property, Plant and Equipment (PPE) in terms of Ind AS 101, “First-time Adoption of Indian Accounting Standards” and the difference between the deemed cost and the current carrying cost is adjusted directly in retained earnings, any fair value gains upon such transition shall be reckoned as Tier II capital for NBFCs at a discount of 55 per cent.

(vi) 12 month expected credit loss (ECL) allowances for financial instruments i.e. where the credit risk has not increased significantly since initial recognition, shall be included under general provisions and loss reserves in Tier II capital within the limits specified by extant regulations. Lifetime ECL shall not be reckoned for regulatory capital (numerator) while it shall be reduced from the risk weighted assets.

(vii) Securitised assets not qualifying for de-recognition under Ind AS due to credit enhancement given by the originating NBFC on such assets shall be risk weighted at zero percent. However, the NBFC shall reduce 50 per cent of the amount of credit enhancement given from Tier I capital and the balance from Tier II capital.

(b) Regulatory ratios, limits and disclosures shall be based on Ind AS figures. Impaired assets and restructured assets shall be considered as non-performing assets (NPA) for calculation of NPA ratios.

Capital requirements for NBFCs-Upper Layer as per Scale Based Regulatory Framework

RBI vide notification dated April 19, 2022 - Large Exposures Framework for Non-Banking Financial Company - Upper Layer (NBFC-UL) has prescribed capital requirements for Non-Banking Financial Companies – Upper Layer (NBFC-UL) which is summarised below:

NBFC -UL shall maintain Common Equity Tier 1 capital of at least 9 per cent of Risk Weighted Assets on an ongoing basis. The detailed guidelines in this regard are provided below:

Common Equity Tier 1 ratio is Common Equity Tier 1 Capital/ Total Risk Weighted Assets

Common Equity Tier 1 capital comprise:

(i) Paid-up equity share capital issued by the NBFC

(ii) Share premium resulting from the issue of equity shares

(iii) Capital reserves representing surplus arising out of sale proceeds of assets

(iv) Statutory reserves

(v) Revaluation reserves arising out of change in the carrying amount of an NBFC's property consequent upon its revaluation in accordance with the applicable accounting standards may, at the discretion of the NBFC, be reckoned as CET 1 capital at a discount of 55%, instead of as Tier 2 capital under extant regulations, subject to meeting the following conditions:

- the property is held for own use, by the NBFC;
- the NBFC is able to sell the property readily at its own will and there is no legal impediment in selling the property;
- the revaluation reserves are presented/disclosed separately in the financial statements of the NBFC;
- revaluations are realistic, in accordance with applicable accounting standards;
- valuations are obtained, from two independent valuers, at least once in every 3 years;
- where the value of the property has been substantially impaired by any event, these are to be immediately revalued and appropriately factored into capital adequacy computations; and
- the external auditors of the NBFC have not expressed a qualified opinion on the revaluation of the property.

(vi) Other disclosed free reserves, if any.

Note: For Mortgage Guarantee Companies, free reserves include contingency reserves maintained as per paragraph 14(a) of the Master Directions - Mortgage Guarantee Companies (Reserve Bank) Directions, 2016 dated November 10, 2016(updated as on June 20, 2023).

(vii) Balance in Statement of Profit & Loss after allocations and appropriations i.e. retained earnings at the end of the previous financial year. Accumulated losses shall be reduced from CET 1.

(viii) Profits in the current financial year may be included on a quarterly basis if it has been audited or subject to limited review by the statutory auditors of the NBFC. Further, such profits shall be reduced by average dividend paid in the last three years and the amount which can be reckoned would be arrived at as under:

$EP_t = NP_t - 0.25 * D * t$

Where:

EP_t=Eligible profit up to quarter 't' of the current financial year, t varies from 1 to 4

NP_t=Net profit upto quarter 't'

D=average dividend paid during the last three years

Losses in the current year shall be fully deducted from CET 1.

(ix) The following regulatory adjustments / deductions shall be applied in the calculation of CET 1 capital [i.e. to be deducted from the sum of items (i) to (viii)]:

a) Goodwill and other intangible assets

1. Goodwill and all other intangible assets should be deducted from Common Equity Tier 1 capital.

2. The full amount of the intangible assets is to be deducted net of any associated deferred tax liabilities which would be extinguished if the intangible assets become impaired or derecognized under the relevant accounting standards. For this purpose, the definition of intangible assets would be in accordance with the relevant accounting standards. Losses in the current period and those brought forward from previous periods should also be deducted from Common

Equity Tier 1 capital, if not already deducted.

b) Deferred Tax Assets (DTAs)

The following DTAs shall be deducted in full, from CET 1 capital –

1. DTAs associated with accumulated losses
2. DTAs (excluding DTAs associated with accumulated losses) net of Deferred Tax Liabilities (DTL)

Note: Where the DTL is in excess of the DTA (excluding DTA associated with accumulated losses), the excess shall neither be adjusted against item (i) nor added to CET 1 capital.

c) Investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund of the NBFC.

Note:

1. The lower of acquisition cost or fair value of investments/advances shall be used to arrive at the amount of deduction mentioned above.
2. For the purpose of the above deduction, margin money placed with a subsidiary or company in the same group shall be considered as deposits.

d) Impairment Reserve shall not be recognised in CET 1 capital.

e) Deductions/ exclusions, required on unrealised gains and/or losses from regulatory capital in terms of paragraphs 3(a) (i) to (iii) of the Annex to circular on Implementation of Indian Accounting Standards reference DOR (NBFC).CC.PD.No.109/ 22.10.106/2019-20 dated March 13, 2020 read with circular DOR(NBFC). CC.PD.No.116/22.10.106/2020-21 dated July 24, 2020 on “Implementation of Indian Accounting Standards”, shall be reduced from CET 1 capital.

f) Securitisation Transactions: NBFCs shall be guided by the Master Direction no. DOR.STR.REC.53/ 21.04.177/2021-22 dated September 24, 2021 titled Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021(updated as on December 5, 2022) in this regard.

g) Defined Benefit Pension Fund Assets and Liabilities: Defined benefit pension fund liabilities, as included on the balance sheet, must be fully recognised in the calculation of CET 1 capital (i.e. CET 1 capital cannot be increased through derecognising these liabilities). For each defined benefit pension fund that is an asset on the balance sheet, the asset should be deducted in the calculation of CET 1.

h) Investments in Own Shares (Treasury Stock): Investment in an NBFC's own shares is tantamount to repayment of capital and therefore, such investments, whether held directly or indirectly, shall be deducted from CET 1 capital. This deduction would remove the double counting of equity capital which arises from direct holdings, indirect holdings via index funds and potential future holdings as a result of contractual obligations to purchase own shares.

The Total Risk Weighted Assets (RWAs) to be used in the computation of CET 1 ratio shall be the same as the total RWAs computed under the relevant Directions of the concerned NBFC category.

Framework for Scale Based Regulation (SBR) for Non-Banking Financial Companies

https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0

2.22 As mentioned in paragraph 1.22, RBI has put in place a revised regulatory framework for NBFCs and these guidelines shall be effective from October 01, 2022. The instructions relating to ceiling on IPO funding given vide para 3.1(d) of the guidelines shall come into effect from April 01, 2022.

According to these guidelines, regulatory structure for NBFCs shall comprise of four layers based on their size, activity, and perceived riskiness.

i) NBFCs in the lowest layer shall be known as NBFC - Base Layer (NBFC-BL).

ii) NBFCs in middle layer and upper layer shall be known as NBFC - Middle Layer (NBFC-ML) and NBFC - Upper Layer (NBFC-UL) respectively.

iii) The Top Layer is ideally expected to be empty and will be known as NBFC - Top Layer (NBFC-TL).

A. Base Layer

The Base Layer shall comprise of

(a) non-deposit taking NBFCs below the asset size of Rs.1000 crore and (b) NBFCs undertaking the following activities-

- (i) NBFC-Peer to Peer Lending Platform (NBFC-P2P),
- (ii) NBFC-Account Aggregator (NBFC-AA),
- (iii) Non-Operative Financial Holding Company (NOFHC) and
- (iv) NBFCs not availing public funds and not having any customer interface.

B. Middle Layer

The Middle Layer shall consist of

(a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size,

(b) non-deposit taking NBFCs with asset size of Rs.1000 crore and above and

(c) NBFCs undertaking the following activities

- (i) Standalone Primary Dealers (SPDs),
- (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs),

(iii) Core Investment Companies (CICs),

(iv) Housing Finance Companies (HFCs) and

(v) Infrastructure Finance Companies (NBFC-IFCs).

C. Upper Layer

The Upper Layer shall comprise of those NBFCs which are specifically identified by the Reserve Bank as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology as provided in the Appendix to the circular(refer link above). The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

D. Top Layer

The Top Layer will ideally remain empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

Following prescriptions shall apply in respect of the NBFCs considering scale based and activity based regulation:

- NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.
- NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.
- The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.
- Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.

Scale based Regulatory Framework

(a) From October 01, 2022, all references to NBFC-ND shall mean NBFC-BL and all references to NBFC-D and NBFC-ND-SI shall mean NBFC-ML or NBFC-UL, as the case may be.

(b) Progressive application of regulations - Regulatory revisions applicable to lower layers of NBFCs will automatically be applicable to NBFCs residing in higher layers, unless stated otherwise.

(c) Regulatory guidelines for NBFCs in Base Layer - NBFCs in the Base Layer (NBFC-BL) shall be subject to regulations as currently applicable to NBFC-ND except for the changes mentioned at paras 3.1 and 3.2 of aforesaid scale based regulatory framework (SBRF). NBFC-P2P, NBFC-AA, and NOFHC shall be subject to extant regulations governing them.

(d) Regulatory guidelines for NBFCs in Middle Layer - NBFCs in the Middle Layer (NBFC-ML) shall continue to follow regulations as currently applicable for NBFC-ND-SIs, NBFC-Ds, CICs, SPDs and HFCs, as the case may be, except for the changes mentioned at paras 3.1 and 3.2 of the SBRF.

(e) Regulatory guidelines for NBFCs in Upper Layer - NBFCs lying in the Upper Layer (NBFC-UL) shall be subject to regulations applicable to NBFC-ML in addition to the changes mentioned at paras 3.1 and 3.2 of the SBRF.

Guidelines mentioned in paragraph 3.1 (Regulatory changes under SBR for all the layers in the regulatory structure) and paragraph 3.2 (Regulatory changes under SBR for different layers in the regulatory structure) of the aforesaid RBI circular on SBRF need to be considered before considering the applicability of regulatory revisions in points (b), (c) and (d) above.

Net owned funds: As per this framework, the net owned funds should be increased to Rs. 10 crores by the year 2027 from the present 2 crores or 5 crores as the case may be for NBFC-MFIs, NBFC-Factors and NBFC- ICC. For NBFCs with no public funds and no customer interface, net owned funds will remain at Rs. 2 crores.

For NBFCs in middle and upper layer, the Internal Capital Adequacy Assessment Process (ICAAP) is to be put in place similar to banks factoring credit risk, market risk, operational risk and all other residual risks as per methodology to be determined internally.

RBI will issue a detailed circular on restrictions on grant of loans to directors, their relatives and entities where they have major shareholding and also loans granted to senior officers of NBFCs. NBFCs are required to constitute a risk management committee and adhere to the disclosure requirements as prescribed by RBI from time to time. Auditor should consider guidance as and when it is issued by the RBI.

Disclosure requirements under SBR

2.23 NBFCs shall, in addition to the existing regulatory disclosures, disclose the following in their Annual Financial Statements, with effect from March 31, 2023:

i. Corporate Governance report containing composition and category of directors, shareholding of non-executive directors, etc.

ii. Disclosure on modified opinion, if any, expressed by auditors, its impact on various financial items and views of management on audit qualifications.

iii. Items of income and expenditure of exceptional nature.

iv. Breaches in terms of covenants in respect of loans availed by the NBFC or debt securities issued by the NBFC including incidence/s of default.

v. Divergence in asset classification and provisioning above a certain threshold to be decided by the Reserve Bank.

Additional regulatory changes under SBR applicable to NBFC-UL

2.24 NBFCs in the upper layer shall be mandatorily listed within 3 years of identification as NBFC-UL. Disclosure requirements shall be put in place on the same lines as applicable to a listed company even before the actual listing, as per Board approved policy of the NBFC.

Concentration of credit / investment

2.25 The extant credit concentration limits prescribed for NBFCs separately for lending and investments is merged under the new regulatory framework. Accordingly, it will be a single exposure limit of 25% for a single borrower/ party and 40% for single group of borrowers/ parties. Further, the concentration limits shall be determined with reference to the NBFC's Tier 1 capital instead of their owned fund. Additional 5% relaxation is given for NBFC -IFCs.

As per the scale based regulatory framework effective from October 1, 2022, extant instructions on concentration norms for different categories of NBFC, other than the changes indicated above, will continue to remain applicable. Group companies are to be determined as per definitions in AS 21 "Consolidated Financial Statements" for subsidiary parent relationship, AS 27 "Financial Reporting of Interests in Joint Ventures" for Joint Ventures, Associates in AS 23 "Accounting for Investments in Associates in Consolidated Financial Statements", Promoter- Promotee as provided in SEBI (Acquisition of Shares and Take over) Regulations, 1997 for listed companies, a related party (defined in terms of AS 18), Common brand name, and investments in equity shares of 20% and above.[Reference: Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (Updated as on June 20, 2023)] and limits are to be computed as percentage of owned funds.

- Ceiling in investment of shares not applicable in respect of investment in equity of insurance company (with RBI approval).
- Ceiling not applicable for investments of NBFC in shares of its subsidiaries, companies in the same group to the extent they have been reduced from owned funds for the calculation of net owned funds.

- Also ceiling not applicable in respect of the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with-
  - (i) subsidiaries of the NBFC; and
  - (ii) companies in the same group, to the extent they have been reduced from owned funds for the calculation of net owned funds.
- An investment in debentures is treated as credit and not investment.
- Through Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (updated as on June 20, 2023), RBI has notified that concentration of credit/ investment norms shall not apply to a systemically important non-banking financial company not accessing public funds in India, either directly or indirectly, and not issuing guarantees.
- These ceilings shall be applicable to the credit/investment by such a non-banking financial company to companies/firms in its own group as well as to the borrowers/ investee company's group.
- Definition of 'public funds' includes funds raised either directly or indirectly through public deposits, inter-corporate deposits, bank finance and all funds received from outside sources such as funds raised by issue of commercial papers, debentures etc. but excludes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

2.26 There are certain end use restrictions for the finance availed from banks for the activities of NBFCs such as:

- Following activities are not eligible for bank credit:
  - o For bills discounted/rediscounted by NBFCs except those arising on sale of commercial vehicles and two and three wheelers subject to following conditions:

(a) the bills should be drawn by the manufacturers on dealers only.

(b) bills should represent genuine sale transactions.

- Investments by NBFCs in any company/entity by way of shares, debentures, etc., (Stock broking companies may be provided need based credit);
- For unsecured loans/inter-corporate deposits by NBFCs to/in any company;
- All types of loans and advances by NBFCs to their subsidiaries, group companies;
- Finance to NBFCs for further lending to individuals for subscribing to initial public offerings.

2.27 The auditor should plan his work to meet the overall audit objective of expressing an opinion on the true and fair view of the financial statements. In the planning stage, the auditor should gather relevant organisational information for developing his audit plan. The preliminary study would help the auditor in the following:

- Understand the business issues and the associated risks.
- Communication with the management and where required, with those charged with governance on timely basis.
- Identify the issues that may require special attention in the audit.
- Develop an audit scope that may add value to the NBFC by focussing on areas more meaningful to the management.

Chapter 3
Financial Reporting Framework

3.1 NBFCs that are required to implement Indian Accounting Standards (Ind AS) as per the Companies (Indian Accounting Standards) Rules, 2015 shall prepare their financial statements in accordance with Ind AS notified by the Government of India and shall comply with the regulatory guidance specified in the RBI Directions. Other NBFCs shall comply with the requirements of notified Accounting Standards (AS) insofar as they are not inconsistent with any of these directions.

NBFCs are required to provide disclosures as required under relevant RBI guidelines. RBI vide its circular on Disclosures in Financial Statements- Notes to Accounts of NBFCs RBI/2022-23/26 DOR.ACC.REC.No.20/21.04.018/2022-23 dated April 19, 2022 has provided disclosure requirements under scale based regulations in the notes to accounts of NBFCs. These regulations are in addition to other disclosure requirements required under relevant guidelines and applicable accounting standards. Refer **Appendix E** to this Technical Guide containing an illustrative list of disclosure requirements.

3.2 NBFCs having net worth below Rs. 250 crore which are not covered under Ind AS shall continue to apply Accounting Standards specified in Annexure to the Companies (Accounting Standards) Rules, 2021 (hereinafter referred to as the 'Notified AS' or 'AS')

Compliance with Schedule III to the Companies Act, 2013

3.3 NBFCs registered under the Companies Act, 1913/1956/2013 and requiring to follow Indian Accounting Standards are required to comply with Division III of Schedule III to the Companies Act, 2013 in respect of presentation and disclosure in financial statements.

Regulatory Guidance on Implementation of Indian Accounting Standards by NBFCs

3.4 RBI has provided certain guidelines relating to specific prudential aspects of Ind AS implementation by NBFCs in the Annex XXVI of the Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (updated as on June 20, 2023). These guidelines inter alia provide as under:

The responsibility of preparing and ensuring fair presentation of the financial statements of an NBFC vests primarily with its Board of Directors. These guidelines relate to specific prudential aspects of Ind AS implementation by NBFCs and are not meant to be comprehensive. Accordingly, with respect to matters not dealt with in these guidelines, NBFCs are required to refer to the notified Indian accounting standards, application guidance, educational material and other clarifications issued by the Institute of Chartered Accountants of India (ICAI).

Extract from the above referred RBI Guidelines from the Master Directions is reproduced below:

I. Governance Framework:

(a) NBFCs are advised to have Board approved policies that clearly articulate and document their business models and portfolios and also articulate the objectives for managing each portfolio.

(b) Policy should be framed for sales out of amortised cost business model portfolios and disclose the same in their notes to financial statements.

(c) Sound methodology and underlying documentation should be in place for computation of Expected Credit Loss (ECL) that address various factors like policies, procedures and controls for assessing and measuring credit risk on all lending exposures, commensurate with the size, complexity and risk profile of the entity. The rationale and justification for any change in the ECL model should be documented and approved by the Board. Similarly, any adjustments to the model output (i.e. a management overlay) should be approved by the Audit Committee of the Board (ACB) and its rationale and basis should be clearly documented.

(d) Ind AS 109 does not explicitly define default but requires entities to define default in a manner consistent with that used for internal credit risk management. It is recommended that the definition of default adopted for accounting purposes is guided by the definition used for regulatory purposes. The Audit committee should approve the classification of accounts that are past due beyond 90 days but not treated as impaired, with the rationale for the same clearly documented. Further, the number of such accounts and the total amount outstanding and the overdue amounts should be disclosed in the notes to the financial statements.

(e) There is a rebuttable presumption under Ind AS 109 that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. Ind AS 109 also permits that an NBFC can rebut this presumption if it has reasonable and supportable information that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due. It should be done only with clear documentation of the justification for doing so. All such cases shall be placed before the Audit Committee. NBFCs should not defer the recognition of significant increase in credit risk for any exposure that is overdue beyond 60 days.

II. Prudential floor for ECL

A comparison (as per the template given in Appendix E to this Technical Guide) between provisions required under IRACP and impairment allowances made under Ind AS 109 should be disclosed by NBFCs in the notes to their financial statements to provide a benchmark to their Boards, RBI supervisors and other stakeholders, on the adequacy of provisioning for credit losses.

Refer link below for accessing the template.

https://rbidocs.rbi.org.in/rdocs/content/pdfs/NSIND01092016_AN.pdf

A separate impairment reserve is required to be created if the provisioning as per Ind AS 109 is less than the provisioning required under IRACP (including standard asset provisioning). The impairment reserve will not be considered as part of regulatory capital and any withdrawals from this reserve will require RBI approval.

III. Computation of regulatory capital and regulatory ratios

The requirements are elaborated in paragraph 2.21.

Chapter 4
Auditing Framework

4.1 Auditors are required to ensure compliance with the Standards on Auditing issued by the Institute of Chartered Accountants of India (ICAI) which are also specified under section 143(10) of the Companies Act, 2013 while discharging their audit obligations. In addition, the auditor is required to follow other applicable authoritative pronouncements of ICAI like "Guidance Note on Reports or Certificates for Special Purposes" while issuing certificates and reports mandated by RBI. Certain important standards on auditing that need to be considered by the auditor are as follows.

Objective and Scope of the Audit of Financial Statements

4.2 The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements of the NBFC are prepared, in all material respects, in accordance with an identified financial reporting framework.

The auditor's report indicates the financial reporting framework that has been used to prepare the NBFC's financial statements.

Agreeing to the Terms of Engagement

4.3 The engagement letter documents and confirms the auditor's acceptance of the appointment, the objective and scope of the audit, the extent of the auditor's responsibilities and the form of audit report.

4.4 Some of the characteristics are unique to NBFCs and indicate the areas where the auditors and the audit team may require specialised skills. In considering the objective and scope of the audit and the extent of the responsibilities, the auditor should consider his own skills and competence and those of his team to conduct the engagement. In doing so, the auditor should consider the following factors:

- The need for sufficient expertise in the aspects of financing relevant to the audit of the NBFC's business activities.

- The need for expertise in the context of the IT systems and communication networks the NBFC uses.

4.5 Through an announcement in September 2005, ICAI has informed the members about receipt of a communication dated September 23, 2005 from the Department of Non-Banking Supervision of the RBI in respect of the role that can be played by the statutory auditors of Non-Banking Financial Companies (NBFCs) in fighting the menace of vanishing NBFCs. The Reserve Bank, in its said communication, has desired that the statutory auditors of an NBFC inform the Regional Office of the RBI under whose jurisdiction the NBFC is functioning on their appointment or cessation as statutory auditors of the NBFC concerned. ICAI has requested the members to ensure compliance with the above-mentioned requirement of the RBI.

