UNIT 2 – SPECIAL FEATURES OF AUDIT OF NON-BANKING FINANCIAL COMPANIES (NBFCs)

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Understand the definition, regulations and types of Non-Banking Finance Companies (NBFCs).
- Difference between Banks and NBFCs.
- Gain the knowledge of the prudential norms- Capital Requirements, Income Recognition, and Provisioning requirements.
- Learn the audit procedures and Audit Checklist for NBFCs.
- Apply & analyse the above-mentioned concepts in moderately complex scenarios.

UNIT OVERVIEW

Audit of NBFCs

- Definition, Registration and Regulations
- Audit Procedures
- Audit Check-list
- Auditor's Duties
- Audit Report

CA Sachet is appointed as the statutory auditor of an NBFC. How important are NBFCs in financial system of a large and diverse country as India? Part of the country's financial services sector, NBFCs cater to variety of customers in rural and urban areas thus promoting inclusive growth. Such entities have become an important source of credit for those segments of society which cannot meet strict requirements of banks for lending purposes. They are popular in the areas of housing finance, financing for commercial vehicles, microfinance industry, MSME sector and in other areas. And how does an NBFC differ from a bank? Although NBFCs lend like banks, they cannot accept demand deposits and are not part of payment and settlement system like banks.

As part of understanding NBFCs, Sachet found such entities to be strictly regulated. They have to obtain certificate of registration to commence business of non-banking financial institution. There are RBI directions and norms on acceptance of public deposits, capital adequacy, risk exposure and other measures to monitor financial solvency and reporting.

NBFCs are also subject to regulatory norms for asset classification, provisioning and income recognition as per directions of RBI. NBFCs having applicability of Ind AS are also required to consider principles of relevant Ind AS in the preparation of financial statements. In fact, financial statements of an NFBC having applicability of Ind-AS are required to be prepared in accordance with Division III of Schedule III of the Companies Act, 2013. Audit approach to an NBFC has to take into account all such issues.

He was also checking for regulatory updates in NBFC sector as part of understanding it. He became aware of applicability of *"scale based"* regulations defining NBFCs on basis of their size, activity and perceived riskiness into four layers i.e., base layer, middle layer, upper layer and top layer.

Whereas upper layer comprises of NBFCs specifically identified by RBI for enhanced regulatory requirement, top layer would ideally remain empty unless RBI is of the opinion that there is substantial increase in potential systemic risk from specific NBFCs in upper layer. Not in the upper layer published by RBI, he was trying to confirm classification of this very auditee company in accordance with such regulations.

Sensing that there was increased responsibility of an auditor of NBFC in view of various RBI directions, he tweaked his audit approach accordingly. Not only auditor of NBFC is required to report to shareholders, he is also responsible for making an additional report to the Board of Directors of the company on certain specified matters in accordance with RBI directions.

1. INTRODUCTION

Non-Banking Finance Company sector has evolved considerably in terms of its size, operations, technological sophistication, and entry into new areas of financial services and products. NBFCs are now deeply interconnected with the entities in the financial sector, on both sides of their balance sheets. Being financial entities, they are exposed to risks arising out of counterparty failures, funding and asset concentration, interest rate movement and risks pertaining to liquidity and solvency, as any other financial sector player. At the same time there are segments within the sector that do not pose any significant risks to the system.

Fig. : NBFCs*

Fig.: Audit of NBFCs*

** Source: Techno Legal Journalists*
** Source: Inventicon*

Definition of NBFC: 45 I(f) of Reserve Bank of India (Amendment) Act, 1997 defines a 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;"

Fig. : What is NBFC*

Further, in order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by

** Source: Slideshare*

intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

Registration and Regulation of NBFC:

Under Section 45–IA of the Reserve Bank of India Act, 1934, no non-banking financial company is allowed to commence or carry on the business of a non-banking financial institution without

- obtaining a certificate of registration issued by the Reserve Bank of India and
- 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.
- Provided that the Bank may notify different amount of net owned fund for different categories of non-banking financial companies.