Auditors should consider including this requirement in the terms of engagement.

Audit Planning

4.6 A well designed audit plan is necessary for the auditor to conduct an effective and efficient audit. The audit plan gives details of the audit objectives and steps the auditor should consider, to ensure that all important issues in the audit are covered. A well designed audit plan includes the following:

- Obtaining a sufficient knowledge of the NBFC's business and governance structure, and a sufficient understanding of the accounting and internal control systems, including risk management and internal audit functions;
- Considering the assessments of inherent and control risks i.e. the risk that material misstatements occur (inherent risk) and the risk that the NBFC's system of internal control does not prevent or detect and correct such misstatements on a timely basis (control risk);
- Determining the nature, timing and extent of the audit procedures to be performed; and
- Considering the appropriateness of the going concern assumption regarding the NBFC's ability to continue its

operations for the foreseeable future, which will be the period used by management in making its assessment under the financial reporting framework. This period will ordinarily be for a period of at least one year after the balance sheet date unless a longer period is specified by financial reporting framework or by law or regulation.

Table A: Obtaining knowledge of the NBFC's business

The auditor needs to understand:

- *Corporate governance structure:* Corporate governance plays a particularly important role in NBFCs; many regulators set out requirements for NBFCs to have effective corporate governance structures. Accordingly, the auditor should obtain an understanding of the NBFC's corporate governance structure and how those charged with governance discharge their responsibilities for the supervision, control and direction of the NBFC.
- The economic and regulatory environment prevailing in the principal countries in which the NBFC operates.
- The market conditions existing in each of the significant sectors in which the NBFC operates.
- *Services:* In obtaining and maintaining that knowledge, the auditor should be aware of the many variations in the basic deposit, loan and treasury services that are offered by NBFCs in response to market conditions. The auditor should obtain an understanding of the nature of services rendered or financial transactions undertaken through instruments such as letters of credit, acceptances, interest rate futures, forward and swap contracts, options and other similar instruments in order to understand the inherent risks and the auditing, accounting and disclosure implications thereof.
- *Service Organisation:* NBFC may use service organizations to provide core services or activities such as sourcing of loans platforms and employing collection agencies, cash and securities settlement, back office activities or internal audit

services. The responsibility for compliance with rules and regulations and sound internal controls however remains with those charged with governance and the management of the outsourcing NBFC. The auditor should consider legal and regulatory restrictions, and obtain an understanding of how the management and those charged with governance monitor that the system of internal control (including internal audit) operates effectively. SA 402, "Audit Considerations Relating to an Entity Using a Service Organization" gives further guidance on this subject. RBI has also come out with the Master Direction on Outsourcing of Information Technology Services RBI/2023-24/102 DoS.CO.CSITEG/SEC.1/ 31.01.015/2023-24 dated April 10, 2023 (Link: https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12486). Auditor should ensure that the NBFC is compliant with the requirement of aforesaid Master Direction.

- *Risk:* There are a number of risks associated with financing activities of NBFC that are important in that, they serve to shape financing operations. The auditor should obtain an understanding of the nature of these risks and how the NBFC manages them. This understanding allows the auditor to assess the levels of inherent and control risks associated with different aspects of NBFC's operations and to determine the nature, timing and extent of the audit procedures.

  For example, an NBFC financing movable assets, needs to ensure that asset exists and is traceable. If not, the security valuation could be an issue from a provisioning perspective.

  If the NBFC is a micro finance institution, fraud risk on misappropriation of cash becomes a significant risk. This misappropriation could be done during disbursement or during the collections process.

  Another example could be, in case of a NBFC dealing with loans against shares, valuation of shares could be a risk.

4.7 In developing an overall plan for the audit of the financial statements of an NBFC, the auditor should give particular attention to:

- The complexity of the transactions undertaken by the NBFC and the documentation in respect thereof;
- The extent to which any core activities are provided by service organizations;
- Regulatory considerations;
- The extent of IT and other systems used by the NBFC;
- The expected assessments of inherent and control risks;
- The work of internal auditor;
- The assessment of audit risk;
- Assessment of management estimates;
- The assessment of materiality;
- Management's representations;
- The involvement of other auditors;
- Contingent liabilities and off-balance sheet items;
- The geographic spread of the NBFC's operations and the co-ordination of work between different audit teams;
- Transactions with related parties;
- Going concern considerations;
- The necessity for involvement of subject matter experts for assessment of fair valuation of complex financial instruments and complex expected credit loss computations.

Audit Evidence

4.8 The auditor should review the NBFC's sources of revenue, policies for asset classification and provisioning, and obtain sufficient appropriate audit evidence regarding the following:

a) The accuracy and completeness of the NBFC's accounting records relating to such transactions.

b) The existence and operating effectiveness of key controls to limit the risks arising from such transactions.

c) The appropriateness of asset classification / staging and adequacy of provisions, if any, for loss which may be required.

d) The adequacy of financial statements disclosures and presentation.

4.9 The auditor is required to obtain sufficient appropriate audit evidence and should design and perform audit procedures that are appropriate in the circumstances for this purpose.

4.10 It is important for the auditor to consider the relevance and reliability of the information gathered/obtained as audit evidence. The auditor may need to consider the information prepared by the NBFC, information provided by third parties as well as by the external expert. The auditor needs to evaluate the competence, capability and objectivity of that expert as well as his independence and should evaluate work performed by an expert.

4.11 The auditor is required to check the accuracy and completeness of the information and evaluate whether it is sufficient and detailed for audit purposes.

4.12 Since the transactions of NBFCs are substantially financial in nature, the underlying documents / agreements form important audit evidence for the auditor. The auditor should verify all the relevant documents for obtaining sufficient appropriate audit evidence.

The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements

4.13 It is the primary responsibility of the management and those charged with governance to prevent and detect frauds. The auditor is only concerned with frauds that cause a material misstatement in the financial statements. Misstatements may arise from fraudulent financial reporting and/or misappropriation of assets.

4.14 Fraudulent activities may take place within an NBFC by, or with the knowing involvement of, management or employees of the NBFC. Alternatively, fraud may be perpetrated on an NBFC without the knowledge or complicity of the NBFC's management or employees.

4.15 Frauds may include:

- fraudulent financial reporting, (for example, to conceal trading losses, under reporting of delinquent loan assets), or
- misappropriation of assets that may or may not involve the falsification of records.

4.16 SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" gives detailed guidance on the nature of the auditor's responsibilities with respect to fraud. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risks of material misstatement due to fraud. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggest that a material misstatement due to fraud has occurred.

4.17 Members of the audit team should engage in a timely discussion with management and should also discuss, as a team, the potential for material misstatement due to fraud. The discussion among the audit team members about the susceptibility of the NBFC's financial statements to material misstatement due to fraud should include a consideration of the known external and internal factors affecting the entity that might (a) create incentives or pressures for management and others to commit fraud, (b) provide the opportunity for fraud to be perpetrated, and (c) indicate a culture or environment that enables management to rationalize committing fraud. Communication among the audit team members about the risks of material misstatement due to fraud also should continue throughout the audit.

4.18 The RBI has issued a circular requiring all NBFCs to report the occurrence of any 'fraud' by or on the NBFC during the financial year. The circular has been updated by Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016 dated September 29, 2016**.** In the Master Direction, a ceiling has been prescribed for reporting of frauds to the Central/Regional offices of the RBI.

Reporting of Frauds to RBI

Classification of Frauds

4.19 For the purpose of reporting, the RBI has classified the frauds in the following categories:

- Frauds involving Rs. 1 lakh and above,
- Frauds committed by unscrupulous borrowers, and
- Frauds involving Rs. One crore and above

Reporting of Frauds

4.20 An NBFC is required to submit the following forms to the RBI for reporting of frauds:

Form No.	**Purpose of the Form**	**Reporting due date**	**Submitted to**
FMR – 1	Report on Actual or Suspected Frauds in NBFCs	Three weeks from the date of detection	Regional Office of the Department of Non-Banking Supervision of Reserve Bank of India under whose jurisdiction the Registered Office of the NBFC falls. However, in cases

			where the amount involved is more than Rs. One Crore, the same also needs to be submitted to Central Office (CO) of the Reserve Bank of India, Department of Banking Supervision, Frauds Monitoring Cell.
FMR – 2	Quarterly Report on Frauds Outstanding	Within 15 days from the end of the quarter	Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls.
FMR – 3	Quarterly Progress Report on Frauds of Rs. 1.00 Lakh & Above	Within 15 days from the end of the quarter	NBFCs should furnish case-wise quarterly progress reports on frauds involving Rs. 1 lakh and above in the format given in FMR – 3 to Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls.

4.21 An NBFC is also required to report in cases where central investigating agencies have initiated criminal proceedings suo moto and/or where the Reserve Bank has directed that they be reported as frauds.

4.22 While reporting on fraud, the NBFC also needs to include frauds perpetrated in their subsidiaries and affiliates / joint ventures. However, the same need not be included in the report on outstanding frauds and the quarterly progress reports (FMR 2 & 3).

Cases of attempted fraud

4.23 From December 2012, the practice of reporting the attempted fraud to RBI has been discontinued. However, the individual cases involving Rs. 25 lakh or more of attempted fraud should be placed before the Audit Committee of NBFC's Board. The Audit Committee should also be informed about the modus operandi, how the fraud was detected, measures taken by the NBFC to strengthen the existing systems and controls, new systems and controls put in place in the area where fraud was attempted etc.

4.24 As per the requirement of the RBI circular, NBFCs should ensure that all frauds of Rs. 1 lakh and above are reported to their Boards promptly on their detection. Such reports should, among other things, take note of the failure on the part of the concerned officials, and consider initiation of appropriate action against the officials responsible for the fraud.

4.25 As a general guideline, following cases should invariably be reported to the state police:

- Cases of fraud involving an amount of Rs. 1 lakh and above, committed by outsiders on their own and/or with the connivance of NBFC staff/officers.
- Cases of fraud committed by NBFC employees, when it involves NBFC funds exceeding Rs. 10,000/-.

4.26 Attention is also drawn to the obligation cast on the auditor to report fraud to the Central Government pursuant to the requirement of Section 143(12) of the Companies Act, 2013. In this regard, auditor should refer to the "Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013" issued by ICAI.

Risk Assessment and Internal Controls

4.27 Any audit of NBFCs should include the evaluation of its internal controls, either as a part of the audit methodology or as a basis for reliance on evidence being gathered as a part of the audit. The extent of assessment of the controls would depend on the audit objectives of the auditor; the auditor should assess the effectiveness of controls over a period of time; and the auditor should develop the audit plan on the basis of evaluation of the internal controls. For instance, in using computer programmes to test data files, the auditor, probably with the help of system auditor, should evaluate controls over program libraries containing programs being used for audit purposes to determine the extent to which the programs are protected from unauthorised access/modification.

4.28 Attention is also drawn to auditor's responsibility to report on internal financial controls with reference to financial statements under clause(i) of sub-section 3 of Section 143 of the Companies Act, 2013. In this regard, auditor should refer to the "Guidance Note on Audit of Internal Financial Controls Over Financial Reporting" issued by ICAI.

Using the Work of an Expert

4.29 The auditor of an NBFC may come across various occasions where he may have to rely on the work of an expert. They mostly relate to the assets given as security against the lending of NBFCs or financial assets held by the NBFC. Some examples are:

- Valuations of certain types of non-financial assets, for example, land and buildings, plant and machinery etc.
- Valuation of financial instruments at fair value through profit and loss (FVTPL) or through other comprehensive income.
- Review of methodology and assumptions used for calculation of impairment loss on financial instruments.
- Legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc.

4.30 Following factors would determine the need to consider the work of an expert:

- Materiality of the item being examined in relation to the financial information as a whole;
- Nature and complexity of the item including the risk of error therein; and
- Other audit evidence available with respect to the item.

Table B: Evaluating the work of an expert

a) Evaluate the professional competence, objectivity and experience of the expert by considering the following:

   i) the expert's professional qualifications, for example, professional certification, license or other recognition of the competence of the expert in the field, as appropriate;

   ii) the experience and reputation of the expert in the field in which auditor is seeking audit evidence;

   iii) the expert's objectivity or relationship, if any, to the client, including but not limited to financial interests or employment relationships. The risk that an expert's objectivity will be impaired increases when the expert is:

      1. employed by the NBFC; or

      2. related in some other manner to the NBFC, for example, by being financially dependent upon or having an investment in the NBFC.

b) Obtain sufficient appropriate evidence that the expert's work is adequate for the purposes of the audit (i.e. it constitutes appropriate audit evidence in support of the financial statements assertions being considered), by considering:

   i) the objectives and the scope of the expert's work;

   ii) the source data used;

   iii) the assumptions and methods used and if appropriate, their consistency with the prior period;

iv) when the expert carried out the work;

v) the reasons for any changes in assumptions and methods compared with those used in the prior period; and

vi) the results of the expert's work in the light of both auditor's overall knowledge of the business and the results of his audit procedures.

c) Consider obtaining, in conjunction with the NBFC or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert.

d) Where the expert's work should be subject to a recognised methodology, for example published by organisation to which expert belongs, confirm this has been used.

e) Considering the results of assessment of the expert's work:

i) If the findings of the expert support the related assertions in the financial statements, it may be reasonably concluded that sufficient appropriate audit evidence has been obtained. In these circumstances, no reference to the use of expert should be included in the auditor report.

ii) If the results of the expert's work do not provide sufficient appropriate audit evidence or if the results are not consistent with other audit evidence, additional procedures should be applied which may include obtaining the opinion of another expert or performing additional audit procedures. Consider the implications on the audit opinion if the auditor is unable to obtain adequate assurance. If considered necessary to issue a modified audit report, consider referring to or describing the work of the expert (including the identity of the expert and the extent of the expert's involvement). In these circumstances, obtain the permission of the expert before making such a reference.

While considering the competence or objectivity of the expert, it is necessary to discuss any reservations with management and consider whether sufficient appropriate audit evidence can be obtained concerning the work of an expert.

To an extent based on materiality and inherent risk, document the understanding of the matters as below:

a) the objectives and scope of the expert's work;

b) clarification of the expert's representations as to his relationship, if any, to the client;

c) confidentiality of the client information;

d) the methods or assumptions to be used, for example, if property is involved, the client's plans and intentions for the property;

e) the extent of the expert's access to appropriate records and files;

f) a comparison of the methods or assumptions to be used with those used in the preceding period;

g) the expert's understanding of auditor's use of the expert's findings in relation to the representations in the financial statements;

h) the form and content of the expert's report in relation to the representations in the financial statements; and

i) the intended use of the expert's report including the possible communication to third parties of the expert's identity and extent of involvement.

Consider whether the expert has used source data which is appropriate in the circumstances, by, for example:

a) making inquiries of the expert to determine how the expert has obtained satisfaction that the source data is sufficient, relevant and reliable; and

b) performing audit procedures, based on materiality and inherent risk, on the data provided by the client to the expert to obtain reasonable assurance that the data is appropriate, including:

   i) verify the completeness of the information provided to the expert;

   ii) examine listing of transactions, account balances or other information provided to the expert; and

   iii) consider discussing the work performed with the expert.

When the expert's findings include a range of results using different assumptions, ensure that management's assessment of the findings, and decisions taken on the assumptions, is reasonable.

Representations by Management

4.31 The objective of the auditor is to obtain written representations from the management and where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor.

4.32 Although the written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any matters with which they deal. The auditor should obtain audit evidence independently about the fulfilment of management's responsibilities or about specific assertions.

Responsibility of Joint Auditors

4.33 RBI has issued guidelines for appointment of statutory auditors (SAs) of NBFCs (including HFCs). As per the Guidelines, NBFCs with asset size of Rs.15,000 crore and above as at the end of previous year, should have their statutory audit conducted under joint audit of a minimum of two audit firms which do not have common partners and they are not under the same network of audit firms. NBFCs may have a Board approved policy on the number of auditors considering various factors like complexity of transactions, level of technology used, identified risks in financial reporting etc. In such situations of joint audit, the auditor is required to comply with the requirements of SA 299(Revised), "Joint Audits of Financial Statements".

Consideration of Laws and Regulations in an Audit of Financial Statements

4.34 NBFCs are governed by various regulations of RBI concerning their conduct of business and reporting requirements. This is apart from the usual compliance and reporting requirements of the Companies Act under which it is incorporated as well as SEBI regulations, if it is a listed entity.

4.35 The auditor should understand the compliance and reporting requirements under various enactments which would help the conduct of audit. With the business getting complex and globalisation of finance business, the monitoring agencies make amendments to the existing rules and regulations. The auditor should be aware of such amendments affecting the NBFC.

Documentation

4.36 Apart from the usual audit documentation, it is very helpful for the auditor to prepare and retain audit documentation of all the significant matters identified during the audit and how those were addressed. Audit summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant objective of SAs that the auditor has not met or is unable to meet that would prevent the auditor from achieving the auditor's overall objective.

4.37 The documentation is not limited to records prepared by the auditor but may include other appropriate records such as minutes of meetings prepared by the NBFC's personnel and agreed by the auditor. The auditor should document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place. Others with whom the auditor may discuss significant matters may include other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

4.38 The auditor also needs to have proper audit documentation to evidence how inconsistencies identified during the audit have been addressed.

Reporting

4.39 Apart from the reporting under Section 143 of the Companies Act, 2013, RBI, through Section 45MA of the RBI Act, 1934 lays out the powers and duties of the auditors of an NBFC.

- Section 45 MA(1) - Casts duty on auditors to inquire if NBFC has submitted to the RBI, the requisite information, statements or particulars regarding deposits accepted by it. On exception, the auditors need to report to RBI, the "aggregate of such deposits held" by NBFC.
- Section 45 MA (2) - Where auditors report or intend to report to RBI under Section 45 MA(1) above, the matter should also be included in his report under section 143 of Companies Act, 2013.
- Section 45 MA(1A) - Empowers RBI to issue directions to NBFCs or auditors of NBFCs relating to Balance Sheet, Profit and Loss Account, disclosures or other matters.

4.40 RBI has also issued the Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016. According to these directions, the auditor, in addition to the report under Section 143 of the Companies Act, 2013, should also make a separate report to the Board of Directors on specific matters. Where the report is modified, the reasons therefore need to be given by the auditor.

4.41 In case the additional report to Board of Directors is modified, auditor under the aforesaid directions has an obligation to report the same directly to the RBI. It is an obligation directly cast on the auditor. Hence auditor is required to ensure that the exception report is addressed to the RBI and is submitted by him directly to RBI at the office located in the area where the company is situated.

4.42 The auditors need to report on whether the NBFC has obtained a Certificate of Registration. Some of the other matters to be reported to Board of Directors of Non Deposit taking NBFCs are as follows:

- Whether the Company is entitled to hold such Certificate of Registration;
- Whether the Board of Directors has passed a resolution for Non-Acceptance of any public deposits;
- Whether the Company has accepted any Public Deposit during the year/period;
- Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (both updated as on June 20, 2023);
- Whether the Company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts' impairment allowance on financial instruments under Ind AS 109 etc. applicable to it in terms of Non-Banking Financial

Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (both updated as on June 20, 2023);

- In case the NBFC is a Micro Finance Institution, whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016;
- Where any exemption is given from having certificate of registration, auditor has to report whether the requirements stipulated, while granting exemption from registration by the RBI, have been complied with.

4.43 In addition, for systemically important NBFCs (NBFC-SI-ND), the auditor also needs to comment on the correctness of Capital Adequacy Ratio (CAR) and conformity / compliance with the minimum Capital to Risk Assets Ratio (CRAR), disclosed in the return submitted to the RBI in Form NBS 7; and the adherence to timelines for furnishing NBS 7.

4.44 Additionally, the following matters are to be reported by the auditors to Board of Directors of deposit taking NBFCs:

- Whether public deposits (including unsecured non-convertible debentures/bonds and deposits from public/ shareholders in case of a public limited company) accepted are within the limits prescribed under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016. (Referred to as Public Deposits Directions);
- If the deposits accepted are in excess of limits prescribed above, whether the same has been regularized as per Public Deposit Directions;

- Whether the NBFC is accepting deposits without Minimum Investment Grade Credit Rating from an approved credit rating agency;
- Whether the NBFC has violated any restriction on acceptance of Public Deposit;
- Whether the credit rating is in force for each of the deposit schemes and deposits outstanding at any point of time during the year was within the limit prescribed by rating agency;
- Whether the company has defaulted in payment of interest and principal to depositors when such interest and/or principal became due;
- Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the Act and whether the company has intimated RBI about the designated bank in which approved securities are held by the company;
- Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;
- Whether the company has furnished NBS 1 return on deposits and the quarterly return on prudential norms within the stipulated time as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;
- Whether the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 with regard to opening of new branches and closing of existing branches.

4.45 In addition, Exception Reporting i.e. reporting only on instances of non-compliances is required to be made to the RBI for modified audit opinions, or comments on the specified matters or in the opinion of the auditor, there is non-compliance with

Chapter III-B of the RBI Act, 1934, Public Deposits Directions, NBFC Non-Systemically Important Non-deposit taking Company (Reserve Bank) Directions, 2016 and NBFC Systemically Important Non-deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. The auditor of NBFC should be familiar with Chapter III-B of the RBI Act, 1934 and the notifications issued thereon.

In addition to the above, the auditors are required to file an XBRL return for the NBFCs that they are auditing. The return has specific 42 questions for which the auditor is required to comment on. Also, it requires the auditor to comment on exceptions if any in relation to RBI Master Directions/ Notifications/ RBI Act, 1934 as the case may be.

4.46 The auditor should be aware of:

a) The RBI directions on auditor's report and any amendments therein.

b) In case of listed NBFCs, SEBI directions with regard to modifications in the audit report which are required to be filed with the stock exchange.

c) RBI guidelines on implementation of Indian Accounting Standards which now forms part of the RBI Master Directions.

d) NBFCs that are required to comply with Ind AS should present their financial statements in accordance with Division III of Schedule III to the Companies Act, 2013. Auditors should be aware of the instructions provided therein with regard to presentation and disclosure in the financial statements. Disclosures which are required to be made in accordance with Ind AS and RBI directions not forming part of the Division III are required to be given in the notes to financial statements. Auditors can refer to the "Guidance Note on Division III - Schedule III to the Companies Act, 2013 for NBFC that is required to comply with IND AS" issued by ICAI for reference.

4.47 While issuing certificates and reports other than the audit report, the auditor should consider the requirements of "Guidance

Note on Reports or Certificates for Special Purposes" issued by ICAI.

Appendices B and C to this Technical Guide contain specified audit reports and other reporting templates for the benefit of users.

Chapter 5
Areas of Audit Concern

5.1 The auditor needs to identify the assertions that are ordinarily of particular importance in relation to the typical items in an NBFC's financial statements. The following paragraphs describe some of the audit considerations that the auditor should be aware of, to plan substantive procedures and suggest some of the techniques that could be used in relation to the items selected by the auditor for testing. The procedures do not represent an exhaustive list of procedures that need to be performed, nor do they represent a minimum requirement that should always be performed. The auditor should also consider the compliance of accounting standards/Indian accounting standards (AS/Ind AS, as applicable to the NBFC) with regard to recognition, measurement and disclosure requirements.

5.2 Following are the key areas which the auditor should be aware of while conducting the audit of NBFCs.

A. Balances with Banks

5.3 The auditor should consider third party confirmations of the balance as persuasive audit evidence.

5.4 The auditor should understand and evaluate key controls in place to assess the operating effectiveness of key controls, on sample basis test check bank reconciliations and perform cut-off procedures. The auditor is also required to assess if there are any reconciling items impacting the loan balance/ interest income. The auditor should also review the reconciliation pertaining to escrow/ control accounts.

5.5 The auditor should consider whether the balances with other NBFCs as at the date of the financial statements represent bonafide commercial transactions or whether any significant variation from normal or expected levels reflect transactions entered into primarily to give a misleading impression of the financial position of the NBFC or to improve liquidity and asset ratios (often known as "window-dressing").

B. Money Market Instruments

5.6 The auditor should ensure that the money market operations of the NBFC is in accordance with the board approved policy in compliance with the RBI regulations.

The auditor should consider the need for physical inspection or confirmation with external custodians and the reconciliation of the related amounts with the accounting records.

5.7 The auditor should consider the feasibility of checking the receipt of the related income as a means of establishing ownership. The auditor should pay particular attention to establishing the ownership of instruments held in bearer form. The auditor also should consider whether there are any encumbrances on the title to the instruments.

5.8 The auditor should test for the existence of sale and forward repurchase agreements for evidence of unrecorded liabilities and losses.

5.9 The auditor should consider the appropriateness of the valuation techniques including estimates as employed by management.

5.10 The auditor should consider whether there is a need to test for accrual of income earned on money market instruments, which in some cases is through the amortization of a purchase discount.

5.11 The auditor also should consider whether:

- The relationship between the types of securities owned and the related income is reasonable; and
- All significant gains and losses from sales and revaluations have been reported in accordance with the financial reporting framework (for example, where gains and losses on trading

securities are treated differently from those on investment securities).

C. Other Financial Assets

5.12 The auditor should examine the underlying documentation supporting the purchase/sale of such assets in order to determine whether all rights and obligations, such as warranties and options, have been properly accounted for.

5.13 Additionally, the auditor should consider the appropriateness of the valuation techniques employed. Since there may not be established markets for such assets, it may be difficult to obtain independent evidence of value. Additionally, even where such evidence exists, there may be a question as to whether there is sufficient depth to existing markets to rely on quoted values for the asset in question and for any related off setting hedge transactions that the NBFC has entered into in those markets. The auditor should also consider the nature and extent of any impairment reviews that management has carried out and whether their results are reflected in the assets' valuations.

D. Financial Instruments (under Ind AS 109)

Recognition and initial measurement

5.14 Financial assets and liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Financial assets and liabilities are initially recognised at fair value on a trade date basis. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value measured on initial recognition of financial assets or financial liability. Transaction costs of financial instruments carried at fair value through profit or loss are expensed in profit or loss.

Classification and subsequent measurement

5.15 The entity assesses the classification and measurement of a financial asset based on the contractual cash flow characteristics of the asset and the entity's business model for managing the asset.

The entity subsequently classifies its financial assets in the following measurement categories:

- amortised cost
- fair value through profit or loss (FVTPL)
- fair value through other comprehensive income (FVTOCI)

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows. Financial assets are not reclassified subsequent to their initial recognition, except if and in the period the entity changes its business model for managing financial assets. A financial asset is measured at amortized cost using the Effective Interest Rate (EIR) method if it meets both of the following conditions:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All financial assets not classified and measured at amortized cost or FVTOCI as described above are measured at FVTPL. On initial recognition, the entity may irrevocably designate the financial assets that otherwise meet the requirements to be measured at amortized cost or at FVTOCI or at FVTPL, if doing so eliminates or significantly reduces the accounting mismatch that would otherwise arise.

All financial assets are classified and measured at FVTOCI if both of the following conditions are met:

- Financial assets that are held within a business model whose objective is achieved by both, selling financial assets and collecting contractual cash flows that are solely payments of principal and interest; and

- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Business model assessment

5.16 The entity should make an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed, and information is provided to management. If cash flows after initial recognition are realised in a way that is different from the entity's original expectations, the entity does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice;
- how the performance of the portfolio is evaluated and reported to the entity's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectation about future sales activity.

Reclassification

5.17 If the business model under which the entity holds financial assets changes, the financial assets affected are reclassified. The classification and measurement requirements related to the new category apply prospectively from the first day of the first reporting period following the change in business model that results in reclassifying the entity's financial assets. Changes in contractual cash flows are considered under the accounting policy on modification and derecognition of financial assets described below.

De-recognition or transfer of Financial Assets

5.18 The entity should derecognise a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred.

When the entity has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred substantially all of the risks and rewards of the asset, nor transferred control of the asset, the entity continues to recognise the transferred asset to the extent of the entity's continuing involvement. In that case, the entity should also recognise an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the entity could be required to repay.

Investments

5.19 In respect of investments held for trading, the auditor should consider the internal control considerations and audit procedures in respect of trading operations. Another important consideration would be to ensure that these are consistent with the investment policy of the company.

5.20 The auditor should consider physical inspection of securities or confirmation with external custodians and the reconciliation of the amounts with the accounting records.

5.21 The auditor should consider the feasibility of checking the receipt of the related income as a means of establishing ownership. The auditor should pay particular attention to establishing the ownership of securities held in bearer form. The auditor also should consider whether there are any encumbrances on the title to the securities.

5.22 The auditor should consider the requirements of Ind AS and applicable RBI guidelines with regard to accounting for financial instruments. Under Ind AS, investments fall under financial instruments category and its accounting will follow the accounting for financial instruments. The overall requirements are briefly summarised below:

i) The Board of directors of the Company should frame investment policy and implement the same.

ii) The classification of investment should be made at the time of making the investments.

Schedule III (Division III) requirement

5.23 Schedule III (Division III) of Companies Act, 2013 requires classification of investments under the following categories:

(a) Equity instruments

(b) Debt securities

(c) Government securities including treasury bills

(d) Other approved securities

(e) Investment in subsidiaries, associates and joint ventures

(f) Mutual fund

(g) Others

Schedule III (Division III) further requires that the investments are further classified as:

(a) Measured at amortised cost,

(b) Fair value through Other Comprehensive Income,

(c) Fair value through Profit or Loss, and

(d) Designated at fair value through Profit or Loss.

Additional disclosure of investments within and outside India is required to be provided.

Where the NBFC has used a basis other than amortised cost or fair value, the same may be included in column 'Others', with the basis of measurement to be disclosed as a footnote e.g. investment in subsidiaries measured at cost under Ind AS 27, "Separate Financial Statements" shall be classified under 'Others' in the Separate Financial Statements of the NBFC.

5.24 The impairment loss allowance as per Ind AS 109 should be disclosed as a separate line item under the sub-heads (measurement categories) mentioned above.

As per Division III of Schedule III, this amount should be disclosed separately. As per Ind AS 109, the company is required to recognize a loss allowance (i.e. impairment) for expected credit losses on investments measured at amortized cost. Such loss allowance should be presented as an adjustment to the amortized cost of the investment.

5.25 As per Ind AS 109, in case of debt investments measured at fair value through other comprehensive income, the fair value changes will be presented in other comprehensive income. A company should estimate a portion of fair value change, if any, attributable to a change in credit risk of such investment, by applying the impairment requirements of Ind AS 109 in recognising and measuring the loss allowance and disclose the same in the statement of profit and loss with a corresponding impact in other comprehensive income. In other words, the company shall not reduce/increase the carrying amount of such investment in the balance sheet on account of change in the credit risk as the investment needs to be presented at fair value. Disclosure pertaining to impairment shall be disclosed by way of Notes in accordance with the requirements of Ind AS 107, "Financial Instruments: Disclosures".

As per Ind AS 109, equity instruments measured at other than at cost and debt instruments measured at fair value through profit or loss do not require a separate evaluation of impairment amount. Hence, in such cases, the disclosure pertaining to impairment shall not be applicable.

For the purpose of disclosing aggregate impairment allowances in the value of investments, an entity shall disclose an amount equal to the aggregate amount of impairment recognized and measured in accordance with Ind AS 109, as stated in the paragraphs above.

The aggregate impairment allowances as per Ind AS 36, “Impairment of Assets” should be presented in totality, where relevant for each measurement category.

5.26 The auditor should inquire if the NBFC has obtained any valuation report in respect of any of its unquoted investments. The auditor should verify the appropriateness of the valuation and should consider whether any provision is required to be made for any diminution in the value of such unquoted investments. The auditor should follow the requirements of SA 500 “Audit Evidence” while using the work of management’s expert.

Table C: Fair Value hierarchy

Ind AS 113, “Fair Value Measurement” establishes a three level fair value hierarchy for inputs to measure fair value. They are.

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 - Inputs other than quoted prices included in Level 1 that are observable, either directly or indirectly

Level 3 - Unobservable inputs for assets or liability

The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

Investments in Subsidiaries and Associated Entities

5.27 In many cases the audit of an NBFC's investments in subsidiaries and associated entities does not differ from the audit of such investments held by any other entity.

5.28 The auditor should consider the implications of any legal or practical requirement for the NBFC to provide future financial support to ensure the maintenance of operations (and hence the value of the investment) of subsidiaries and associated entities. The auditor should consider whether the related financial obligations are appropriately recorded in the NBFC books.

5.29 The auditor should determine whether appropriate adjustments are made when the accounting policies of subsidiaries/associates accounted for on an equity basis or consolidated do not conform to accounting policies of the NBFC.

5.30 The auditor should be aware of the restrictions imposed on the kind of investments and the limits for such investments. These are usually prescribed in the prudential norms guidelines for NBFCs issued by RBI.

5.31 RBI vide its Master Direction - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 (Updated as on May 02, 2022) has imposed following restrictions:

(a) Restriction on investments in land and building and unquoted shares: This restriction is in respect of an investment and credit company (ICC) which is accepting public deposits. The regulations prohibit the ICC from investing in land and buildings beyond 10% of its owned fund except for its own use. ICC cannot invest in unquoted shares of another company, which is not a subsidiary company or a company in the same group of the non-banking financial company, an amount exceeding twenty per cent of its owned fund. Those land or building or unquoted shares which were acquired in satisfaction of debts shall be disposed off by the NBFC within a period of three years or within such period as extended by RBI. However, investment in an insurance company is not considered in the restriction imposed by RBI to the extent specifically permitted by the RBI.

(b) To lend and invest (loans/investments taken together) exceeding.

  (a) twenty five per cent of its owned fund to a single party; and

  (b) forty per cent of its owned fund to a single group of parties.

RBI has announced Scale based regulatory framework in this regard on October 22, 2021 which is applicable from October 1, 2022.

Notes:

(1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as illustrated in paragraph 2.18.

(2) The investments in debentures for the purposes specified in this paragraph shall be treated as credit and not investment.

(3) These ceilings shall be applicable to the credit/investment by such a non-banking financial company to companies/firms in its own group as well as to the borrowers/ investee company's group.

Table D: Impairment of financial assets

Loans

5.32 The auditor should consider the loan booking, approval and disbursement process, subsequent collections and collateral management. The auditor should also consider the appropriateness of impairment allowances/ provision for loan. The auditor should understand the laws and regulations that may influence the amounts determined by management. RBI's prudential norms and applicable Ind AS 109 (for NBFCs following Ind AS) provide guidance to NBFCs on recognition and measurement of loans, establishment of loan loss provisions, credit risk disclosure in financial statements and related matters. It sets out views on sound loan accounting and disclosure practices and so may influence the financial reporting framework within which an NBFC prepares its financial statements.

5.33 The major audit concern is the adequacy of the recorded provision for loan losses/ impairment losses on financial instruments and consequent impact on classification/staging of loans. In establishing the nature, extent and timing of the work to be performed, the auditor should consider the following factors:

- Know Your Client/Customer (KYC) procedures performed.
- Credit approval process including authorisation.
- Loan documentation obtained from the existing/prospective borrower, test check the documents for borrower's financial position/ credit worthiness.
- Internal credit rating assigned to borrower.
- Credit monitoring by credit committee.
- Scope and extent of work performed by internal audit department.
- Collateral coverage (if any).
- Given the relative importance of foreign lending, the auditor should ordinarily examine:
    - The information on the basis of which the NBFC assesses and monitors the country risk and the criteria (for example, specific classifications and valuation ratios) it uses for this purpose; and
    - Whether and, if so, by whom credit limits are set for the individual countries, what the limits are and the extent to which they have been reached.
- The auditor is also required to verify whether there has been any window dressing/ ever greening i.e., sanction of new loans to repay an existing doubtful loan. This method may be resorted to by the NBFC to cover up bad loans.
- For NBFCs following Ind AS 109, allowance for loan losses are determined using expected credit loss ('ECL') estimation model. Significant judgement is used in classifying financial assets and applying appropriate measurement principles and critical estimates involving greater level of management

judgement. Some of the key elements of estimating ECL are:

- The data inputs which have risk of completeness and accuracy.
- Use of inherently judgmental model which involves determining the probabilities of default loss given default and exposures at default.
- Auditor should focus on the judgement in the modelling approach including the following areas:
  - Qualitative and quantitative factors used in staging the financial assets (e.g. loan assets) measured at amortised cost;
  - Basis used for estimating probabilities of default ('PD'), loss given default ('LGD') and exposure at default ('EAD') at product level with past trends;
  - Judgements used in projecting economic scenarios and probability weights applied to reflect future economic conditions; and
  - Adjustments to model driven ECL results to address emerging trends. ECL model thus requires several data inputs and the auditor has to ensure completeness and accuracy of the data.

E. Accounts with Depositors

(i) General

5.34 The auditor should assess the system of internal control over accounts with depositors. The auditor should also consider obtaining confirmation and performing analytical procedures on average balances and on interest expense to assess the reasonableness of the recorded deposit balances.

5.35 The auditor should determine whether deposit liabilities are classified in accordance with regulations and relevant accounting principles.

5.36 Where deposit liabilities have been secured by specific assets, the auditor should consider the need for appropriate disclosure.

5.37 The auditor should also consider the need for disclosure where the NBFC has a risk due to economic dependence on a few large depositors or where there is an excessive concentration of deposits due within a specific time period.

(ii) Deposits in transit

5.38 The auditor should determine whether items in transit between branches, between the NBFC and its consolidated subsidiaries, and between the NBFC and counterparties, are eliminated and that reconciling items have been appropriately addressed and accounted for.

5.39 Additionally, the auditor should examine individual items comprising the balance that have not been cleared within a reasonable time period and should also consider whether the related internal control procedures are adequate to ensure that such items have not been temporarily transferred to other accounts in order to avoid their detection.

F. Capital and Reserves

5.40 Banking regulators pay close attention to NBFC's capital and reserves in monitoring the level of an NBFC's activities and in determining the extent of its operations. Small changes in capital or reserves may have a large effect on an NBFC’s ability to continue operating, particularly if it is near to its permitted minimum capital ratios. In such circumstances there are greater pressures for management to engage in fraudulent financial reporting by miscategorising assets and liabilities or by describing them as being less risky than they actually are.

5.41 The auditor should consider whether NBFC’s capital and reserves are adequate for regulatory purposes (for example, to meet capital adequacy requirements), the disclosures have been appropriately made and that the disclosures are both appropriate and in accordance with the applicable financial reporting framework. Auditors are required to report on a wide range of disclosures about the NBFC's capital and its capital ratios, either because that information is included in the financial statements or because there is requirement to make a separate report to regulatory supervisors.

5.42 In addition, where applicable regulations provide for restrictions on the distribution of retained earnings, the auditor should consider whether the restrictions are adequately disclosed and complied with.

G. Income Recognition under Ind AS 115, "Revenue from Contracts with Customers"

5.43 The financial reporting framework i.e. recognised accounting principles would guide the income recognition. Illustrative accounting policy is given below:

- **Interest income** shall be accounted for by using the effective interest rate (EIR) method. Interest income is recorded using the EIR method for all financial instruments measured at amortised cost. The EIR is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial instrument.

  The EIR (and therefore, the amortised cost of the asset) is calculated by taking into account any discount or premium on acquisition, commission, fees and costs incrementally and directly attributable to the specific lending arrangement. The NBFC shall recognize interest income using a rate of return that represents the best estimate of a constant rate of return over the expected life of the financial asset. The future cash flows are estimated taking into account all the contractual terms of the asset. If expectations regarding the cash flows on the financial asset are revised for reasons other than credit risk, the adjustment is booked as a positive or negative adjustment to the carrying amount of the asset in the balance sheet. The adjustment is subsequently amortized in the statement of profit and loss. When a financial asset becomes credit impaired subsequent to initial recognition, the NBFC shall calculate interest income by applying the effective interest rate to the amortised cost (net of provision) of the financial asset. If the financial assets are cured and are no longer credit impaired, the NBFC can revert to calculating interest income on a gross basis. Interest income on financial assets classified as FVTPL shall be recognized at contractual interest rate of financial instruments.

- **Fee income** (**Loan processing fee/document fees/stamp fees)** which are an integral part of financial assets shall be recognized through effective interest rate over the term of the loan. For the agreements foreclosed or transferred through assignment, the unamortized portion of the fee shall be recognized as income in the statement of profit and loss at the time of such foreclosure/transfer through the assignment.

- **Dividend income** shall be recognized as and when the right to receive payment is established.

- **Net gain from financial instruments at FVTPL** which represents difference between the carrying amount of a financial instrument at the beginning of the reporting period, or the transaction price if it was purchased in the current reporting period, and its settlement price shall be recognized in the statement of profit and loss on trade date basis. The unrealised gain which represents the difference between the carrying amount of a financial instrument at the beginning of the period, or the transaction price if it was purchased in the current reporting period, and its carrying amount at the end of the reporting period shall be recognized in the statement of profit and loss at each reporting date.

- **Rendering of services** i.e. revenue from contracts with customers to be recognized based on a five step model as set out in Ind AS 115 to determine when to recognize revenue and at what amount. Revenue is measured based on the consideration specified in the contract with a customer and excludes amounts collected on behalf of third parties. Revenue from contracts with customers is recognized when services are provided and it is highly probable that a significant reversal of revenue is not expected to occur. If the consideration promised in a contract includes a variable amount, NBFC shall estimate the amount of consideration to which it will be entitled in exchange for rendering the promised services to a customer. An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.

- In case of Asset Reconstruction Companies (ARC) following Ind AS, RBI vide its circular RBI/2022-23/182DOR. ACC.REC.No. 104/21.07.001/2022-23 dated February 20, 2023 on Implementation of Indian Accounting Standards (Ind AS) has issued following clarification to address the prudential concerns arising from continued recognition of unrealised income by such ARCs. Accordingly following amounts shall be reduced from the net owned funds while calculating the capital adequacy ratio and the amount available for payment of dividend:

  (a) Management fee recognised during the planning period that remains unrealised beyond 180 days from the date of expiry of the planning period.

  (b) Management fee recognised after the expiry of the planning period that remains unrealised beyond 180 days of such recognition.

  (c) Any unrealised management fees, notwithstanding the period for which it has remained unrealised, where the net asset value of the security receipts has fallen below 50 per cent of the face value.

The amount reduced from net owned funds and amount available for payment of dividend shall be net of any specific expected credit loss allowances held on unrealised management fee referred to in sub-paragraphs (a), (b) and (c) above and the tax implications thereon, if any.

Table E - Income recognition under Notified AS

Income Recognition

The financial reporting framework i.e. recognised accounting principles would guide the income recognition. Sample accounting policy is given below:

- Income including interest/discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.
- Leased and Hire purchase assets, where instalments are overdue for more than 3 months or more, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.
- Income from investments:
  - Income from dividends on shares of corporate bodies and units of mutual funds shall be taken into account on a cash basis. Provided where dividend has been declared by the corporate in its annual general meeting, income can be recognised on accrual basis where the NBFC's right to receive the payment is established.
  - Income from securities, bonds, and debentures of corporate bodies and from Government securities/bond has to be accounted on an accrual basis provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.
  - Where the principal and interest is guaranteed by the Government, income is to be accounted on accrual basis.