RBI has notified different amounts of net owned fund for different categories of NBFCs including rupees 2 crore for certain categories of NBFCs

(For certain categories companies currently applying for registration as an NBFC, the minimum net owned fund requirement is INR 10 Crore (previously it was INR 2 Crore) (Minimum NOF amount may be higher depending on specific type of NBFC).

RBI has prescribed a timeline to meet NOF amount of INR 10 Crore in a phased manner for certain categories of existing NBFCs by 31st March 2027. However, for NBFC-P2P, NBFC-AA, and NBFCs with no public funds and no customer interface, the NOF shall continue to be INR 2 Crore. ***For NBFC-IFC and IDFNBFC, the NOF shall be ₹300 crore.***

A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45–IA of the RBI Act, 1934 can apply to the Reserve Bank of India in prescribed form along with necessary documents for registration. The RBI issues the Certificate of Registration after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

The Reserve Bank of India has issued directions to non-banking financial companies on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

Directions were also issued to auditors to report non-compliance with the RBI Act and the Regulations to the RBI, Board of Directors and shareholders. RBI has also issued the Fair Practices Code to be adopted by all NBFCs while doing lending business. The guidelines inter alia, covered general principles on adequate disclosures on the terms and conditions of a loan and also adopting a non-coercive recovery method.

Types of NBFCs- Compliance and Regulatory Perspective:

In terms of the Section 45-I(f) read with Section 45-I (c) of the RBI Act, 1934, as amended in 1997, non-banking financial company (NBFC) is a company registered under the Companies Act,1956/2013, engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

NBFCs mandated to register under RBI

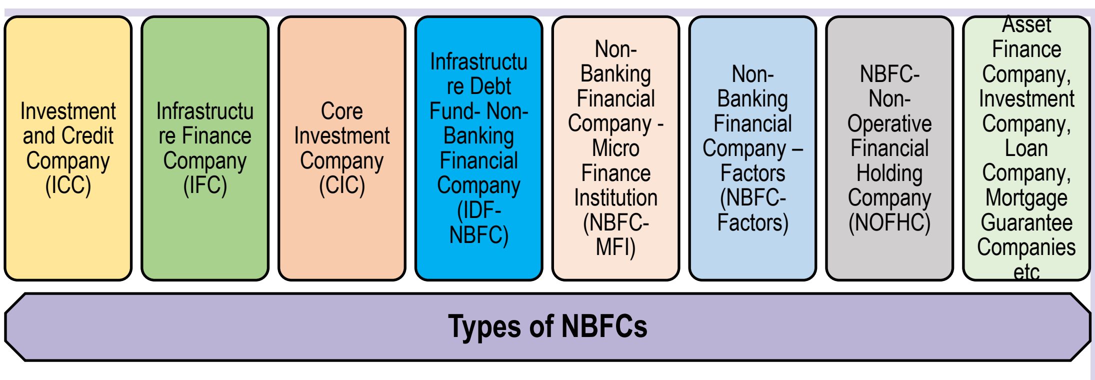
NBFCs registered with RBI are categorized as follows:

(a) in terms deposit acceptance or otherwise into Deposit and Non-Deposit accepting NBFCs;

(b) non deposit taking NBFCs by their size into Base Layer, Middle Layer, Upper Layer and Top Layer; and

(c) by the kind of activities, they conduct.

Within the categorization mentioned in (c) above, (i.e. by the kind of activity they conduct) the different types of NBFCs are as follows:



All NBFCs are either deposit taking or non-deposit taking. If they are non-deposit taking, ND is suffixed to their name (NBFC-ND).

A. Companies exempted from registration under RBI

Companies that do financial business but are regulated by other regulators are given specific exemption by the Reserve Bank from its regulatory requirements for avoiding duality of regulation. Following NBFCs have been exempted from the requirement of registration under Section 45-IA of the RBI Act, 1934 subject to certain conditions.