5.44 *Securitisation/ Factoring/ Assignment Transactions:*

A company primarily funds its operations through external term loans from banks and financial institutions. As a means of financing, the company enters into transactions like factoring, securitisation and assignment, with certain banks and financial institutions. The accounting in the instant case would be driven by the Indian accounting standards for NBFCs following Ind AS and for NBFCs complying with notified AS, the accounting will be driven by the "Guidance Note on Accounting for Derivatives (Revised 2021)" issued by ICAI. As per RBI guidelines, NBFC are required to have in place a Financial Asset Acquisition Policy which covers valuation of assets and factorisation. The direct 'assignment' transactions are usually different from both securitisation and factoring and are largely driven by the industry practice and the agreement. NBFCs following accounting standards are required to amortise the gain on assignment as per RBI guidelines whereas NBFCs following Indian Accounting Standards are required to record it upfront as per requirements of Ind AS 109. The assignment agreement plays an important role in determining the appropriate accounting and thus auditors are required to closely monitor those agreements supplemented with a high level of documentation. Auditor should also consider the compliance requirements given in the Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 dated September 24, 2021. (Updated as on December 05, 2022) in respect of securitisation transactions and the Factoring Regulation Act, 2011 and the regulations issued thereunder in respect of factoring transactions.

Table F: Audit procedures

Perform the following with regard to the revenue recognition policies (perform in conjunction with revenue audit area): • update understanding of the company's accounting policies for recording revenue; • determine whether the policy is consistent with prior years and is reasonable in light of the industry; • determine whether the policy is consistent with regulatory requirements. In respect of deferred revenue balances at year-end, obtain the

desired level of assurance by performing the following:

a) for selected account balances, examine supporting invoices and/or contracts and determine the services provided;

b) based on the company's revenue recognition policies, verify the amount of revenue that should be deferred and amortized at year-end for the particular services provided; and

c) test to ensure that the deferred revenue balance was recorded at the appropriate amount by tracing to the detailed deferred revenue listing.

Where significant comfort has been obtained from controls, review the results of analytical procedures and the results of test of controls and, where appropriate, select account balances and test deferred revenue balances at year-end by performing steps (a) to (c) above.

In case of complex transactions, where no financial reporting guidelines exist, auditor needs to be extra careful while discharging his obligation and he may resort to following approach:

- Exercise due care in evaluating the terms of the agreement entered between the Banks/Financial Institutions and the company to understand vesting of the rights, title and interest of the loan portfolio is assigned to the purchaser (i.e. the Bank/Financial Institutions) by the company. Understanding the roles & responsibilities of the company post assignment agreement i.e. whether the company is acting only as a "Collection Agent".
- Giving due consideration to diverse industry practices.
- In absence of any reporting guidelines prescribed, it would be appropriate to draw reference to the existing generally accepted accounting principles.
- Evaluating whether based on the agreement it would be appropriate to de-recognise the portfolio on the assignment as the company transfers the associated risk and reward and show the collateral amount as "receivable" under "current asset".
- In cases where the company does not retain any effective

control and substantial risk/reward has been transferred to the assignee and is acting as collection agent, whether income or loss arising on assignment of portfolio have been recognised upfront.

- Extent of disclosures given in the financial statements and whether it can be concluded to be appropriate.

H. RBI prudential norms for income recognition, classification as NPAs

5.45 RBI issues guidelines containing norms for recognition of income, provisioning for bad debts and classification of such debts in the financial statements of NBFCs, investment valuation, accounting for investments, capital adequacy norms etc. The master directions issued by RBI consolidate requirements of various notifications issued on various aspects regulated by RBI.

5.46 For NBFCs following Notified AS, provision under Income Recognition, Asset Classification and Provisioning (IRACP) is made in accordance with RBI prudential norms. NBFCs following Ind AS are required to recognise impairment allowances as required by Ind AS. However, such NBFCs also need to maintain asset classification and compute provisions as per RBI prudential norms. A comparison (as per the template given in Appendix E to this Technical Guide) between provisions required under IRACP and impairment allowances made under Ind AS 109 should be disclosed by NBFCs in the notes to their financial statements to provide a benchmark to their Boards, RBI supervisors and other stakeholders, on the adequacy of provisioning for credit losses. The auditor should verify recognition of expected credit losses as per the requirements of Ind AS 109 in the financial statements. It is imperative that the auditor carefully analyses the provisioning requirements and performs audit procedures to obtain audit evidence on correct categorisation of financial instruments as per Ind AS 109. For the purpose of assessing the need for creating impairment reserve for short provision, if any, as per Ind AS 109 as compared to the provisioning required as per RBI guidelines, auditor should understand the categorisation of financial instruments as standard asset, substandard asset, doubtful asset and loss asset and also including standard asset in correct SMA 0, SMA 1 and SMA 2 buckets. The auditor should verify whether appropriate approval is obtained from the RBI for withdrawal from such reserve. Auditor should be aware of these requirements given in following RBI guidelines:

1. Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.
2. Non-Banking Financial Company Systemically Important Non-Deposit taking Company and Deposit taking company (Reserve Bank) Directions, 2016.

The links to aforesaid Master directions are given in the **Appendix F** to this Technical Guide. These directions can also be downloaded from RBI website (**www.rbi.org.in**).

Every NBFC shall recognise incipient stress in loan accounts, immediately on default, by classifying such assets as special mention accounts (SMA) as per the following categories:

- SMA-0 - Principal or interest payment or any other amount wholly or partly overdue upto 30 days.
- SMA-1 - More than 30 days and upto 60 days.
- SMA-2 - More than 60 days and upto 90 days.

The above instructions on SMA classification of borrower accounts are applicable to all loans, including retail loans, irrespective of size of exposure of the lending institution.

The date of SMA/NPA shall reflect the asset classification status of an account at the day-end of that calendar date and shall be done as part of day-end process for the relevant date.

Example given in the Master Directions is reproduced below:

If due date of a loan account is March 31, 2021, and full dues are not received before the lending institution runs the day-end process for this date, the date of overdue shall be March 31, 2021. If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running the day-end process on April 30, 2021 i.e. upon completion of 30 days of being continuously overdue. Accordingly, the date of SMA-1 classification for that account shall be April 30, 2021.

Similarly, if the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on May 30, 2021 and if continues to remain overdue further, it shall get classified as NPA upon running day-end process as per extant asset classification norms.

While determining the NPA status of a borrower, auditor should verify whether the borrower whose account has become NPA, is enjoying any other facilities. As per the RBI Master directions, in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower / beneficiary is treated as NPA when any of the above credit facilities becomes non-performing asset (NPA).

In case of borrowers having more than one credit facility, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities. With regard to upgradation of accounts classified as NPA due to restructuring, non-achievement of date of commencement of commercial operations (DCCO), etc., the instructions as specified for such cases shall continue to be applicable. Auditor should refer to the RBI circular RBI/2021-2022/125-DOR.STR.REC.68/21.04.048/2021-22 dated November 12, 2021 Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances - Clarifications.

I. Restructuring Norms

An NBFC is required to create provision as per the restructuring guidelines given in Annex VI to the RBI Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

5.47 A restructured account is one where the NBFC, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the NBFC would not otherwise consider. Restructuring would normally involve modification of terms of the advances / securities, which would generally include, among others, alteration of repayment period / repayable amount / the amount of instalments / rate of interest (due to reasons other than competitive reasons).

5.48 Any change in the terms due to financing difficulty of the borrower or borrower cannot make payment on existing terms will be termed as restructuring for the purpose mentioned above.

5.49 However, extension in repayment tenor of a floating rate loan on reset of interest rate, so as to keep the EMI unchanged provided it is applied to a class of accounts uniformly will not render the account to be classified as 'Restructured account'. In other words, extension or deferment of EMIs to individual borrowers as against to an entire class, would render the accounts to be classified as 'restructured accounts'.

5.50 Further in case where there are changes in the loan repayment terms like EMI, tenor or interest rate which is in normal course of business and that facility is available to all borrowers uniformly then it will not be termed as restructuring of the loan facility.

5.51 In the cases of roll-over of short term loans, where proper pre-sanction assessment has been made, and the roll-over is allowed based on the actual requirement of the borrower and no concession has been provided due to credit weakness of the borrower, then these might not be considered as restructured accounts. However, if such accounts are rolled-over more than two times, then third roll-over onwards the account would have to be treated as a restructured account. Besides, NBFCs should be circumspect while granting such facilities as the borrower may be availing similar facilities from other banks / creditors in the consortium or under multiple banking. Further, short term loans for the purpose of this provision do not include properly assessed regular working capital loans like revolving cash credit or working capital demand loans.

Ind AS 109 requirements for modification in contractual cash flows in a financial asset

5.52 A modification of a financial asset occurs when the contractual terms governing the cash flows of a financial asset are renegotiated or otherwise modified between initial recognition and maturity of the financial asset. A modification affects the amount and/or timing of the contractual cash flows either immediately or at a future date. In addition, the introduction or adjustment of existing covenants of an existing loan would constitute a modification even if these new or adjusted covenants do not yet affect the cash flows immediately but may affect the cash flows depending on whether the covenant is or is not met (e.g. a change to the increase in the interest rate that arises when covenants are breached).

When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.

For the modified financial assets, the date of modification will be the date of initial recognition of that financial asset.

5.53 If the contractual cash flows on a financial asset have been renegotiated or otherwise modified, but the financial asset is not derecognised, that financial asset is not automatically considered to have lower credit risk. For example, a history of missed or incomplete payments would not typically be erased by simply making one payment on time following a modification of the contractual terms.

Assets Classification upon Restructuring

5.54 Once the account is restructured as discussed above, its classification will get change as below:

1. If a standard asset is restructured the accounts should be immediately reclassified as 'sub-standard assets' upon restructuring.

2. The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule.

3. Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the NBFC should be upgraded only when all the outstanding loan/facilities in the account perform satisfactorily during the period of one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium under the terms of restructuring package.

Income Recognition Norms on Restructured Assets

5.55 Interest income in respect of restructured accounts classified as 'standard assets' will be recognized on accrual basis and that in respect of the accounts classified as 'non-performing assets' will be recognized on cash basis.

Provision on Restructured Advances

5.56 (i) An NBFC shall create provision as per the extant provisioning norms (Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016).

(ii) Restructured accounts classified as standard advances shall attract a higher provision (as prescribed from time to time) in the first two years from the date of restructuring. In cases of moratorium on payment of interest/ principal after restructuring, such advances shall attract the prescribed higher provision for the period covering moratorium and two years thereafter.

(iii) Restructured accounts classified as non-performing advances, when upgraded to standard category shall attract a higher provision (as prescribed from time to time) in the first year from the date of upgradation.

(iv) Additional provision should be made for diminution in the fair value of the restructured advances since it is an economic loss for the NBFC.

J. Special Mention Accounts

5.57 RBI issued a circular dated March 21, 2014- 'Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy' (circular updated from time to time) which would be fully effective from April 1, 2014. The circular has outlined a corrective action plan that will incentivize early identification of problem account, timely restructuring of accounts which are considered to be viable, and taking prompt steps by lenders for recovery or sale of unviable accounts.

5.58 The said circular provides corrective action plan to arrest increasing of NPA cases, means to identify accounts based on early recognition of stress and Reporting to Central Repository of Information on Large Credits (CRILC).

5.59 However, as soon as an account is reported as SMA -2 as per the circular by one or more lending banks/notified NBFCs, this will trigger the mandatory formation of a Joint Lenders' Forum (JLF) and formulation of Corrective Action Plan (CAP) as envisioned in Para 2.3 of the Framework for Revitalising Distressed Assets in the Economy.

K. Foreign Direct Investment & External Commercial Borrowings

a. Foreign Direct Investment (FDI)

Link: https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf

(Auditor should refer the most recent circular from the website: www.dipp.nic.in)

5.60 Foreign Investment in Investing Companies registered as Non-Banking Financial Companies (NBFC) with the RBI, being overall regulated, would be under 100% automatic route.

5.61 Foreign Investment in Core Investment Companies (CICs) and other investing companies, engaged in the activity of investing in the capital of other Indian company(ies)/LLPs, is permitted under Government approval route. CICs will have to additionally follow RBI's regulatory framework for CICs.

Note: Foreign Investment into other Indian companies/LLPs would be in accordance/ compliance with the relevant sectoral conditions on entry route, conditionalities and caps.

5.62 For Financial Services activities regulated by RBI or other financial regulators, 100% FDI is permitted under automatic route subject to following conditions:

a) The entities should adhere to minimum capitalisation norms as specified by the respective financial regulators (like RBI, SEBI, PFRDA, NHB, IRDAI).

b) The NBFC activities are regulated by the respective financial regulators (otherwise it will be under approval route).

c) Investment limits will be restricted to the limits if any prescribed in any other Act applicable to NBFC.

d) Downstream investments by any of these entities engaged in "Other Financial Services" will be subject to the extant sectoral regulations and provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, as amended from time to time.

5.63 Under the Foreign Direct Investments (FDI) Scheme, investments can be made in equity shares, compulsorily and mandatorily and fully convertible debentures and compulsorily and mandatorily and fully convertible preference shares of an Indian company by non-residents through two routes:

i. Automatic Route: Under the Automatic Route, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Government of India for the investment subject to compliance of the prescribed requirements.

ii. Approval Route: Under the Approval Route, the foreign investor or the Indian company should obtain prior approval of the Government of India (Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be) for the investment.

The investments should be in compliance with the relevant guidelines of the RBI.

b. External Commercial Borrowings (ECBs)

Link:

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11510#22

Brief requirements are given below. Auditor should refer to the most recent RBI master directions on external commercial borrowings for understanding the ECB regulation framework.

Automatic route

5.64 As per Master Direction - External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers (Updated as on November 22, 2018) issued by the RBI, the individual limits of ECB that can be raised by eligible entities under the automatic route per financial year is USD 750 million or equivalent for Non-Banking Financial Companies-Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies, up to USD 100 million or equivalent for entities engaged in micro finance activities; and up to USD 500 million or equivalent for remaining entities. ECB proposals beyond aforesaid limits will come under the approval route. The aforesaid Master Direction prescribes terms and conditions in respect of availment of ECB by NBFCs.

L. Susceptibility to Fraud and diversion of funds

5.65 As per Section 447 of the Companies Act, 2013,“Fraud” in relation to the affairs of a company or any body corporate, includes any act, omission, concealment of any fact, or, abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain, or any wrongful loss.

5.66 The Reserve Bank of India, in one of its reports "Report of the Working Group on Electronic Banking" (chapter 6-Cyber Fraud) has defined the term "fraud" as under.

"A deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of accounts maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank".

RBI Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016 has classified the types of frauds mainly based on the provisions of the Indian Penal Code (Refer paragraph 1 under chapter III of aforesaid Master Direction).

5.67 SA 240 defines fraud as: – "An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."

5.68 There are various kinds of frauds that can be committed on the NBFCs. It includes:

a) Fake KYC documents submitted for opening a fraudulent account.

b) Stolen cheques and forged signatures.

c) In this digital era, the common fraud that is rising is digital fraud which involves enticing the customers and getting access to the digital data to hack and withdraw funds from the customer accounts.

d) Loan fraud- loan sanctioned without appropriate documents or sufficient securities, loan sanctioned in collusion with NBFC management to ineligible customers.

e) Forged documents placed as security against sanctioned loans.

f) Fraudulent removal of hypothecated security without NBFC's knowledge and inflating the value of security and availing excess finance from the lending NBFC.

g) Money Laundering Fraud**:** This type of fraud is committed by concealing the existence, source or use of illegally obtained money, by converting the cash into untraceable transactions in NBFC.

h) Fraud that can be perpetrated by the NBFC could be evergreening of borrower accounts to avoid being classified as a defaulter.

5.69 The primary responsibility for the prevention and detection of fraud is that of both those charged with governance of the entity and management. As the fraud incidents can result in material impact on financial statements, auditor should evaluate the emphasis laid by the management and those charged with governance on fraud prevention, which may reduce opportunities for fraud to take place, mechanism to deter frauds which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.

5.70 The auditor should further verify whether there is whistle blower mechanism in place and inquire into the incidents that have been reported and the action taken by the Management especially from fraud perspective.

Auditor should verify whether background screening checks for employee joining are in place. Auditor should examine the robustness of anti-fraud controls and staff accountability, especially its relevance and its impact thereof on financial statements. The auditor should inquire if there are mechanisms for reporting to the RBI and verify Action Taken Report (ATR) in respect of all red flagged accounts / fraud accounts.

5.71 Auditor should also examine related party transactions and borrower group accounts to examine if there are any diversion of funds. NBFCs should have a mechanism to create one single unique identification ID for various facilities availed by an entity and also other entities under the same management. This will facilitate in assessing classification of the account as standard or otherwise. Auditor may also verify significant intra group transactions of the group in NBFC accounts to check if there had been any flight of funds or funds being used for other than intended purposes. Auditor may also check the transactions of the NBFC with its related parties and ensure they are in compliance with the extant laws and regulations.

M. Reporting under Rule 11(e) of the Companies (Audit and Auditors) Rules 2014

5.72 Rule 11(e) is reproduced below:

"(e) (i) Whether the management has represented that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

(ii) Whether the management has represented, that, to the best of it's knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate

Beneficiaries") or provide any guarantee, security or the like on behalf of the ultimate Beneficiaries; and

(iii) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material misstatement."

The rule 11(e)(i) requires management to represent that, other than the disclosure in the notes to accounts, the company has not acted as a funding party and used an intermediary for advancing, loaning, investing funds to an ultimate beneficiary identified by the company or has provided any guarantee, security or the like on behalf of the ultimate beneficiary.

The management is also required to represent in terms of rule 11(e)(ii) that they have not acted as an intermediary for advancing, loaning, investing funds to an ultimate beneficiary identified by the funding party or has not provided any guarantee/ security or the like on behalf of the funding party.

Disclosure requirements

Any company having entered into such transactions is required to make following disclosure in the financial statements:

As a funding party:

(I) date and amount of fund advanced or loaned or invested in intermediaries with complete details of each intermediary.

(II) date and amount of fund further advanced or loaned or invested by such intermediaries to other intermediaries or ultimate beneficiaries alongwith complete details of the ultimate beneficiaries.

(III) date and amount of guarantee, security or the like provided to or on behalf of the ultimate beneficiaries.

(IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act, 2013 has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering Act, 2002.

As an intermediary

(I) date and amount of fund received from funding parties with complete details of each funding party.

(II) date and amount of fund further advanced or loaned or invested other intermediaries or ultimate beneficiaries alongwith complete details of the other intermediaries' or ultimate beneficiaries.

(III) date and amount of guarantee, security or the like provided to or on behalf of the ultimate beneficiaries

(IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 and Companies Act, 2013 has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002.

The above requirement will also be applicable for a branch audit. Where the transactions are non-funded between the funding party and intermediary and between intermediary and the ultimate beneficiary, the rule will not be applicable. However, if one leg of transaction is funded, the rule will become applicable.

5.73 Auditor's responsibilities

Auditor is required to perform procedures and examine the appropriateness of such representations of the management and report whether anything has come to his notice that would cause him to believe that the representation is materially misstated.

The auditor may come across a situation when there is no written understanding to suggest that the intermediary is lending or investing on behalf of the funding party. Auditor may look at the timing of the two transactions and even if there is a time lag, auditor should inquire and evaluate before concluding.

There could be cases where the funding is received by the intermediary in one year and the amount is advanced to the ultimate beneficiary in the subsequent period. The auditor needs to carefully evaluate the timing for reporting under Rule 11(e) under various scenarios. In this regard, the auditor should consider the disclosure requirements by the company under Schedule III to the Companies Act, 2013 and align his reporting with such disclosure requirements. The auditor should examine the underlying records to determine if the transaction is in the nature of providing security or guarantee or the like.

For detailed guidance on this aspect, the auditor should refer to the "Implementation Guide on Reporting under Rule 11(e) and Rule 11(f) of the Companies (Audit and Auditors) Rules, 2014" issued by the Auditing and Assurance Standards Board of ICAI.

N. CARO 2020 –Reporting Requirements

5.74 The Central Government has issued the Companies (Auditor's Report) Order, 2020 (CARO, 2020) on 25th February 2020. CARO 2020 has been issued in supersession of CARO 2016. However, the scope of applicability of CARO 2020 vis-à-vis CARO 2016 remains unchanged.

Many of the requirements of CARO 2020 are relevant for NBFCs. The auditor should refer to the "Guidance Note on the Companies (Auditor's Report) Order, 2020" issued by ICAI for complying with the reporting requirements of CARO 2020.

O. Digital Lending Guidelines

5.75 RBI has come out with "Guidelines on Digital Lending" vide its Circular RBI/2022-23/111DOR.CRE.REC.66/ 21.07.001/ 2022-23 dated September 2, 2022. In the circular, it is reiterated that outsourcing arrangements entered by Regulated Entities (REs) with a Lending Service Provider (LSP)/ Digital Lending App (DLA) does not diminish the REs' obligations and they shall continue to conform to the extant guidelines on outsourcing. The REs are advised to ensure that the LSPs engaged by them and the DLAs (either of the RE or of the LSP engaged by the RE) comply with the guidelines contained in this circular. Refer link below:

https://rbidocs.rbi.org.in/rdocs/notification/PDFs/GUIDELINESDIGITALLENDINGD5C35A71D8124A0E92AEB940A7D25BB3.PDF

The Guidelines refer to customer protection and conduct requirements with regard to loan disbursal, servicing and repayment, collection of fees etc. Auditor should refer to the aforesaid Guidelines for understanding the operational aspect of digital lending. NBFCs are required to report lending done through digital platform to credit information company irrespective of its nature and tenor.

Chapter 6
Operations of an NBFC

Treasury Operations

6.1 Treasury operations of NBFC represent all activities relating to the purchase, sale, borrowing and lending of financial instruments. Financial instruments may be securities, money market instruments or derivative instruments. Investment companies/ NBFCs usually enter into such transactions for their own use (for example, for the purpose of hedging risk exposures) or for meeting customers' needs. They also carry out, to a larger or smaller extent, trading activities. Trading may be defined as the purchase and sale (or origination and closing) of financial instruments (including derivatives) with the intention of deriving a gain from the change in market price parameters (for example, foreign exchange rates, interest rates, equity prices) over time. NBFCs manage and control their treasury activities on the basis of the various risks involved rather than on the basis of the particular type of financial instrument dealt with. The auditor is required to consider the audit implications of derivatives acquired by the NBFC. The management of NBFCs need to base their business decisions on a dynamic and integrated risk management system and process, driven by corporate strategy. NBFCs are exposed to several major risks in the course of their business - credit risk, interest rate risk, equity / commodity price risk, liquidity risk and operational risk. It is, therefore, important that NBFCs introduce effective risk management systems that address the issues relating to interest rate and liquidity risks.

6.2 The auditor needs to check that the NBFC/ investment companies have well documented investment policy describing the nature of treasury operations proposed to be undertaken by the company as well as setting out the limits / authorisation for such operations. RBI Master Direction 2016 on both Non-Systemically Important Non-Deposit taking NBFC and Systemically Important Non Deposit Taking NBFC and Deposit taking NBFC provides guidelines on liquidity risk management. Though it is not mandatory for NBFCs with asset size below Rs. 100 crores, RBI has recommended the guidelines to be adopted on voluntary basis by all NBFCs.

The guidelines deal with following aspects of the Liquidity Risk Management framework.

A. Liquidity Risk Management Policy, Strategies and Practices – Required to ensure that NBFC has and maintains sufficient liquidity in its operations and is also able to withstand stress situations like loss or impairment of secured and unsecured funding sources. Key elements of liquidity risk management framework are:

i) Governance of Liquidity Management- which has to emanate from the top management.

ii) Liquidity risk tolerance that is appropriate for its business strategy and ensure sufficiency of liquidity in the system.

iii) Quantify the liquidity cost and benefit analysis.

iv) Off balance sheet exposure and contingent liabilities.

v) Funding strategy - Diversified funding.

vi) Collateral position management.

vii) Stress testing.

viii) Contingency funding plan.

ix) Public disclosure.

x) Intra group exposures.

B. Management Information System (MIS) – MIS is to be designed in such a way that it provides timely and forward looking information on the liquidity position to the Asset Liability Management Committee and the Board.

C. Internal Controls - Appropriate internal controls, systems and procedures are required to ensure adherence to liquidity risk management policies and procedure.

D. Maturity profiling is required to assess the future cash flows in different time buckets.

E. Liquidity Risk Measurement – Stock Approach - NBFCs are required to monitor certain critical ratios in this regard by putting in place internally defined limits as approved by their Board. The ratios and the internal limits are based on an NBFC's liquidity risk management capabilities, experience and profile. An indicative list of certain critical ratios to monitor are short-term liability to total assets; short term liability to long term assets; commercial papers to total assets; non-convertible debentures (NCDs) (original maturity of less than one year) to total assets; short-term liabilities to total liabilities; long-term assets to total assets; etc.

F. Currency Risk arising out of volatility in exchange rates having impact on NBFCs with foreign assets or liabilities.

G. Managing Interest Rate Risk which may severely impact the NBFC's earnings and the financial condition of the NBFC.

H. Liquidity Risk Monitoring Tools.

Auditor should go through the risk management policy and examine the stress indicators in such analysis carried out by the NBFC. This would give an indication on the impact on the financial statements of the NBFC. Refer Liquidity Risk Management Framework for Non-Banking Financial Companies and Core Investment Companies for details at the below link.

https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11719#ANA

In addition to the above, NBFC Systemically Important Non Deposit and Deposit taking NBFCs are required to comply with Guidelines on liquidity coverage ratio as given in Annexure III of Master Directions - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

Liquidity coverage ratio is represented by stock of high quality liquid assets/total net cash outflows over the next 30 calendar days.

Internal Controls in treasury operations

6.3 The auditor should obtain an understanding of internal controls in treasury operations. The auditor should look out for significant risks that may arise on account of significant non routine transactions or judgmental matters. Such risks could exist because of greater management intervention to specify the accounting treatment or greater manual intervention for data collection and processing. Generally, treasury operations involve transactions that are recorded in IT systems. The identification of IT dependencies and the evaluation of related IT risks is an integral part of the audit process. Information technology general controls (ITGC) are used to manage the IT activities and computer environment. ITGC policies and procedures relate to many applications and support the effective functioning of IT dependencies. IT dependencies include automated control procedures or manual controls that are dependent on IT, system generated reports, calculations within automated applications, security that facilitates the segregation of duties and automated interfaces among applications. ITGCs help auditors to determine the continued reliability of information generated by applications and check for consistency in operations of automated applications.

General audit procedures

6.4 Certain audit procedures apply to the environment in which treasury activities are carried out. To understand this environment, the auditor initially should obtain an understanding of the scale, volume, complexity and risk of treasury activities. The auditor is required to understand the importance of treasury activities relative to other business of the NBFC and should understand the framework within which the treasury activities take place.

6.5 Once the auditor has obtained this understanding and has performed tests of controls with satisfactory results, the auditor should ordinarily perform substantive tests to assess the accuracy of the recording of transactions entered into during the period and related profits and losses. The auditor may examine:

- the deal tickets and confirmation slips;
- the completeness of transactions and proper reconciliation between the front office and accounting systems of open positions at the period end;
- the existence of outstanding positions by means of third party confirmations at an interim date or at the period end;
- the appropriateness of the exchange rates, interest rates or other underlying market rates used at the period end date to calculate unrealized gains and losses;
- the appropriateness of the valuation models and assumptions used to determine the fair value of financial instruments outstanding as at the year end; and
- the appropriateness of the accounting policies used particularly around income recognition and the distinction between hedged and trading instruments.

Relevant aspects of treasury operations that generally pose increased audit risks are addressed below.

Changes in products or activities

6.6 Particular risks often arise where new products or activities are introduced. To address such risks the auditor should initially seek to confirm that predefined procedures are in place for these cases. Generally, the entity should commence such activities only when the smooth flow of the new transactions through the controls system is ensured, the relevant IT systems are fully in place (or where adequate interim system support is in place) and the relevant procedures are properly documented. Newly traded instruments are ordinarily subject to careful review by the auditor, who should initially obtain a list of all new products traded during the period (or a full list of all instruments transacted). Based on this information, the auditor should establish the associated risk profile and seek to confirm the reliability of the internal control and accounting systems.

Reliance on Computer Experts

6.7 Due to the volume of transactions, virtually all NBFCs/investment companies support the treasury transactions cycle using IT systems. Due to the complexity of systems in use and the procedures involved, the auditor should ordinarily seek the assistance of IT experts to supply appropriate skills and knowledge in the testing of systems and relevant account balances. Auditor is also required to seek assistance from IT experts when the NBFCs application system undergoes a change.

6.8 With the growing complexity and size of NBFCs, dependency on systems has increased and there are expectations of enhanced safety, security, efficiency in system based operations. RBI also has acknowledged need to focus on IT Governance, IT Policy, Information & Cyber Security, IT Operations, IS Audit, Business Continuity Planning and IT Services Outsourcing. RBI has issued Master Direction on Information Technology Framework for the NBFC sector vide its circular RBI/DNBS/2016-17/53 Master Direction DNBS.PPD.No.04/66.15.001/2016-17 dated June 08, 2017.

NBFCs are required to report to RBI on cyber incidents like:

a) Outage of critical IT systems

b) Cyber security incidents

c) Theft or loss of information

d) Outage of infrastructure related to IT Systems

NBFCs are also required to report on the impact of such incidents and root cause analysis.

Auditor should inquire and go through such reporting to evaluate impact of deficiency in the IT systems on financial statements.

6.9 *Guidelines on Liquidity Risk Management Framework*

(Applicable to Non-deposit taking NBFCs with asset size of Rs.100 crore and above, systemically important Core Investment Companies and all deposit taking NBFCs (except Type I NBFC-

ND, Non-Operating Financial Holding Company and Standalone Primary Dealer)

Applicable NBFCs are required to explain its risk management strategy for each risk category of risk exposures as per Ind AS 107 “Financial Instruments: Disclosures”. This explanation should enable users of financial statements to evaluate (for example):

(a) how each risk arises.

(b) how the entity manages each risk; and why.

(c) the extent of risk exposures that the entity manages.

Purpose for which transactions are undertaken

6.10 The auditor should consider whether the NBFC holds speculative positions in financial instruments or hedges them against other transactions. The purpose for entering such transactions, whether hedging or trading, should be identified at the inception stage in order for the correct accounting treatment to be applied. Where transactions are entered for hedging purposes, the auditor should consider the appropriate accounting treatment and presentation of such transactions and the matched assets/liabilities, in accordance with relevant accounting requirements.

Valuation procedures

Table G: Determination of Value of Instruments

The auditor might test valuation of all instruments as of the date of the financial statements. The auditor might test transactions on dates selected from the period under audit for agreement with the values computed by the company. The extent of those tests should be based on the auditor's judgment after considering the tolerable misstatement, the assessed risk of material misstatement, and the degree of assurance the auditor plans to obtain. Extent of testing could also depend upon the fair value hierarchy of inputs for measurement.

When investments are valued by the NBFC using a valuation model (including an internally developed matrix pricing model), the auditor should obtain an understanding of the NBFC's process for determining fair value, including:

- controls over the process used to determine fair value measurements, including, for example, controls over data and the segregation of duties between investment management functions and those responsible for undertaking the valuations;
- the expertise and experience of those determining fair value measurements;
- the role of information technology in the valuation process, including the integrity of change controls and security procedures for valuation models and information systems;
- significant assumptions used in determining fair value, as well as the process used to develop and apply management's assumptions, including whether management used available market information in order to develop the assumptions;
- documentation supporting management's assumptions;
- controls over the consistency, timeliness, completeness and reliability of data used in valuation models; and
- the role of the company's board of directors in establishing valuation policies, and the conformity of the valuation model with those policies, consistent with the guidelines issued by the concerned regulating authority.

6.11 The auditor should ordinarily test the valuation models used, including the controls surrounding their operation, and consider whether details of individual contracts, valuation rates and assumptions are appropriately entered into such models. Many of these instruments/ contracts have evolved in the recent past and hence, while testing their valuation, the auditor should bear the following factors in mind:

- There may be no legal precedents concerning the terms of the underlying agreements. This makes it difficult to assess the enforceability of those terms.
- There may be a relatively small number of management personnel who are familiar with the inherent risks of these instruments. This may lead to a higher risk of misstatements occurring and a greater difficulty in establishing controls that would prevent misstatements or detect and correct them on a timely basis.

6.12 Some of these instruments have not existed through a full economic cycle (bull and bear markets, high and low interest rates, high and low trading and price volatility) and it may therefore be more difficult to assess their value with the same degree of certainty as for more established instruments. Similarly, it may be difficult to predict with a sufficient degree of certainty the price correlation with other offsetting instruments used by the NBFC to hedge its positions.

6.13 There can be situations when the market conditions are not normal leading to high volatility in valuation rates. The models used for valuing such instruments may not operate properly in such conditions. The complexity of certain instruments requires specialised skill and knowledge. If the auditor does not have the professional competence to perform the necessary audit procedures, advice is sought from experts in this field.

6.14 A further issue of particular interest to the auditor is transactions entered into at rates outside the prevailing market rates; these often involve the risk of hidden losses or fraudulent activity. The auditor should obtain sufficient appropriate audit evidence concerning the reliability of such rates. The auditor should consider reviewing a sample of the identified transactions.

The Credit Function

6.15 The credit function may conveniently be divided into the following categories:

- Origination and disbursement.

- Monitoring of Collections.
- Periodic review and evaluation.

Origination and Disbursement

6.16 The auditor should consider whether the NBFC has obtained complete and informative loan applications, including financial statements of the borrower, the source of the loan repayment and the intended use of proceeds. For this purpose, NBFC should have written guidelines as to the criteria to be used in assessing loan applications (for example, interest coverage, margin requirements, debt-to-equity ratios etc.). Where required the NBFC should obtain credit reports or have independent investigations conducted on prospective borrowers.

6.17 The auditor should verify whether the NBFC has procedures in place to ensure that related party lending has been identified. This is important as there is requirement to comply with RBI guidelines on credit concentration norms and related party disclosure requirements.

Planning

6.18 The auditor should obtain knowledge and understanding of the NBFC's method of controlling credit risk. This includes matters such as the following:

- The NBFC's exposure monitoring process and its system for ensuring that all related party lending has been identified and aggregated.
- The NBFC's method for appraising the value of exposure, collateral and for identifying potential and definite losses.

The NBFC's lending practices and customer base

6.19 The auditor should consider whether the exposure review program ensures independence from the lending functions including whether the frequency is sufficient to provide timely information concerning emerging trends in the portfolio and general economic conditions and whether there is increased review frequency for credits identified as problematic.

6.20 The auditor should consider the qualifications of the personnel involved in the credit review function. The auditor should consider whether credit review personnel possess the knowledge and skills necessary to manage and evaluate lending activities.

6.21 The auditor should consider, through information previously generated, the causes of existing problems or weaknesses within the system. The auditor should consider whether these problems or weaknesses present the potential for future problems. The auditor should review management reports and should consider whether they are sufficiently detailed to evaluate risk factors.

6.22 It is difficult to define and audit related party lending transactions because the transactions with related parties are not easily identifiable. Reliance is primarily upon management to identify all related parties and related-party transactions and such transactions may not be easily detected by the NBFC's internal control systems. The auditor should obtain an understanding as to how management identifies, records and monitors related party transactions. The auditor should challenge management’s process and test key controls in identification, accounting and reporting of related party transactions.

Tests of control

6.23 The auditor should obtain knowledge and understanding of the NBFC's method of controlling credit risk. This includes matters such as:

- The portfolio exposure and the various features and characteristics of the exposures;
- The exposure documentation used by the NBFC;
- What constitutes appropriate exposure documentation for different types of exposures; and

- The NBFC's procedures and authority levels for granting an exposure.

6.24 The auditor should review the lending policies and consider:

- Whether the policies are reviewed and updated periodically to ensure they are relevant with changing market conditions; and
- Whether those charged with governance have approved the policies and whether the NBFC is in compliance with policies.

6.25 The auditor should examine the exposure review reporting system, including credit file memoranda and an annual schedule or exposure review plan, and should consider whether it is complete, accurate and timely and whether it will provide sufficient information to allow management to both identify and control risk. The auditor should consider whether the reports include:

- Identification of credits identified as problematic in terms of compliance of terms and conditions of lending and collections;
- Current information regarding portfolio risk; and
- Information concerning emerging trends in the portfolio and lending areas.

6.26 The auditor should consider the nature and extent of the scope of the exposure review, including the following:

- Method of exposure selection.
- Manner in which exposures are reviewed including:
    - An analysis of the current financial condition of the borrower which addresses repayment ability, and
    - Tests for documentation exceptions, policy exceptions, non-compliance with internal procedures, and violations of laws and regulations.

6.27 The auditor should consider the effectiveness of the credit administration and portfolio management by examining the following:

- Management's general lending philosophy in such a manner as to elicit management responses;
- The effect of credits not supported by current and complete financial information and analysis of repayment ability;
- The effect of credits for which exposure and collateral documentation are deficient;
- The volume of exposures improperly structured, for example, where the repayment schedule does not match exposure purpose;
- The volume and nature of concentrations of credit, including concentrations of classified credits (NPAs);
- The appropriateness of transfers of low quality credits to or from another affiliated office;
- The accuracy and completeness of credit monitoring reports;
- Competency of senior management and credit department personnel.

Substantive procedures

6.28 The auditor should consider the extent of management's knowledge of the NBFC's own credit exposure problems through selective exposure file reviews. Selection criteria include the following:

- Accounts with an outstanding balance equal to or greater than a specified amount.
- Accounts on a "Watch List" with an outstanding balance in excess of a specified amount.
- Accounts with a provision in excess of a specified amount.

- Accounts that are handled by the department that manages the higher risk accounts.
- Accounts where principal or interest of more than a specified amount is in arrears for more than a specified period.
- Accounts where the amount outstanding is in excess of the authorized credit line/limit.
- Accounts with entities operating in industries or countries that the auditor's own general economic knowledge indicates could be at risk.
- Problem accounts identified by the NBFC's regulatory authorities and problem accounts selected in the prior year.

6.29 In addition, where the NBFC's personnel have been requested to summarize characteristics of all exposures over a specified size grouped on a connection basis, the auditor should review the summaries. Exposures with the following characteristics may indicate a need for a more detailed review:

- Large operating loss in the most recent fiscal year.
- Sustained operating losses (for example, 2 or more years).
- A high leveraged facility (for example, debt equity ratio in excess of 2:1 - the ratio will vary by industry).
- Failure to comply with terms of agreements and covenants.
- Modified audit report.
- Information provided is not current or complete.
- Advances significantly unsecured or secured substantially by a guarantee.
- Accounts where reviews not performed by NBFC's management on a timely basis.

6.30 The auditor should select the exposures for detailed review from the exposure listings above using the sample selection criteria determined above and obtain the documents necessary to consider the collectability of the exposures. These may include the following:

- The exposure and security documentation files.
- Arrears listings or reports.
- Activity summaries.
- Previous doubtful accounts listings.
- The non-current exposure report.
- Financial statements of the borrower.
- Security valuation reports.
- Analyse exposures to borrowers in SMA 01 and SMA 02 categories as there could be potential increase in loss allowances in such accounts.

6.31 Using the exposure documentation file, the auditor should:

- Ascertain the exposure type, interest rate, maturity date, repayment terms, security and stated purpose of the exposure;
- Consider whether security documents bear evidence of registration as appropriate, and that the NBFC has received appropriate legal advice about the security's legal enforceability;
- Consider whether the fair value of the security appears adequate (particularly for those exposures where a provision may be required) to secure the exposure and that where applicable, the security has been properly insured. Critically evaluate the collateral appraisals, including the appraiser's methods and assumptions;
- Evaluate the collectability of the exposure and consider the need for a provision against the account;

- Determine whether the appropriate authority levels within the NBFC have approved the exposure application or renewal;
- Review periodic financial statements of the borrower and note significant amounts and operating ratios (i.e., working capital, earnings, shareholders' equity and debt-to-equity ratios); and
- Review any notes and correspondence contained in the exposure review file. Note the frequency of review performed by the NBFC's staff and consider whether it is within NBFC’s guidelines.

6.32 In addition to assessing the adequacy of the loss allowances against individual exposures, the auditor should consider whether any additional provisions need to be established against particular categories or classes of exposures (for example, credit card exposures and country risk exposures) and assess the adequacy of any provisions that the NBFC may have established through discussions with management.

6.33 The auditor should review the contractual arrangements with counter parties and evaluate the obligations of the NBFC, to check whether the NBFC is acting as a principal or as an agent in relation to services it provides based on nature of substance of transactions and compliance with relevant RBI guidelines. The obligation of the NBFC and the provision on exposures would depend upon such principal or agency relationship.

Chapter 7
Governance

7.1 The need for best practices and greater transparency, to protect the interests of the stakeholders in the corporate sector has led to the specification of corporate governance guidelines by RBI. Listed NBFCs which are required to adhere to LODR Regulations, 2015 are already required to comply with SEBI prescriptions on corporate governance.

7.2 In order to enable NBFCs to adopt best practices and greater transparency in their operations, all the NBFCs are required to have a board approved policy in place for ascertaining the 'fit and proper' status of directors, not only at the time of appointment, but also on a continuous basis. Systemically important and deposit taking NBFCs are required to comply with corporate governance and disclosure requirements as envisaged in the Master Directions-Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

7.3 Though it is not a duty of the auditor to ensure compliance with corporate governance norms, it would be appropriate for the auditor to understand the corporate governance structure of the NBFC. This may assist the auditor in communications with management and those charged with governance and also in evaluating the internal controls in the NBFC.

7.4 Key highlights of the corporate governance and disclosure requirements are as follows:

Table H: Auditors may consider following with regard to internal governance and reporting

Audit Committee
• Audit Committee as required under Section 177 of the Companies Act, 2013 shall be audit committee for the purpose of these guidelines.
• Review written audit committee charter.

- Sufficiency of length of audit committee meetings and level of discussion to accomplish the committee's objectives.
- Understanding among audit committee, management, NBFC's chief compliance officer, internal auditors and independent auditors to provide constructive feedback on each other's performance, and identify improvements that can be made to enhance each party's effectiveness.
- Means used to keep current with NBFC industry, regulatory and auditing/ accounting/ tax developments affecting responsibilities of audit committee members (continuing education).
- Sufficiency of audit committee's relationships and meetings (general and private session) and other interactions with management, NBFC's chief compliance officer and internal and independent auditors.
- Mutual understanding among the audit committee, NBFC's chief compliance officer and internal and external auditors of expected communications about matters requiring special or immediate attention.
- Review/approve any written report/disclosure made in public filings of audit committee activities.
- Internal auditor's observations concerning:
    - internal control over financial reporting, including management's procedures for monitoring service providers' controls;
    - management's and service providers' ability to maintain adequate internal control over financial reporting during periods of higher growth and activity or increase in the number of services or complexity of their investments; or, alternatively, due to cost reduction programs resulting from declining revenues and profitability;
    - communication protocols between NBFC accounting and reporting functions and other service providers;
    - errors in NAV/per share, their causes, and any corrective actions taken as a result;
    - areas where alternative or extended audit procedures were required because of inadequate records or controls;

and

- sufficiency and timeliness of improvements to internal control over financial reporting made as a result of recommendations provided in current or prior audits.

Internal Control over Compliance with Laws and Regulations

- Non-compliance with laws and regulations could have a material effect on financial statements:
  - scope of work performed or oversight or advice provided in such areas by management, compliance staff, internal and external counsel.
- Significant elements of the annual review of the NBFC's compliance program administered by its chief compliance officer, including (i) those elements pertaining to service providers; (ii) the nature and extent of forensic testing performed; and (iii) findings and any corrective actions taken or necessary to take.
- Significant changes in compliance policies and procedures.
- Status of any legal matters (if any) that could have a material effect on the financial statements.
- Procedures used to identify potential conflicts of interest and ways in which such circumstances are managed and disclosed.
- Unusual or non-recurring transactions with affiliates, and/or other related parties, including nature and extent of related disclosures:
- Procedures for identifying and recording unusual revenue items, such as litigation settlements.
- Identification and review of related party transactions and adequacy of disclosures.
- Nature and extent of information appearing in shareholder report outside of financial statements.
- Assurance that independent auditor received full cooperation from all parties relevant to the audit and no restrictions were placed on his work.