➢ Housing Finance Institutions (regulated by National Housing Bank);
➢ Merchant Banking Companies (regulated by Securities and Exchange Board of India);
➢ Stock Exchanges (regulated by Securities and Exchange Board of India);
➢ Companies engaged in the business of stock-broking/sub-broking (regulated by Securities and Exchange Board of India);
➢ Venture Capital Fund Companies (regulated by Securities and Exchange Board of India);
➢ Nidhi Companies (regulated by Ministry of Corporate Affairs, Government of India);
➢ Insurance companies (regulated by Insurance Regulatory and Development Authority); and
➢ Chit Companies (as defined in clause (b) of section 2 of the Chit Funds Act, 1982 (Act 40 of 1982)).
➢ Specified Micro Finance Companies.
➢ Securitisation and Reconstruction Companies.
➢ Mutual Benefit Companies.
➢ Core Investment Companies.
➢ Alternative Investment Fund (AIF) Companies.

Core Investment Companies with asset size of less than ₹ 100 crore, and those with asset size of ₹ 100 crore and above but not accessing public funds are exempted from registration with the RBI.

Pursuant to the announcement of *Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs* on 22 October 2021 to be effective from 01 October 2022, RBI has revised different facets of existing NBFC Classification and regulation like Capital Requirements, Governance Standards, Prudential Regulations, etc. based on four layers that are defined based on their size, activity, and perceived riskiness.

These four layers are NBFC – Base Layer (NBFC-BL), then NBFC- Middle Layer (NBFC-ML), NBFC Upper Layer (NBFC-UL) and lastly NBFC – Top Layer (NBFC-TL).

The Top layer is ideally expected to be empty and will be filled by RBI based on required need.

Details of NBFCs populating the various layers is mentioned below:

Base Layer

The Base Layer shall comprise of (a) non-deposit taking NBFCs below the asset size of ₹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.

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 ₹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).

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 **(for detailed circular scan the QR code given in Key Takeaways)**. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

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.

Categorisation of NBFCs carrying out specific activity

As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

(a) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.

(b) 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.

(c) 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.

(d) 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.

References to NBFC-ND, NBFC-ND-SI & NBFC-D - From October 01, 2022:

All references to NBFC-ND shall mean NBFC-BL and all references to NBFC-D and NBFC-NDSI shall mean NBFC-ML or NBFC-UL, as the case may be. However, existing NBFC-ND-SIs having asset size between ₹ 500 Crore and below ₹ 1000 Crore (except those necessarily featuring in Middle Layer) will be known as NBFC- BL.

The following glide path is provided for the existing NBFCs, viz., NBFC-ICC, NBFC-MFI5 and NBFC-Factor to achieve the NOF of ₹ 10 crore:

NBFCs	*Current NOF*	*By March 31, 2025*	*By March 31, 2027*
NBFC-ICC	***₹ 2 crore***	***₹ 5 crore***	***₹ 10 crore***
NBFC-MFI	***₹ 5 crore (₹ 2 crore in NE Region)***	***₹ 7 crore (₹ 5 crore in NE Region)***	***₹ 10 crore***
NBFC-Factor	***₹ 5 crore***	***₹ 7 crore***	***₹ 10 crore***

(for detailed circular scan the QR code given in Key Takeaways).

2. DIFFERENCE BETWEEN BANKS AND NBFCS

NBFCs lend and make investments and hence, their activities are akin to that of banks, however, there are a few differences between the two as given below:

i.	NBFC cannot accept demand deposits, however some NBFCs can accept Term Deposits;
ii.	NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
iii.	The deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available to depositors of NBFCs, unlike in case of banks.
iv.	No Minimum Exposure to Priority Sector required by NBFCs.

3. PRUDENTIAL NORMS

3.1 Capital Requirements

Every applicable NBFC as defined in the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 shall maintain a minimum capital ratio consisting of Tier 1 and Tier 2 capital which shall not be less than 15 percent of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items. Tier 1 capital in respect of NBFC (except NBFC-MFI and NBFC primarily engaged in lending against gold jewellery, at any point of time, shall not be less than 10 percent.