Board Committees

As part of harmonisation, the constitution of the three Committees of the Board and instructions with regard to rotation of partners have now been made applicable to all NBFCs-ND-SI, as also all NBFCs-D. Other NBFCs are encouraged to observe such practices, if already being followed.

In addition, the audit committee of all NBFCs-ND-SI, as also all NBFCs-D must ensure that an Information Systems Audit of the internal systems and processes is conducted at least once in two years to assess operational risks faced by the company.

Fit and Proper Criteria for Directors

With the increasing integration of NBFCs in the financial sector and their growing systemic significance, it has become important that the directors and shareholders who are responsible for steering the affairs of the companies are fit and proper, besides having the necessary qualifications.

NBFCs shall ensure that there is a policy put in place for ascertaining the fit and proper criteria at the time of appointment of directors and on a continuing basis. The policy on the fit and proper criteria should be on the lines of the Guidelines contained in Annex XIII of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (updated as on June 20, 2023). It is also applicable to Core Investment companies.

https://rbidocs.rbi.org.in/rdocs/content/pdfs/45MD01092016_AN1.pdf

A declaration in the format provided in Annexure XIV shall be obtained from directors. In addition, directors shall sign a Deed of Covenant as provided in Annexure XV.

NBFCs are required to furnish to the Reserve Bank a quarterly statement on change of Directors certified by the auditors (for the quarter ended March 31 only) and a certificate from the Managing Director that fit and proper criteria in selection of directors have been followed. The statement must be furnished to the concerned

Regional Office within 15 days of the close of the quarter.

Constitution of Nomination Committee

The importance of appointment of directors with 'fit and proper' credentials is well recognised in the financial sector. In terms of Section 45-IA(4)(c) of the RBI Act, 1934, while considering the application for grant of Certificate of Registration to undertake the business of non-banking financial institution it is necessary to ensure that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interest of its depositors. All applicable NBFCs are required to form a Nomination Committee to ensure 'fit and proper' status of proposed/ existing directors. The Nomination Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in section 178 of the Companies Act, 2013.

Constitution of Risk Management Committee

The market risk for NBFC-ND-SI and NBFC with public deposits as on the date of last audited balance sheet is addressed by the Asset Liability Management Committee (ALCO) constituted to monitor the asset liability gap and strategize action to mitigate the risk associated. To manage the integrated risk, a risk management committee shall be formed, in addition to the ALCO in case of the above category of NBFCs.

Governance Guidelines prescribed by the Scale Based Regulatory Framework

The recent revised regulatory framework for NBFCs issued by RBI also provides for Governance Guidelines.

The guidelines prescribe constitution of risk management committee for base layer NBFCs and propose to expand disclosure requirements and restrictions on loan to directors, senior officers and relatives of the directors.

For NBFCs in middle layer and Upper layer, the guidelines prescribe the following:

Key managerial person in the NBFC is restricted from holding any office including directorship in any other NBFC-ML and NBFC -UL and a time limit of 2 years is provided for compliance with these norms.

Within the permissible limits in terms of the Companies Act, 2013, Independent directors in NBFC ML and UL cannot be on the board of more than three NBFCs (ML or UL) at the same time. A time limit of 2 years is provided for compliance with these norms. No such restriction is prescribed for NBFCs at Base layer. However, the provisions of the Companies Act, 2013 would be applicable.

Disclosures: With effect from March 31, 2023, following disclosures are required to be given in the annual financial statements. These are in addition to the other required disclosures:

i. Corporate Governance report containing composition and category of directors, shareholding of non-executive directors, etc.

ii. Disclosure on modified opinion, if any, expressed by auditors, its impact on various financial items and views of management on audit qualifications.

iii. Items of income and expenditure of exceptional nature.

iv. Breaches in terms of covenants in respect of loans availed by the NBFC or debt securities issued by the NBFC including incidence/s of default.

v. Divergence in asset classification and provisioning above a certain threshold to be decided by the Reserve Bank.

NBFC ML and UL are required to have Chief Compliance Officer and a policy should be in place defining his roles and responsibilities.

There should be a nomination and remuneration committee and board approved policy for compensation.

Asset Liability Management (ALM)

As part of ALM, NBFCs have to form Board appointed committee (ALCO) to monitor periodically the asset liability position. The ALCO consisting of the NBFC's top management shall be responsible for ensuring adherence to the risk tolerance/ limits set by the Board as well as implementing the liquidity risk management strategy of the NBFC and this Committee is to be headed by CEO/MD or ED of the NBFC. The role of the ALCO with respect to liquidity risk should include, inter alia, decision on desired maturity profile and mix of incremental assets and liabilities, sale of assets as a source of funding, the structure, responsibilities and controls for managing liquidity risk, and overseeing the liquidity positions of all branches. The auditor is advised to study the findings of the committee in the management of asset liability position of the company which may provide useful information to them in arriving at an opinion on the state of affairs of the company.

Fair Practices Code

RBI has prescribed the broad guidelines on fair practices code that are to be framed and approved by the Board of Directors of all NBFCs. The fair practices code so framed and approved by the Board of Directors needs to be published and disseminated on the website of the company, if any, for the information of the public. The auditor should verify the compliance in this regard in carrying out his audit. The provisions of the guidelines on fair practices code are briefly discussed as under.

Applications for loans and their processing

- Loan application forms should include necessary information which affects the interest of the borrower.
- Loan application forms should indicate the documents required to be submitted with the application form.
- NBFCs should have a system of giving acknowledgement for receipt of all loan applications.

Loan appraisal and terms/conditions

- NBFCs should convey in writing to the borrower by means of sanction letter or otherwise and keep the acceptance of the same.
- A copy of the loan agreement along with a copy each of all

enclosures required in the loan agreement should be furnished to all the borrowers.

Disbursement of loans including changes in terms and conditions

- NBFCs should give notice to the borrower of any change in the terms and conditions.
- NBFCs should release all securities on repayment of all dues or on realisation of the outstanding amount of loan subject to any legitimate right or lien for any other claim the NBFCs may have against the borrower.

General

- In case of receipt of request from the borrower for transfer of borrowal account, the consent or otherwise i.e. objection of the NBFC, if any, should be conveyed within 21 days from the date of receipt of request.
- In the matter of recovery of loans, the NBFCs should not resort to undue harassment, *viz.,* persistently bothering the borrowers at odd hours, use of muscle power for recovery of loans, etc.
- The Board of Directors of NBFCs should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard.
- The Board of Directors should also provide for periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of management.

A consolidated report of such reviews may be submitted to the Board at regular intervals, as may be prescribed by it.

Repossession of assets

- In respect of repossession of assets financed by the NBFC, the auditor should verify as to whether the contract /loan agreement does contain provisions regarding:
  (a) notice period before taking possession;
  (b) circumstances under which the notice period can be waived;

(c) procedure for taking possession of the security;

(d) provision regarding final chance to be given to the borrower for repayment of loan before the sale / auction of the property;

(e) procedure for giving repossession to the borrower; and

(f) procedure for sale / auction of the property.

Rotation of partners of the statutory auditors / audit firm

The need for good corporate governance has been gaining increased emphasis over the years. Globally, companies are adopting best corporate practices to increase the investors' confidence as also that of other stakeholders. Scrutiny of the books of account conducted by auditors rotated periodically would add further value in strengthening corporate governance.

All applicable NBFCs (NDSI, Deposit holding NBFC, MFI, IDF, IFC and Factor NBFCs) stipulate rotation of partners of audit firms appointed for auditing the company. The partner/s of the audit firm conducting the audit could be rotated every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. Companies may incorporate appropriate terms in the letter of appointment of the firm. All NBFCs need to inform RBI (to the same office as applicable to UCBs,) about the appointment of SCAs/SAs for each year by way of a certificate in Form A within one month of such appointment.

RBI has issued Guidelines for Appointment of Statutory Central Auditors (SCAs)/Statutory Auditors (SAs) of Commercial Banks (excluding RRBs), UCBs and NBFCs (including HFCs). These guidelines are applicable for NBFCs except ND NBFC with asset size less than Rs. 1000 crores.

Link:
https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12079&Mode=0

The guidelines prescribe joint audit of a minimum of two firms for conducting the statutory audit of NBFCs with asset size of Rs.

15000 crores and above as at the end of previous year. NBFC should decide on the number of SCAs/SAs based on a Board/Local Management Committee (LMC) Approved Policy, inter alia, taking into account the relevant factors such as the size and spread of assets, accounting and administrative units, complexity of transactions, level of computerization, availability of other independent audit inputs, identified risks in financial reporting, etc.

Guidelines also prescribe the eligibility criteria for auditors, their independence, professional standards guiding the auditors, tenure and rotation of the auditors keeping their independence in mind.

Auditors of NBFCs covered under these guidelines can be appointed for a continuous period of three years and are not eligible for reappointment in the same entity for a period of six years.

Risk-Based Internal Audit (RBIA)

7.5 RBI vide its notification RBI/2020-21/88 Ref.No.DoS.CO.PPG./ SEC.05 /11.01.005 /2020-21 dated February 3, 2021-Risk Based Internal Audit has mandated RBIA framework for the following NBFCs:

- All deposit taking NBFCs, irrespective of their size; and
- All Non-deposit taking NBFCs (including Core Investment Companies) with asset size of Rs. 5,000 crore and above.

The framework was required to be implemented by March 31, 2022 in accordance with the Guidelines on Risk-Based Internal Audit provided in the Annex to aforesaid notification.

Auditor should obtain and examine the observations in the risk based internal audit report and assess its impact on the statutory audit of the applicable NBFC.

Chapter 8
Miscellaneous

Applicability of Other Laws

8.1 The auditor should consider the applicability of other laws while checking the transactions entered by the NBFC. These laws include the Indian Contracts Act 1872, the Sale of Goods Act 1930, the Indian Stamp Act 1899, the Negotiable Instruments Act 1881, the Motor Vehicles Act 1961, the Limitation Act 1963, the Insolvency and Bankruptcy Code 2016 and the Central, State and Integrated Goods and Services Tax Act, 2017 as amended from time to time.

Opening and Closing of Branches

8.2 NBFCs need to comply with the provisions contained in Master Direction - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 regarding opening and closing of branches/ offices by NBFCs which are entitled to accept public deposits. As per the Directions applicable to all NBFCs, NBFC shall open its branch or appoint agents to collect deposits only on fulfilling following criteria:

- NBFC should have a certificate of registration from RBI.
- If net owned funds are upto Rs. 50 crore it can open a branch within the State where its registered office is situated. For net owned funds more than Rs. 50 crore and with a credit rating AA and above, NBFC is permitted to open branches anywhere in India.
- NBFC shall notify RBI about its proposal to open the branch.

While closing its branch, NBFC should publish such an intention in the newspaper and should notify RBI three months before the proposed closure.

NBFCs are required to submit quarterly return on branch within 10 days of expiry of the relative quarter in specified format.

Inspection by RBI

8.3 NBFCs are subject to inspection by RBI under section 45N of the RBI Act, 1934. Where any exceptions are noted during inspections, NBFCs are required to rectify the same and report compliance.

The auditor should examine the inspection report and consider the exceptions noted in such inspection reports.

Listed NBFCs under SEBI purview

8.4 NBFCs which are listed in stock exchanges are also required to comply with rules and regulations issued by the Securities and Exchange Board of India (SEBI). These NBFCs need to adhere to LODR Regulations 2015 and the disclosure requirements as applicable to the kind of securities listed with the stock exchanges.

ICAI Announcement on NBFCs dated September 18, 2007

8.5 Based on communication received from RBI, ICAI has made an announcement to its members on September 18, 2007 listing out certain irregularities in NBFCs which are required to be reported by the auditors but one or more of them have not been reported by some auditors. The auditor should be aware of the list of irregularities pointed out by the RBI. The full text of the announcement is given in **Appendix F** to this Technical Guide.

Know Your Customer (KYC) / Anti Money Laundering (AML) Norms

8.6 In terms of the provisions of the Prevention of Money Laundering Act, 2002 and the Prevention of Money Laundering Rules, 2005, as amended from time to time by the Government of India, Regulated Entities (REs) are required to follow certain customer identification procedures while undertaking a transaction either by establishing an account-based relationship or otherwise and monitor their transactions. In this respect, the RBI introduced norms for KYC and AML to be followed by the NBFCs in carrying out business transactions of accepting deposits and lending to customers. NBFCs are required to frame KYC policy with regard to customer identification procedures and acceptance policy. NBFC needs to comply with the filing of Suspicious Transaction Report (STR) to Financial Intelligence Unit – India in case if NBFC does not satisfy true identity of the customer. NBFC also needs to submit Cash Transaction Report (CTR). The auditor should verify the policy maintained by the NBFC and also periodical reports furnished by the principal officer of the NBFC to the RBI to ensure that all the requirements are complied with in this regard.

8.7 In respect of AML norms, the NBFC has to classify its customers into high, medium and low risk category taking into account their identity, social/ financial status, nature of business activity, occupation etc., with reference to money laundering activities as specified in the RBI guidelines. The NBFC also needs to report suspicious transactions such as receipt of huge volume in cash from customers and also all cash transactions above a specified limit say Rs.10 lakh in a month from a customer. The auditor should verify the compliance by the NBFC in this regard.

Auditor should refer to the RBI Master Direction on KYC Norms which are applicable for all NBFCs for detailed understanding of the requirements.

Link:https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11566

Non-Banking Financial Company - Micro Finance Institutions (NBFC-MFIs) – Directions – Channelizing Partners Requirements

8.8 NBFC-MFIs acting as channelizing agents for schemes operated by the Central/ State Agencies shall abide by the guidelines issued in Non-Banking Financial Company–Non

Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016. For instance, loans given as channelizing agent shall be considered as a separate business segment and is not considered for determining the threshold of microfinance loans. Such loans will be subject to prudential norms and asset classification and income recognition unless the MFI is not bearing credit risk.

Appendices

Appendix A

Illustrative Audit Checklist

Controls checklist

Strategic controls

Have those charged with governance established a formal policy for the NBFC's treasury business that sets out:

- The authorized activities and products the investment company can trade;
- The procedures for measuring, analyzing, supervising and controlling risks;
- The extent of risk positions permissible, after taking into account the risk they regard as acceptable;
- The appropriate limits and procedures covering excesses over defined limits;
- The procedures, including documentation, that must be complied with before new products or activities are introduced;
- The type and frequency of reports to those charged with governance;
- The schedule and frequency, with which the policy is reviewed, updated and approved; and
- Compliance with regulatory requirements.

Operational controls

- Is there appropriate segregation of duties between the front office and back office?
- Are the following activities conducted independently of the front office/business unit:
  - Confirmation of trades;
  - Recording and reconciliation of positions and results;

  - Valuation of trades or independent verification of market prices; and
  - Settlement of trades?
- Does the NBFC have a code of conduct for its dealers that addresses the following:
  - Prohibiting dealers from trading on their own account;
  - Restricting acceptance of gifts and entertainment activities;
  - Confidentiality of customer information;
  - Identification of approved counterparties; and
  - Procedures for the review of dealers' activities by management?
- Are remuneration policies structured to avoid encouraging excessive risk taking?
- Are new products entered only after appropriate approvals are obtained and adequate procedures and risk control systems are in place?

Limits and trading activity

- Does the NBFC have a comprehensive set of limits in place to control the market, credit and liquidity risks for the whole institution, business units and individual dealers? Some commonly used limits are notional or volume limits (by currency or counterparty), stop loss limits, gap or maturity limits, settlement limits and value-at-risk limits (for both market and credit risks)?
- Are limits allocated to risks in line with the overall limits of the NBFC which may be based on regulatory requirement?
- Do all dealers know their limits and the use thereof? Does every new transaction reduce the available limit immediately?
- Are procedures in place that cover excesses over limits?

Risk measurement and management

- Is there an independent risk management function (sometimes referred to as Middle Office) for measuring, monitoring and controlling risk? Does it report directly to those charged with governance and senior management? Assess if there are any independence related issues.

- Which method is employed to measure the risk arising from trading activities (for example, position limits, sensitivity limits, value at risk limits, etc.)? Is the method employed is in line with treasury risk management policy?
- Are the risk control and management systems adequately equipped to handle the volume, complexity and risk of treasury activities?
- Does the risk measurement system cover all portfolios, all products and all risks?
- Is appropriate documentation in place for all elements of the risk system (methodology, calculations, parameters)?
- Are all trading portfolios revalued and risk exposures calculated regularly, at least daily for active dealing operations? How actively treasury head evaluates daily profit and loss position and associated risks?
- Are risk management models, methodologies and assumptions used to measure risk and to limit exposures regularly assessed, documented and updated continuously to take account of altered parameters, etc?
- Are stress situations analyzed and "worst case" scenarios (which take into account adverse market events such as unusual changes in prices or volatilities, market illiquidity or default of a major counterparty) conducted and tested?
- Does management receive timely and meaningful reports? How management uses reports?
- Are decisions documented / agreed and communicated among decision makers in a timely manner?
- How frequently risk committee, treasury committee meet and whether actions taken/ decisions recorded in the minutes of such meetings.

Confirmations

Does the NBFC have written procedures in use:

- For the independent receipt of all incoming confirmations and their matching to pre-numbered copies of internal trade tickets;
- For independent comparison of signatures on incoming confirmations to specimen signatures;
- For the independent confirmation of all deals for which no inward confirmation has been received; and
- For the independent follow-up of discrepancies on confirmations received?

Settlement of transactions

- Are settlement instructions exchanged in writing with counterparties by the use of inward and outward confirmations?
- Are settlement instructions compared to the contracts?
- Are settlements made only by appropriate authorized employees independent of the initiation and recording of transactions and only on the basis of authorized, written instructions?
- Are all scheduled settlements (receipts and payments) notified daily in writing to the settlement department so that duplicate requests and failures to receive payments can be promptly detected and followed-up?
- Are accounting entries either prepared from or checked to supporting documentation by operational employees, other than those who maintain records of uncompleted contracts or perform cash functions?

Recording

- Are exception reports generated for excesses in limits; sudden increases in trading volume by any one trader, customer or counterparty; transactions at unusual contract rates, etc? Are these monitored promptly and independently of the dealers?
- The daily reconciliation of dealer's positions and profits with the accounting records and the prompt investigation of all differences.

- Regular reports to management in appropriate detail to allow the monitoring of the limits referred to above.
- Does the NBFC have an accounting system that allows it to prepare reports that show its spot, forward, net open and overall positions for the different types of products, for example:
  - By purchase and sale, by currency;
  - By maturity dates, by currency; and
  - By counterparty, by currency?
- Are open positions revalued periodically (for example, daily) to current values based on quoted rates or rates obtained directly from approved independent sources?

Credit function checklist

- Are loan approval limits based on the overall credit policy and lending officer's authority and experience?
- Is appropriate lending committee or board of director approval required for loans exceeding prescribed limits?
- Is there appropriate segregation of duties between the loan approval function and the loan disbursement, monitoring, collection and review functions?
- Is the ownership of loan collateral and priority of the security interest verified?
- Does the NBFC ensure that the borrower signs a legally enforceable document as evidence of an obligation to repay the loan?
- Are guarantees examined to ensure that they are legally enforceable?
- Is the documentation supporting the loan application reviewed and approved by an employee independent of the lending officer?
- Is there a control to ensure the appropriate registration of security (for example, recording of liens with governmental authorities)?

- Is there adequate physical protection of notes, collateral and supporting documents?
- Is there a control to ensure that loan disbursements are recorded immediately?
- Is there a control to ensure that to the extent possible, loan proceeds are used by the borrower for the intended purpose?

Monitoring

- Are trial balances prepared and reconciled with control accounts by employees who do not process or record loan transactions?
- Are reports prepared on a timely basis of loans on which principal or interest payments are in arrears?
- Are these reports reviewed by employees independent of the lending function?
- Are there procedures in use to monitor the borrower's compliance with any loan restrictions (for example, covenants) and requirements to supply information to the NBFC?
- Are there procedures in place that require the periodic reassessment of collateral values?
- Are there procedures in place to ensure that the borrower's financial position and results of operations are reviewed on a regular basis?
- Are there procedures in place to ensure that key administrative dates, such as the renewal of security registrations, are accurately recorded and acted upon as they arise?

Collection

- Are the records of principal and interest collections and the updating of loan account balances maintained by employees independent of the credit granting function?
- Is there a control to ensure that loans in arrears are followed up for payment on a timely basis?

- Are there written procedures in place to define the NBFC's policy for recovering outstanding principal and interest through legal proceedings, such as foreclosure or repossession?
- Are there procedures in place to provide for the regular confirmation of loan balances by direct written communication with the borrower by employees independent of the credit granting and loan recording functions, as well as the independent investigation of reported differences?

Periodic review and evaluation

- Are there procedures in place for the independent review of all loans on a regular basis, including:
  - The review of the results of the monitoring procedures referred to above; and
  - The review of current issues affecting borrowers in relevant geographic and industrial sectors?
- Are there appropriate written policies in effect to establish the criteria for:
  - The establishment of loan loss provisions;
  - The cessation of interest accruals (or the establishment of offsetting provisions);
  - The valuation of collateral security for loss provisioning purposes;
  - The reversals of previously established provisions;
  - The resumption of interest accruals; and
  - The writing off of loans?
- Are there procedures in place to ensure that all required provisions are entered into the accounting records on a timely basis?

Appendix B

Illustrative Templates of Audit Report/Certificate

Auditor should refer to the illustrative formats given in the "Guidance Note on Reports or Certificates for Special Purposes" issued by ICAI while issuing certificates/ reports pursuant to RBI directions/ communications received by the NBFC. Few sample templates are as follows:

1. Auditor's Certificate on Foreign Direct Investment

The Board of Directors

[Name of the Company]

[Address]

Auditor's Certificate

1) This certificate is issued in accordance with the terms of our agreement dated [date].