"Tier 1 capital" for NBFCs (except NBFCs-BL) is the sum of

(i) Owned fund as reduced by investment in shares of other NBFCs 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 percent of the owned fund; and

(ii) Perpetual debt instruments issued by a non-deposit taking NBFCs in each year to the extent it does not exceed 15 percent of the aggregate Tier 1 capital of such company as on March 31 of the previous accounting year.

Note – NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 1 capital.

Tier I capital for NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent of more of their financial assets) shall maintain a minimum Tier 1 capital of 12 percent of aggregate risk weighted assets of on-balance sheet and of risk adjusted value of off-balance sheet items.

"Tier 2 capital" for NBFCs (except NBFCs-BL) is the sum of

(i) ***Preference shares other than those which are compulsorily convertible into equity;***

(ii) ***Revaluation reserves at discounted rate of 55 percent;***

(iii) ***General provisions (including that for Standard Assets) and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets;***

(iv) ***Hybrid debt capital instruments;***

(v) ***Subordinated debt; and***

(vi) ***Perpetual debt instruments issued by a non-deposit taking NBFC which is in excess of what qualifies for Tier 1 capital;***

to the extent the aggregate does not exceed Tier 1 capital.

Note – NBFCs-BL are not eligible to include perpetual debt instruments in their Tier 2 capital.

Note for Students : [Students may refer detailed Guidelines given in the Appendix].

Explanations: In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. ***For example, percentage weights assigned to Fixed Assets is 100, Cash & Bank Balances is 0, etc.*** Hence, the value of each asset / item requires to be multiplied by the relevant risk weights to arrive at risk adjusted value of assets. The aggregate shall be taken into account for reckoning the minimum capital ratio. **The risk weighted asset shall be calculated as the weighted aggregate of funded items as detailed hereunder:**

S. No.	Weighted risk assets - On-Balance Sheet items	Percentage weight
(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
		100

	(d) Shares of all companies and debentures / bonds/ commercial papers of all companies and units of all mutual funds (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/*<u>Other Financial Assets</u>*:**	
	(a) Stock on hire (net book value)	100
	(b) Intercorporate loans/deposits	100
	(c) Loans and advances fully secured against deposits held	0
	(d) Loans to staff	0
	(e) Other secured loans and advances considered good	100
	(i) Consumer credit exposure (outstanding as well as new) categorised as retail loans, excluding housing loans, educational loans, vehicle loans, loans against gold jewellery and microfinance/SHG loans	***125***
	(ii) Credit Card Receivables	***125***
	[Except at (vi) below]	
	(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 & Fixture	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 / which are in default for a period not more than 90 days 20	20
	(e)	State Government guaranteed claims, which have remained in default for a period of more than 90 days	100

3.2 Income Recognition

The income recognition shall be based on recognised accounting principles. Income including interest/ discount/ hire charges/ lease rentals 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.

Asset classification: The asset classification norms as given below shall apply to every applicable NBFC (except NBFC-MFIs):

(1) Every NBFC shall, after taking into account the degree of well-defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely:

(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets.

(2) The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

(3) (i) Standard asset shall mean the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem or carry more than normal risk attached to the business.

(ii) "Sub-Standard Asset" shall mean:

(a) ***an asset which has been classified as non-performing asset for a period not exceeding 18 months except for NBFC-ML and above);***

Further, an asset which has been classified as non-performing asset for a period not exceeding 12 months for NBFC-ML and above) will be considered as Sub-Standard Asset;

(b) ***an asset, where the terms of the agreement regarding interest and/or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.***

Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 17 of these Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;

(iii) Doubtful Asset shall mean:

(a) a term loan, or

(b) a lease asset, or

(c) a hire purchase asset, or

(d) any other asset,

- ***which remains a sub-standard asset for a period 'exceeding 18 months' except for NBFC-ML and above.***
- ***which remains a sub-standard asset for a period 'exceeding 12 months' for NBFC-ML and above)***

(iv) Loss Asset shall mean:

(a) an asset which has been identified as loss asset by the NBFC or its internal or external auditor or by the Reserve Bank during the inspection of the applicable NBFC, to the extent it is not written off by the applicable NBFC; and

(b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.