2) The accompanying statement of compliance on foreign direct investment in [Name of the Company] (hereinafter referred to as "the Company") as at [date] (the "Statement") has been prepared by the Company's Management and certified by the [Managing Director/ Chief Executive Officer of the Company or his authorised representative], pursuant to the requirements of Non-Banking Financial Company–Non Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016/ Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 issued by the Reserve Bank of India ("RBI"), ("RBI Directions"), which have been initialled by us for identification purpose only.

Management's Responsibility for the Statement

3) The preparation of the Statement is the responsibility of the Management of the Company including the creation and

maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement.

4) The Management is also responsible for ensuring that the Company complies with the requirements of the RBI Directions and other applicable circulars and guidelines issued by RBI as applicable to Non Banking Financial Companies and for providing all relevant information to RBI

Auditor's Responsibility

5) Pursuant to the requirement of the RBI Directions, it is our responsibility to examine the books and other records of the Company as at [Date] and certify whether:

   a) the Company has complied with the minimum capitalization requirement norms, as prescribed under RBI Directions on an ongoing basis during the year ended […]

   b) the Company has undertaken activities in the nature of [specify] during the year ended […] and the aforesaid activities of the Company were confined to the permissible activities as stipulated in the RBI Directions.

   c) the accompanying Statement is in agreement with the books of account, register of members and other records maintained by the Company as at [Date] and produced to us for our examination.

6) The financial statements prepared from the books and records referred to in paragraph 5 above, have been audited by us on which we issued a modified/ an unmodified audit opinion vide our report dated [date]. Our audit of these financial statements was conducted in accordance with the Standards on Auditing specified under section 143(10) of the Companies Act, 2013 and other applicable authoritative pronouncements issued by the Institute of Chartered Accountants of India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material

misstatement. Our audit was not planned and performed in connection with any transactions to identify matters that may be of potential interest to third parties Or

The financial statements prepared from the books and records referred to in paragraph 5 above are subject to audit pursuant to the requirements of the Companies Act, 2013.

7) We conducted our examination, on test check basis[1], in accordance with the 'Guidance Note on Reports or Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

8) We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Conclusion

9) Based on our examination as above, and the information and explanations given to us, we certify that, to the best of our knowledge:

   a) The Company has complied with the minimum capitalization requirement norms, as prescribed under RBI Directions on an ongoing basis during the year ended […]

   b) The Company has undertaken activities in the nature of [specify] during the year ended […], and the aforesaid activities of the Company were confined to the permissible activities as stipulated in the RBI Directions.

   c) The accompanying Statement is in agreement with the audited/unaudited books of account, register of members and other records as at [Date] maintained by the Company and produced to us for our examination.

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[1] Delete if not applicable.

Restrictions on Use

10) Our work was performed solely to assist you in meeting your responsibilities in relation to your compliance with RBI Directions. Our obligations in respect of this certificate are entirely separate from, and our responsibility and liability is in no way changed by any other role we may have (or may have had) as auditors of the Company or otherwise. Nothing in this certificate nor anything said or done in the course of or in connection with the services that are the subject of this certificate, will extend any duty of care we may have in our capacity as auditors of the Company.

11) This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the requirements of RBI Directions, and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any duty or liability for any other purpose or to any other party to whom our certificate is shown or into whose hands it may come without our prior consent in writing.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Certificate)
(Designation[2])
Membership Number
UDIN

Place of Signature
Date

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[2] Partner or Proprietor, as the case may be.

2. CIC Overseas Investment compliance certificate

Name and address of the Addressee

Auditor's certificate

1. This certificate is issued in accordance with the terms of our agreement dated [Date].

2. The accompanying statement (Statement) of compliance with applicable conditions stipulated under the Core Investment Companies (Reserve Bank) Directions, 2016 issued by the Reserve Bank of India (RBI) vide notification No. DNBR.PD.003/03.10.119/2016-17 dated August 25, 2016, as amended (hereinafter referred to as "CIC Directions") of [Name of the company] (the "Company") has been prepared by the Management of the Company pursuant to the requirement stated under Paragraph 37-'Overseas Investment' of the CIC Directions . We have initialled the Statement for identification purposes only.

Management's Responsibility for the Statement

3. The preparation of the Statement is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances.

4. The Management is also responsible for ensuring that the Company complies with the requirements of the CIC Directions and other applicable circulars and guidelines issued by the RBI as applicable for a registered Core Investment company and for providing all relevant information to RBI.

Auditor's Responsibilities

5. Pursuant to the CIC Directions, it is our responsibility to examine and certify that the particulars set out in the Statement are in agreement with the unaudited/ audited books and records of the Company for the year ended [Date].

6. The books and records referred to in paragraph 5 above have been audited by us on which we issued an unmodified/modified audit opinion vide our report dated [date]. Our audit of these financial statements was conducted in accordance with the Standards on Auditing specified under Section 143(10) of the Companies Act, 2013 and other applicable authoritative pronouncements issued by the Institute of Chartered Accountants of India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit was not planned and performed in connection with any transactions to identify matters that may be of potential interest to third parties[3].

7. We conducted our examination, on test check basis[4], in accordance with the 'Guidance Note on Reports or Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

8. In respect of compliance with Paragraph 37 of CIC Directions as set out in the Statement, we have examined only the Form Overseas Direct Investment and Annual Performance Reports of the Company's overseas investments in wholly owned subsidiaries /joint ventures.

9. We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Conclusion

10. Based on our examination as referred to in paragraphs 7 and 8 above and the information and explanations given to us, we certify that the particulars set out in the Statement are in

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[3] If the books are unaudited replace this paragraph with "The books and records referred to in paragraph 5 above are subject to our audit pursuant to the requirements of the Companies Act, 2013."

[4] Include if applicable.

agreement with the unaudited / audited books and records of the Company for the year ended [Date].

Restrictions on Use

11. Our work was performed solely to assist you in meeting your responsibilities in relation to your compliance with the CIC Directions. Our obligations in respect of this certificate are entirely separate from, and our responsibility and liability is in no way changed by any other role we may have (or may have had) as auditors of the Company or otherwise. Nothing in this certificate nor anything said or done in the course of or in connection with the services that are the subject of this report, will extend any duty of care we may have in our capacity as auditors of the Company.

12. This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission of the certificate to the Reserve Bank of India pursuant to CIC Directions and this certificate should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any duty or liability for any other purpose or to any other party to whom our certificate is shown or into whose hands it may come without our prior consent in writing.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Certificate)
(Designation[5])
Membership Number
UDIN

Place of Signature
Date

[5] Partner or Proprietor, as the case may be.

3. Auditor's Report on Statement of change in directors for the quarter ended [Date]

The Board of Directors,

[Name of the Company]

[Address of the Company]

Auditor's Report

1. This report is issued in accordance with the terms of our agreement dated [Date].

2. The accompanying Statement showing details of change of directors during the quarter ended [date] (hereinafter referred to as the "Statement of Change of Director or Statement") has been prepared by [Name of the Company] ("the Company"), in compliance with the requirement of Paragraph 72(1)(iv) of the Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016, as amended, issued by the Reserve Bank of India (RBI) vide Master Direction No. RBI/DNBR/2016-17/45 DNBR. PD. 008/03.10.119/2016-17 dated September 01, 2016. (Direction). We have initialled the Statement for identification purposes only.

Management's Responsibility for the Statement

3. The Company's Management is responsible for preparation of the Statement including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement and applying an appropriate basis of preparation.

4. The Management is also responsible for ensuring that the Company complies with the requirements of the Direction and for providing all the relevant information to the RBI.

Auditor's Responsibility

5. Pursuant to the requirements of the Direction, it is our responsibility to report whether the details set out in the Statement are in accordance with the audited/unaudited books and records of the Company as at [date].

6. We conducted our examination of the Statement in accordance with the 'Guidance Note on Reports or Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

7. We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Opinion

8. Based on our examination, as above, we report that the details set out in the Statement are in agreement with the audited/ unaudited books and records of the Company as at [date].

Restrictions on Use

9. Our work was performed solely to assist you in meeting your responsibilities in relation to your compliance with the Direction. Our obligations in respect of this report are entirely separate from, and our responsibility and liability is in no way changed by any other role we may have (or may have had) as auditors of the Company or otherwise. Nothing in this report, nor anything said or done in the course of or in connection with the services that are the subject of this report, will extend any duty of care we may have in our capacity as auditors of the Company.

10. The report is addressed to and provided to the Board of Directors of the Company solely for the purpose to enable it to

comply with requirement of the Direction and to submit the accompanying Statement to RBI and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any liability or any duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come without our prior consent in writing.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Report)
(Designation[6])
Membership Number
UDIN

Place of Signature
Date

[6] Partner or Proprietor, as the case may be.

Appendix C

Illustrative Format of Additional Report and Exception Reporting

Auditor should refer paragraphs 4.42 to 4.45 for matters to be reported in the additional report. The aforesaid paragraphs include matters to be reported for a deposit taking NBFCs.

Auditor's Additional Report

The Board of Directors

[Name of the Company]

[Address]

1. This report is issued in accordance with the requirements of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the "Directions")
2. We have audited the accompanying financial statements of [Name of the Company] (hereinafter referred to as the "Company") comprising Balance Sheet as at March 31, [year], the related Statement of Profit and Loss (including Other Comprehensive Income), the Statement of Changes in Equity and Cash Flow Statement for the year ended on that date, on which we have issued our report dated [ ].

Management's Responsibility for the Financial Statements

3. The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements to give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Indian accounting standards /Accounting Standards specified under Section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other

irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, [that were operating effectively for ensuring the accuracy and completeness of the accounting records[7]] relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

4. The Management is also responsible for compliance with the Reserve Bank of India (hereinafter referred to as “RBI” or “Bank”) Act, 1934 and other relevant RBI circulars and guidelines applicable to Non-Banking Financial Companies, as amended from time to time, and for providing all the required information to RBI.

Auditor’s Responsibility

5. Pursuant to the requirements of the Directions, it is our responsibility to examine the audited books and records of the Company for the year ended [Date] and report on the matters specified in the Directions to the extent applicable to the Company.

6. We conducted our examination in accordance with the ‘Guidance Note on Reports or Certificates for Special Purposes’ issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

7. We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements."

Opinion

8. Based on our examination of the audited books and records of the Company for the year ended [Date] as produced for our

[7] To be included in case of a listed NBFC.

examination and the information and explanations given to us, we report that:

8.1 The Company is engaged in the business of non-banking financial institution and has obtained a certificate of registration (CoR) *[Certificate Reference]* dated *[…]* from the Bank's Department of Non-Banking Supervision, [*Location*] Regional Office.

8.2 The Company is entitled to continue to hold such CoR in terms of its asset/(income pattern)[8] as on March 31, *[year]*.

8.3 The Company is meeting the required net owned funds requirement as laid down in Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

8.4 Based on the criteria set forth by the Bank's Notification viz; Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 for classification of NBFCs as NBFC-MFIs, the Company has been correctly classified as NBFC-MFI as defined in the aforesaid Directions with reference to the business carried on by it during the year ended *[ ]*.[9]

8.5 The Board of Directors of the Company have passed a resolution in its meeting held on/ through circulation on *[Date]* for non-acceptance of public deposits.

8.6 The Company has not accepted any public deposits during the year ended *[ ]*.

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[8] To be deleted for a CIC.

[9] Delete this paragraph if not found applicable. Suggested language "As the Company has not been classified as NBFC MFI, accordingly the question of commenting on whether the Company has been correctly classified as NBFC-MFI as defined in the aforesaid Master Directions does not arise".

8.7 The Company has complied with the prudential norms relating to income recognition, Indian accounting standards/accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

8.8 [The annual statement of capital funds, risk assets / exposures and risk asset ratio (NBS – 7) has been furnished to the Bank on *[Date]* within the stipulated period based on the audited/unaudited books of account. The Company had correctly arrived at and disclosed the capital adequacy ratio (CRAR), based on the audited/unaudited books of account, in the return submitted to the Bank in Form NBS – 7 and such ratio is in compliance with the minimum CRAR prescribed by the Bank.][10]

[In the case of NBFC which has accepted public deposits, the reporting will include the following matters as given in paragraph 3(B) of Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016]

8.9 (i) the public deposits accepted by the Company together with other borrowings indicated below viz.

(a) from public by issue of unsecured non-convertible debentures/bonds;

[10] This is to be included only in case of systemically important Non-Deposit taking NBFCs. Also this is not applicable in case the company is a CIC. In case of company being a CIC, replace this paragraph with "Para 8.8-"Requirement as to capital adequacy" of Prudential Norms Directions is not applicable to the Company. Accordingly the question of commenting on whether the Company had correctly arrived at and disclosed the capital adequacy ratio (CRAR), based on the audited/unaudited books of account, in the return submitted to the Bank in Form NBS – 7 and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank does not arise." In other cases, factual change to be made to say that the provisions are not applicable to the Company.

(b) from its shareholders (if it is a public limited company); and

(c) which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(ii) the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularised in the manner provided in the said Directions;

(iii) the Company is accepting "public deposit" with minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(iv) the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 has been correctly determined and , such ratio is in compliance with the minimum CRAR prescribed therein;

(v) (a) the credit rating has been assigned by permitted Credit Rating Agencies for each of the fixed deposits schemes; and

(b) the aggregate amount of deposits outstanding as at any point during the year has not exceeded the limit specified by such Credit Rating Agency;

(vi) the Company has not violated any restriction on acceptance of public deposits as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(vii) the Company has not defaulted in paying to its depositors the interest and /or principal amount of the deposits after such interest and/or principal became due;

(viii) the Company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and the details of the designated bank in which the approved securities are held is communicated to the office concerned of the Bank in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(ix) the Company has furnished to the Bank within the stipulated period the return on deposits in the NBS 1 as specified in Non- Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(x) the Company has furnished to the Bank within the stipulated period the quarterly return on prudential norms as specified in the Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(xi) in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the Company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

Restriction on Use

9. Our obligations in respect of this report are entirely separate from, and our responsibility and liability is in no way changed by, any other role we may have (or may have had) as auditors

of the Company or otherwise. Nothing said in this report, nor anything said or done in the course of or in connection with the services that are the subject of this report, will extend any duty of care we may have in our capacity as auditors of any financial statements of the Company.

10. This report is issued pursuant to our obligations under the Directions to submit a report on additional matters as stated in the Directions, to the Board of Directors of the Company and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Report)
(Designation[11])
Membership Number
UDIN

Place of Signature

Date

[11] Partner or Proprietor, as the case may be.

Exception Reporting

To be addressed to Regional Office of the Department of Non-banking supervision of RBI

1. This report is issued in accordance with the requirements of Master Direction- Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the "Directions").

2. We have audited the accompanying financial statements of [Name of the Company] (hereinafter referred to as the "Company") comprising of Balance Sheet as at March 31, [ ], the related Statement of Profit and Loss (including Other Comprehensive Income), the Statement of Changes in Equity and Cash Flow Statement for the year ended on that date on which we have issued our modified /unmodified report dated [ ].

Management's Responsibility for the Financial Statements

3. The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements to give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Indian Accounting Standards/ Accounting Standards specified under Section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, [that were operating effectively for ensuring the accuracy and

completeness of the accounting records[12]], relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

4. As required by the Directions and on the basis of such checks of the books and records of the Company as we considered appropriate and the information and explanations given to us during the course of our audit, we give below a statement on the matters specified in paragraph 5 of the said Directions to the extent applicable to the Company:

5. We conducted our examination in accordance with the 'Guidance Note on Reports or Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

6. We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements."

Basis for exception reporting

7. **[Provide brief background of requirement]**

Exception Report

8.

Restriction on Use

9. This report is issued pursuant to our obligations under the Directions, to submit a report on exceptions, noted while issuing our report dated [ ] on additional matters as stated in

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[12] to be included in case of a listed NBFC.

the Directions, to Reserve Bank of India and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Report)
(Designation[13])
Membership Number
UDIN

Place of Signature

Date

[13] Partner or Proprietor, as the case may be.

Appendix D

Illustrative List of Returns to be submitted by an NBFC

(As per Master Direction- Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10620

The details of returns and their periodicity across distinct categories of NBFCs are consolidated in the following table.

A. Details of returns to be submitted by NBFCs-D

Sr.	Name of the Return	Periodi-city	Reference Date	Reporting Time	Due on	Remarks
1	NBS1	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.	
2	NBS2	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.	
3	NBS3	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.	
4	ALM (NBFC-D)	Half yearly	31st March/ 30th Sept.	30 days	30th April/ 30th Oct.	NBFCs-D having public deposit of > Rs. 20 crore Or asset size

						of > Rs. 100 crore
5	Branch Information return	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.	
6	Statutory Auditor Certificate	Annual	31st March	One month from the date of finalisation of Balance Sheet		Not later than 31st December
7	Reporting to Central Repository of Information on Large Credits (CRILC)	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	21 days	21st April/ 21st July/ 21st Oct/ 21st Jan	
8	Reporting of Special Mention Account status (SMA-2 return)	Weekly	On Every Friday			
9	Statutory Auditor Certificate	Annual	31st March	One month from the date of finalisation of Balance Sheet		Not later than 31st December

B. Details of returns to be submitted by NBFC-ND-SI

Sr. No	**Name of the Return**	**Periodicity**	**Reference Date**	**Reporting Time**	**Due on**
1	NBS7	Quarterly	31st March/ 30th June/ 30th Sept/ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.

2	NBFCs-ND-SI 500 crores asset size	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.
3	ALM-1	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.
4	ALM-2 & 3	Half yearly	31st March/ 30th Sept.	30 days	30th April/ 30th Oct.
5	ALM-(NBFC-ND-SI)	Annual	31st March	15 days	15th April
6	Branch Info return	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.
7	Reporting to Central Repository of Information on Large Credits (CRILC)	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	21 days	21st April/ 21st July/ 21st Oct/ 21st Jan
8	Reporting of Special Mention Account status (SMA-2 return)	Weekly	On Every Friday		
9	Statutory	Annual	31st March	One month from the	

	Auditor Certificate			date of finalisation of Balance Sheet. Not later than 31st December.

C. Details of returns to be submitted by NBFC-ARC

Sr. No	Name of the Return	Periodicity	Reference Date	Reporting Time	Due on
1	ARC	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.
2	Statutory Auditor Certificate	Annual	31st March	One month from the date of finalisation of Balance Sheet. Not later than 31st December.	

D. Details of returns to be submitted by NBFC-ND- having asset size of Rs. 100 crore - Rs. 500 crore

Sr No	Name of the Return	Periodicity	Reference Date	Reporting Time	Due on
1	NBS-9	Annual	31st March	60 days	30th May
2	Statutory Auditor Certificate	Annual	31st March	One month from the date of finalisation of Balance Sheet. Not later than 31st December.	

E. Details of returns to be submitted by NBFC-ND- having asset size below Rs. 100 crore

Sr No	Name of the Return	Periodicity	Reference Date	Reporting Time	Due on
1	NBS-8	Annual	31st March	60 days	30th May
2	Statutory Auditor	Annual	31st March	One month from the date of finalisation of	

	Certificate			Balance Sheet. Not later than 31st December.

F. Details of returns to be submitted by RNBCs

Sr No	Name of the Return	Periodicity	Reference Date	Reporting Time	Due on
1	NBS1A	Annual	31st March	6 months	30th Sept
2	NBS3A	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.
3	Statutory Auditor Certificate	Annual	31st March	One month from the date of finalisation of Balance Sheet. Not later than 31st December.	

G. Other Returns by concerned NBFCs

Sr No	Name of the Return	Periodicity	Reference Date	Reporting Time	Due on
1	Return on FDI	Half yearly	31st March/ 30th Sept.	30 days	30th April/ 30th Oct.
2	Overseas Investments	Quarterly	31st March/ 30th June/ 30th Sept./ 31st Dec.	Within 15 days	15th April/ 15th July/ 15th Oct./ 15th Jan.

Appendix E

Illustrative Disclosure Norms for NBFCs as per Prudential Norms and other RBI Directions

The illustrative disclosures given below are based on the requirements of disclosures as prescribed by the RBI under scale based regulatory framework (Refer RBI circular dated RBI/2022-23/26 dor.acc.rec.No.20/21.04.018/2022-23 dated April 19, 2022) and other disclosure requirements under other RBI guidelines. It may be noted that this Appendix gives the various disclosure requirements of relevant guidelines/notifications in a summarised manner. Auditor should refer to the relevant guidelines/notifications to ensure completeness of the disclosure requirements.

The below illustration is common to all types of NBFCs and to the extent they are not applicable, such requirements can be omitted. They are effective for financial statements for the year ending March 31, 2023 onwards.

NBFCs shall refer to the extant statutory and regulatory requirements while determining the permissibility or otherwise of an activity or transaction.

NBFCs shall disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements. Further, NBFCs shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.

A. Exposure

NBFCs may omit those line items which are not applicable/ not permitted or have nil exposure both in current and previous year. Further, exposures against pledge of shares by promoters of a company shall be shown separately under the respective line items.

1) Exposure to real estate sector

(Amount in Rs. crore)

Category	Current year	Previous Year
i) *Direct exposure*		
a) Residential Mortgages Lending fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented. Exposure would also include non-fund based (NFB) limits. b) Commercial Real Estate Lending secured by mortgages on commercial real estate (office buildings, retail space, multipurpose commercial premises, multifamily residential buildings, multi tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction, etc.). Exposure would also include non-fund based (NFB) limits. c) Investments in Mortgage-Backed Securities (MBS) and other securitized exposures i. Residential ii. Commercial Real Estate		
ii) Indirect Exposure Fund based and non-fund-based exposures on National Housing Bank and Housing Finance Companies.		
Total Exposure to Real Estate Sector		

2) Exposure to capital market

Particulars	Current year	Previous year
i) Direct investment in equity shares, convertible bonds, convertible debentures and units of equity oriented mutual funds the corpus of which is not exclusively invested in corporate debt		
ii) Advances against shares / bonds / debentures or other securities or on clean basis to individuals for investment in shares (including IPOs / ESOPs), convertible bonds, convertible debentures, and units of equity oriented mutual funds		
iii) Advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security		
iv) Advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares / convertible bonds / convertible debentures / units of equity oriented mutual funds does not fully cover the advances		
v) Secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers		

vi) Loans sanctioned to corporates against the security of shares / bonds / debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources		
vii) Bridge loans to companies against expected equity flows / issues		
viii) Underwriting commitments taken up by the NBFCs in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds		
ix) Financing to stockbrokers for margin trading		
x) All exposures to Alternative Investment Funds: (i) Category I (ii) Category II (iii) Category III		
Total exposure to capital market		

3. Sectoral exposure

Sectors	Current year			Previous year		
	Total exposure (includes on balance sheet and off-balance sheet exposure)	Gross NPAs	% of Gross NPAs to Total Exposure in that sector	Total exposure (includes on balance sheet and off-balance sheet exposure)	Gross NPAs	% of Gross NPAs to Total Exposure in that sector

1. Agriculture and Allied Activities						
2. Industry (specify separately)						
Total industry						
3. Services (specify separately)						
Total services						
4. Personal loans(specify categories)						
Total personal loans						
5. Others						

In the disclosures as above, if within a sector, exposure to a specific sub-sector/industry is more than 10 per cent of Tier I Capital of an NBFC, the same shall be disclosed separately within that sector. Further, within a sector, if exposure to specific sub-sector/industry is less than 10 per cent of Tier I Capital, such exposures shall be clubbed and disclosed as “Others” within that sector.

4) Intra-group exposures (for current year and previous year)

i) Total amount of intra-group exposures

ii) Total amount of top 20 intra-group exposures

iii) Percentage of intra-group exposures to total exposure of the NBFC on borrowers/customers

5) Unhedged foreign currency exposure

Details of NBFC’s unhedged foreign currency exposures. Further, NBFCs are required to disclose their policies to manage currency induced risk.

B. Related Party disclosures – Related party disclosures to be given in the prescribed format given in the aforementioned circular.

C. Indicative List of Balance Sheet Disclosure for Non-deposit Taking NBFCs with asset size Rs. 500 Crore and above and Deposit Taking NBFCs

a. Capital to risk assets ratio (CRAR):

	Current Year	**Previous Year**
CRAR (%)		
CRAR - Tier I Capital (%)		
CRAR - Tier II Capital (%)		
Amount of Subordinated Debt considered as Tier-II Capital		
Amount raised by issue of Perpetual Debt Instruments		

b. Details of Investments

(i) Investments in Mutual funds (ii) Investments in Government securities (iii) Investments in Other approved securities (iv) Investments in Debt Securities (v) Investments in Equity Instruments (vi) Investments in Subsidiaries (vii) Investments in Associates (viii) Investments in Joint Ventures (ix) Others (Specify)

Investments should further be classified as:

(a) Measured at amortised cost,

(b) Fair value through Other Comprehensive Income,

(c) Fair value through Profit or Loss, and

(d) Designated at fair value through Profit or Loss.

Additional disclosure of investments within and outside India is required to be provided. Where the NBFC has used a basis other than amortised cost or fair value, the same may be included in column 'Others', with the basis of measurement to be disclosed as a footnote. e.g. investment in subsidiaries measured at cost under Ind AS 27 shall be classified under 'Others' in the Separate Financial Statements of the NBFC.

The impairment loss allowance as per Ind AS 109 should be disclosed as a separate line item under the sub-heads (measurement categories) mentioned above.

c. Derivatives

Particulars	Current Year	Previous Year
(i) Forward Rate Agreement / Interest Rate Swap		
a. The notional principal of swap agreements b. Losses which would be incurred if counterparties failed to fulfill their obligations under the agreements c. Collateral required by the NBFC upon entering into swaps d. Concentration of credit risk arising from the swap @ e. Fair value of Swap book # Note: Nature and terms of the swaps including information on credit and market risk and the accounting policies adopted for recording the swaps should also be disclosed. @ Examples of concentration could be exposures to particular industries or swaps with highly geared companies # If the swaps are linked to specific assets,		

liabilities, or commitments, the fair value would be the estimated amount that the applicable NBFC would receive or pay to terminate the swap agreements as on the balance sheet date.		
ii) Exchange Traded Interest Rate (IR) Derivatives		
a. Notional principal amount of exchange traded IR derivatives undertaken during the year (instrument-wise) i) ii) iii) b. Notional principal amount of exchange traded IR derivatives outstanding as on 31st March (instrument-wise) i) ii) iii) c. Notional principal amount of exchange traded IR derivatives outstanding and not "highly effective" (instrument-wise) i) ii) iii) d. Mark-to-market value of exchange traded IR derivatives outstanding and not "highly effective" (instrument-wise) i) ii) iii)		

iii) Disclosure on Risk Exposure in Derivatives

Qualitative Disclosure

NBFCs shall describe their risk management policies pertaining to derivatives with particular reference to the extent to which derivatives are used, the associated risks and business purposes served. The discussion shall also include:

- the structure and organization for management of risk in derivatives trading.
- the scope and nature of risk measurement, risk reporting and risk monitoring system.
- policies for hedging and/ or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/ mitigants.
- accounting policy for recording hedge and non-hedge transactions; recognition of income, premiums and discounts; valuation of outstanding contracts; provisioning, collateral and credit risk mitigation.

Quantitative Disclosure

S.No	**Particular**	**Currency derivatives**	**interest rate derivatives**
(i)	Derivatives (Notional Principal Amount)		
	For Hedging		
(ii)	Marked to Market Positions [1]		
	a) Asset (+)		
	b) Liability (-)		
(iii)	Credit Exposure [2]		
(iv)	Unhedged Exposures		

D. Disclosure of Restructured Accounts (Current Year and Previous Year)

		Standard	Sub-Standard	Doubtful	Loss	Total
Restructured accounts as on April 1 of the FY (opening figures)	No. of borrowers					
	Amount outstanding					
	Provision thereon					
Fresh restructuring during the year	No. of borrowers					
	Amount outstanding					
	Provision thereon					
Upgradation to restructured standard category during the year	No. of borrowers					
	Amount outstanding					
	Provision thereon					
Restructured standard advances which cease to attract higher provisioning and /or additional risk weight at the end of the year and hence need not be shown as restructured	No. of borrowers					
	Amount outstanding					
	Provision thereon					

advances at the beginning of the next year						
Down gradation of restructured accounts during the year	No. of borrowers					
	Amount outstanding					
	Provision thereon					
Write off of restructured accounts during the year	No. of borrowers					
	Amount outstanding					
	Provision thereon					
Restructured accounts as on March 31	No. of borrowers					
	Amount outstanding					
	Provision thereon					

Note: The above details to be given separately for advances restructured under CDR mechanism, under SME debt restructuring mechanism, others and total under all the category.

E. Details of Single Borrower Limit (SGL) / Group Borrower Limit (GBL) exceeded by the NBFC

The NBFC should make appropriate disclosure in the Notes to the annual financial statements in respect of the exposures where the NBFC had exceeded the prudential exposure limits during the year. The sanctioned limit or entire outstanding, whichever is high, shall be reckoned for exposure limit.

F. Unsecured Advances

NBFCs should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in Notes to accounts. This would differentiate such loans from other entirely unsecured loans.

G. Maturity Pattern of certain items of assets and liabilities

Items to be disclosed like Deposits, Advances, Investments, Borrowings, Foreign currency assets, foreign currency liabilities etc. For an illustrative format, refer table below:

Current Year/ Previous Year

	1 day to 30/31 days (one month)	Over one month to two months	Over two months to three months	Over three months to six months	Over six months to one year	Over one year to three years	Over three years to five years	Over five years	Total
Deposits									
Advances									
Investments									
Borrowings									
Foreign currency assets									
Foreign currency liabilities									

H. Securitisation

The Notes to accounts of the originating NBFCs should indicate the outstanding amount of securitised assets as per books of the

SPVs sponsored by the NBFC and total amount of exposures retained by the NBFC as on the date of balance sheet to comply with the Minimum Retention Requirements (MRR). These figures should be based on the information duly certified by the SPV's auditors obtained by the originating NBFC from the SPV. These disclosures, as per Master Direction-Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021, should be made in the format given below.

(i) No of SPVs sponsored by the NBFC for securitisation transactions.

(ii) Total amount of securitised assets as per books of the SPVs sponsored.

(iii) Total amount of exposures retained by the NBFC to comply with MRR as on the date of balance sheet- Off balance sheet and On balance sheet.

(iv) Amount of exposures to securitisation transactions other than MRR.

(v) Sale consideration received for the securitised assets and gain/loss on sale on account of securitisation.

(vi) Form and quantum (outstanding value) of services provided by way of, liquidity support, post-securitisation asset servicing, etc.

(vii) Performance of facility provided. Please provide separately for each facility viz. Credit enhancement, liquidity support, servicing agent etc. Mention percent in bracket as of total value of facility provided. (a) Amount paid (b) Repayment received (c) Outstanding amount.

(viii) Average default rate of portfolios observed in the past. Please provide breakup separately for each asset class i.e. RMBS, Vehicle Loans etc.

(ix) Amount and number of additional/top up loan given on same underlying asset. Please provide breakup separately for each asset class i.e. RMBS, Vehicle Loans etc.

(x) Investor complaints (a) Directly/Indirectly received and; (b) Complaints outstanding.

I. Disclosures as required in terms of NBFC-Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and NBFC-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016

Liabilities Side

1. Break-up of loans and advances availed by NBFC inclusive of interest accrued thereon but not paid

(i) Debentures

(ii) Deferred Credits

(iii) Term Loans

(iv) Inter-Corporate Loans and Borrowing

(v) Commercial Paper

(vi) Public Deposits

(vii) Other Loans (Specify nature)

2. Break-up of outstanding public deposits inclusive of interest accrued thereon but not paid

(i) Unsecured Debentures

(ii) Partly Secured Debentures

(iii) Other Public Deposits

Assets Side

3. Break-up of Loans and Advances including bills receivables

(i) Secured

(ii) Unsecured

4. Break up of Leased Assets and stock on hire and other assets counting towards asset financing activities

- Lease assets including lease rentals under sundry debtors
  - (i) Finance lease
  - (ii) Operating lease
- Stock on hire including hire charges under sundry debtors
  - (i) Assets on hire
  - (ii) Repossessed assets
- Other loans counting towards asset financing activities
  - (i) Loans where assets have been repossessed
  - (ii) Loans other than (i) above

5. Breakup of Investments

(i) Current Investments

Quoted

Unquoted

(ii) Long Term investments

Quoted

Unquoted

6. Borrower Group wise classification of assets financed as in (3) and (4) above

7. Investor group-wise classification of all investments (current and long term in shares and securities)

8. Other Information

Particulars	**Current year**	**Previous year**
1. Gross Non Performing Assets (a) Related Parties (b) Other than related parties	X	X
2. Net Non Performing Assets	X	X

	(a) Related Parties (b) Other than related parties		
3.	Assets acquired in satisfaction of debt	X	X

J. Additional Disclosures

a. Provisions and Contingencies (Current Year and Previous Year)

i) Break up of 'Provisions and Contingencies' shown under the head Expenditure in Profit and Loss Account

ii) Provisions for depreciation on Investment

iii) Provision towards NPA

iv) Provision made towards Income Tax

v) Other Provisions and contingencies (with details)

vi) Provision for standard assets

b. Draw Down from Reserves

Make suitable disclosures in the notes to accounts.

c. Concentration of Deposits, Advances, Exposures and NPAs

- Disclose total deposits /advances/ exposures of 20 largest depositors/borrowers and percentage of deposits/ advances/ exposure of 20 largest depositors/borrowers to total deposits/ advances/ exposure of the NBFC
- Disclose total exposures to top four NPA accounts

d. Sector wise NPAs

Disclose percentage of NPAs to total advances in that sector.

(i) Agriculture & allied activities

(ii) MSME

(iii) Corporate borrowers

(iv) Services

(v) Unsecured personal loans

(vi) Auto Loans and

(vii) other personal loans

e. Movement of NPAs (Current Year and Previous Year)

i. Net NPAs to net advances (%)

ii. Movement of NPAs (Gross) during the Year

iii. Movement of Net NPAs during the year

iv. Movement of provision for NPAs (excluding provisions on standard assets) during the year

f. Overseas Assets (for those with Joint Ventures and Subsidiaries abroad)

g. Off-balance Sheet SPVs sponsored (which are required to be consolidated as per accounting norms)

Name of the SPV sponsored overseas and domestic.

h. Penalties / fines imposed by the RBI and other regulators

Penalties imposed by any regulators or directions or adverse findings in inspection reports.

i. Ratings assigned by credit rating agencies and migration of ratings during the year

j. Disclosure of Complaints

No. of complaints pending at the beginning of the year

No. of complaints received during the year

No. of complaints redressed during the year

No. of complaints pending at the end of the year

Disclosure of top five grounds of complaints received from customers.

K. LCR Disclosure Template (Rs. in Crore)

S. No.	Particulars	Separately to be given for each quarter	
		Total unweighted value (average)	**Total weighted value (average)**
	High Quality Liquid Assets		
1.	Total High Quality Liquid Assets (HQLA) (See Note below)		
	Cash Outflows		
2.	Deposits (for deposit taking companies)		
3.	Unsecured wholesale funding		
4.	Secured wholesale funding		
5.	Additional requirements, of which		
	(i) Outflows related to derivative exposures and other collateral requirements		
	(ii) Outflows related to loss of funding on debt products		
	(iii) Credit and liquidity facilities		
6.	Other contractual funding obligations		
7.	Other contingent funding obligations		

8.	**Total cash outflows**		
	Cash inflows		
9.	Secured lending		
10.	Inflows from fully performing exposures		
11.	Other cash inflows		
12.	**Total cash inflows**		
			Total adjusted value
13.	Total HQLA		
14.	Total net cash outflows		
15.	Liquidity coverage ratio (%)		

Note: Components of HQLA need to be disclosed

L. In the case of stressed loans transferred or acquired, the following disclosures should be made:

Details of stressed loans transferred during the year (to be made separately for loans classified as NPA and SMA)			
(all amounts in Rs. Crore)	**To ARCs**	**To permitted transferees**	**To other transferees (please specify)**
No: of accounts			
Aggregate principal outstanding of loans transferred			
Weighted average residual tenor of the loans transferred			
Net book value of loans transferred (at the time of transfer)			

Aggregate consideration			
Additional consideration realized in respect of accounts transferred in earlier years			
Details of loans acquired during the year			
(all amounts in Rs. Crore)	**From lenders listed in Clause 3**		**From ARCs**
Aggregate principal outstanding of loans acquired			
Aggregate consideration paid			
Weighted average residual tenor of loans acquired			

The transferor(s) should also make appropriate disclosures with regard to the quantum of excess provisions reversed to the profit and loss account on account of sale of stressed loans. Also, the lenders should disclose the distribution of the SRs held by them across the various categories of Recovery Ratings assigned to such SRs by the credit rating agencies.

M. Template for Disclosure in Notes to Financial Statements for impairment reserve, if any that needs to be created as per RBI Master Directions on NBFC Non-SI-ND and NBFC SI-ND and Deposit taking companies

Asset Classification as per RBI Norms	Asset classification as per Ind AS 109	Gross Carrying Amount as per Ind AS	Loss Allowances (Provisions) as required under Ind AS 109	Net Carrying Amount	Provisions required as per IRACP norms	Difference between Ind AS 109 provisions and IRACP norms
1	2	3	4	5=3-4	6	7=4-6
Performing Assets						

Standard	Stage 1					
	Stage 2					
Sub total						
Non performing assets						
Sub-standard	Stage 3					
Doubtful -up to 1 year -1-3 years -More than 3 years	Stage 3					
Sub total for doubtful						
Loss	Stage 3					
Sub total for NPA						
Other items like guarantees etc not covered under RBI norms	Stage 1 Stage 2 Stage 3					
Sub total						
Total	Stage 1					
	Stage 2					
	Stage 3					
	Total					

N. For NBFC-MFIs

In respect of loans extended by NBFC-MFIs against funding by National Scheduled Castes Finance & Development Corporation(NSFDC), the funding should be done by direct credit to the borrower's account with banks. Such NBFCs should make appropriate disclosure in their balance sheet. The minimum disclosures should include quantum of funds received from NSFDC, cost of such funds, loans disbursed therefrom, rate of interest on such loans and the number of beneficiaries.

O. ARCs following Ind AS are required to provide following disclosures as per RBI circular RBI/2022-23/182 DOR.ACC.REC.No.104/21.07.001/2022-23 dated February 20, 2023 on Implementation of Indian Accounting Standards (Ind AS)

https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12458&Mode=0

	As at the end of current year	As at the end of previous year
Outstanding amount of unrealised management fee receivable		
1. Out of the above, amount outstanding for:		
(a) Amounts where the net asset value of the security receipts has fallen below 50 per cent of the face value		
(b) Other amounts unrealised for: (i) More than 180 days but upto 1 year (ii) More than 1 year but upto 3 years (iii) More than 3 years		
Allowances held for unrealised management fee		
Net unrealised management fee receivable		

Auditor should refer to “Guidance Note on Division III - Schedule III to the Companies Act, 2013 for NBFC that is required to comply with IND AS” issued by ICAI with regard to presentation and disclosure requirements of financial statements as per the Companies Act, 2013 for NBFCs complying with Indian Accounting Standards.

APPENDIX F

Illustrative List of Master Directions, Circulars, RBI Notifications

1. **Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs**

https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0

2. **Master Direction - Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10621

3. **Master Direction- Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10620

4. **Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016** https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10622

5. **Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 (Updated as on June 20, 2023)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10585

6. **Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (Updated as on June 20, 2023)** https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10586

7. **Master Direction - Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 (Updated as on May 02, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10563

8. **Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (Updated as on December 29, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10564

9. **Master Direction – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021 (Updated as on June 20, 2023)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12030

10. **Master Direction - Exemptions from the provisions of RBI Act, 1934 (Updated as on April 01, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10565

11. **Master Direction - Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 2016**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10566

12. **Master Direction - Standalone Primary Dealers (Reserve Bank) Directions, 2016 (Updated as on November 14, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10567

13. **Master Direction - Residuary Non-Banking Companies (Reserve Bank) Directions, 2016 (Updated as on February 22, 2019)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10568

14. **Master Direction - Fit and Proper Criteria for Sponsors - Asset Reconstruction Companies (Reserve Bank) Directions, 2018**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11402

15. **Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 (Updated as on December 29, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11137

16. **Master Direction - Information Technology Framework for the NBFC Sector**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10999

17. **Master Direction - Mortgage Guarantee Companies (Reserve Bank) Directions, 2016 (Updated as on June 20,2023)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10690

18. **Master Direction- Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016 (Updated as on December 29, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10598

19. **Master Circular - Asset Reconstruction Companies (Updated as on October 14, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=12267

20. **Guidelines for Appointment of Statutory Central Auditors (SCAs)/Statutory Auditors (SAs) of Commercial Banks (excluding RRBs), UCBs and NBFCs (including HFCs) dated April 27, 2021**

https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12079&Mode=0

21. **Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 (Updated as on December 05, 2022)**

https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12165

22. **Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 (Updated as on December 05, 2022)**

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12166

23. Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022 (Updated as on July 25, 2022)

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12256

24. Master Direction – Credit Card and Debit Card – Issuance and Conduct Directions, 2022

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12300

25. Master Direction – Amalgamation of Private Sector Banks, Directions, 2016

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10364

26. Master Direction - Know Your Customer (KYC) Direction, 2016 (Updated as on May 04, 2023)

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11566

27. Master Direction on Digital Payment Security Controls - February 18, 2021 (Applicable to credit card issuing NBFCs)

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12032

28. Master Direction on Outsourcing of Information Technology Services – April 10, 2023 (Coming into effect from October 1, 2023)

https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12486

ICAI Announcement dated September 18, 2007

https://resource.cdn.icai.org/7741announ1158.pdf

Audits of NBFCs

Non-Banking Finance Companies (NBFCs) are playing a vital role as the financial resource mobiliser in India given the country's geographical and population spread. However, having regard to the locations at which they generally operate, the type of clientele they serve and the some of instances of fraudulent/ mismanaged NBFCs, the Reserve Bank of India (RBI) established a strict regulatory framework for operation of NBFCs. Annual statutory audit of the NBFCs, including the NBFC Auditor's Report (Reserve Bank) Directions, 1998 constitutes important pillar of that framework. The aforesaid Directions include a number of reporting responsibilities, including making of exception reports, for the statutory auditors of NBFCs.

The Institute of Chartered Accountants of India has recently received a communication from the Department of Non-Banking Supervision of the RBI in respect of audit of NBFCs. In its said communication the Reserve Bank of India has given an illustrative inclusive list of irregularities in NBFCs, required to be reported by the statutory auditors of NBFCs in terms of the requirements of the aforesaid Directions, but one or more of which have not been reported by some of the statutory auditors.

The abovementioned list is as follows:

- Net owned funds below the minimum required level not reported.
- Item not eligible for inclusion in 'Free Reserve' for the purpose of calculation of Net Owned Fund not excluded nor reported e.g. Share Premium included in Free Reserve in case where the shares are redeemable at premium and the NBFC has not created any redemption reserve.
- Company engaged in the business of Non-Banking Financial Institution without obtaining Certificate of Registration from the Reserve Bank of India.
- Failure to comply with the prudential in terms of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

- Non-reporting of downgrading of credit rating of deposit-taking NBFCs having bearing on the quantum of deposits permissible under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- Failure to report passing of Board Resolution by NBFCs (Non Deposit Taking) that they shall not accept public deposits.
- Failure to report acceptance of deposit by the NBFCs in excess of the quantum of deposits permitted in terms of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- Failure to report adherence to conditions subject to which a company is classified as Core Investment Company.

Members are requested to take note of the above.