(v) **Non-Performing Asset (referred as "NPA") shall mean:**

(a) an asset, in respect of which, interest has remained overdue for a period of more than 180 days.

(b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of more than 180 days or on which interest amount remained overdue for a period of more than 180 days.

(c) a demand or call loan, which remained overdue for a period of more than 180 days from the date of demand or call or on which interest amount remained overdue for a period of more than 180 days.

(d) a bill which remains overdue for a period of more than 180 days.

(e) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short-term loans/advances, which facility remained overdue for a period of more than 180 days.

(f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of more than 180 days.

(g) the lease rental and hire purchase instalment, which has become overdue for a period of more than 180 days.

(h) 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 when any of the above credit facilities becomes non-performing asset.

[Provided that in the case of lease and hire purchase transactions, an applicable NBFC shall classify each such account on the basis of its record of recovery.]

Note: The period of more than 180 days for NPA classification as mentioned above shall be adjusted as per glide path outlined as under.

Non-Performing Asset (referred as "NPA") Glide Path:

The extant NPA classification norm stands changed to the overdue period of more than 90 days for applicable NBFCs. A glide path is provided to applicable NBFCs to adhere to the 90 days NPA norm as under –

– NPA Norms	Timeline
>150 days overdue	By March 31, 2024
>120 days overdue	By March 31, 2025
> 90 days	By March 31, 2026

Note: The glide path will not be applicable to NBFCs which are already required to follow the 90-day NPA norm.

3.3 Provisioning Requirements

The provisioning requirements as given below shall apply to every applicable NBFC (except NBFC-MFIs): Every applicable NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as provided hereunder:

The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

(i) **Loss Assets:** The entire asset shall be written off. If the assets are permitted to remain in the books for any reason,100% of the outstanding shall be provided for;

(ii) **Doubtful Assets:**

(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the applicable NBFC has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis;

(b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. Estimated realisable value of the outstanding) shall be made on the following basis:

Period for which the asset has been considered as doubtful	Percent of provision
Up to one year	20
One to three years	30
More than three years	50

(iii) **Sub-standard assets:** A general provision of 10 percent of total outstanding shall be made.

(iv) ***Standard asset provisioning (except NBFC-ML and above): NBFC-BL shall make provision for standard assets at 0.25 percent of the outstanding, which shall not be reckoned for arriving at net NPAs. The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.***

Standard asset provisioning (Not applicable for NBFC-UL) NBFC shall make provisions for standard assets at 0.40 percent of the outstanding, which shall not be reckoned for arriving at net NPAs. The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

The above regulatory requirements are to be amended in a phased manner under the Scale-Based Regulation prescribed by RBI for NBFCs.

[Students may refer Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 for detailed guidelines on prudential norms relating to Non-Banking Financial Companies covered in these Directions.]

4. AUDIT PROCEDURES

The following are the necessary steps involved -

(1) **Ascertaining the Business of the Company -** The first step in carrying out the audit of NBFC is to scan through the Memorandum and Articles of Association of the company, so as to acquaint oneself with the type of business that the company is engaged into. Normally, the Memorandum of Association of any company would be very wide in scope thereby permitting

it to undertake a host of business activities, but companies generally lend to specialise in and focus on a few select activities. An auditor should, therefore, make a careful study of the business policy of the company so as to ascertain its principal business activities. For this purpose, an auditor may also scan through the minutes of the Board/Committee Meetings and hold discussions with the top level management to ascertain the corporate business plan/strategy which would give him a clear picture as to the principal objects of the company. An auditor should then independently corroborate his findings with the actual business done by the company, as reflected by the company's financial results.

The task of ascertaining the principal business activity of any NBFC is of paramount importance since the very classification of a company as an NBFC and its further classification would all depend upon its principal business activity. Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions.

(2) Evaluation of Internal Control System - The responsibility of maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of its business vests with the management. A sound internal control system would enable an organisation to plug loopholes in its workings, particularly in the detection of frauds and would also aid in timely decision making. An auditor should gain an understanding of the accounting system and related internal controls adopted by the NBFC to determine the nature, timing and extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate and are being effectively followed.

In particular, an auditor should review the effectiveness of the system of recovery prevalent at the NBFC. He should ascertain whether the NBFC has an effective system of periodical review of advances in place which would facilitate effective monitoring and follow up. The absence of a periodical review system could result in non-detection of sticky advances at their very inception which may ultimately result in the NBFC having an alarmingly high level of NPAs.

(3) Registration with the RBI - Section 45-IA inserted in the RBI Act, 1934, w.e.f. 9th January, 1997, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of ₹ 10 crore (Although the requirement of minimum NOF at present stands at ₹ 200 lakh, . However, for strengthening the financial sector and technology adoption, and in view of the increasing complexities of services offered by NBFCs, it shall be mandatory for all NBFCs to raise minimum NOF to ₹ 10 crore) for commencing/ carrying on its business. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC.

Every NBFC holding public deposits is required to invest a specified percentage (as the RBI may specify from time to time). The RBI has also prescribed a format for reporting to ensure compliance with the requirement of maintenance of liquid assets on a quarterly basis. This quarterly return (duly signed by an officer of the NBFC) is required to be submitted within prescribed time limit from the end of the relevant quarter and with reference to investments held in approved securities during the relevant quarter. The auditor should ascertain whether investment in prescribed liquid assets have been made and whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.

(4) **NBFC Acceptance of Public Deposit Directions (Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016) -** The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results. Thereafter, it must be ascertained whether the company has complied with the following aspects in relation to the activity of mobilisation of public deposits:

(i) The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. Obtain a copy of the credit rating assigned to NBFC and check whether the public deposits accepted/held by it are in accordance with the level of credit rating assigned to it.

In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI in writing.

In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment and credit company or a factor, shall regularise the excess deposit as provided hereunder:

(a) with immediate effect, stop accepting fresh public deposits and renewing existing deposits;

(b) all existing deposits shall run off to maturity; and

(c) report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered.

Provided no matured public deposit shall be renewed without the express and voluntary consent of the depositor.

(ii) Test check the interest calculations in respect of public deposits mobilised by an NBFC to ascertain that the NBFC has not paid interest in excess as per specification.

Likewise, test check the brokerage/ commission/ incentive calculations with the bills and vouchers for reimbursement of out of pocket expenses submitted by the parties to ascertain that the NBFC has not paid brokerage/ commission/ incentive/ reimbursement of expenses in excess as per specification.

(iii) Ascertain whether the NBFC has accepted or renewed any public deposit only after a written application form the depositor in the form to be supplied by the company, and shall contain all particulars specified in the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977. Further ensure whether it contain the specific category of depositor, i.e., whether depositor is a shareholder or a director or a promoter or a member of public.

(iv) Verify the deposit register maintained by NBFC and test check the particulars that have been entered therein in respect of each depositor with supporting receipts issued to the depositors. Also check whether the NBFC is regularly paying its deposits on due dates and in the case of a delay/default, the reasons for the delay/default and the actual date of payment.

(v) Check whether the investments made in approved liquid assets by NBFC holding public deposits have been lodged in safe custody with a designated scheduled commercial bank as required by the NBFC Acceptance of Public Deposits Directions and also whether. certificate was obtained from the RBI to that effect.

(vii) Check whether the NBFC has filed its prescribed returns in a timely manner.

(viii) In the case of NBFCs not accepting/holding public deposits, check whether a board resolution has been passed by the NBFC to the effect that it has neither accepted any public deposits nor would it accept any public deposits during the year.

(ix) In the case of Group Holding Investment Companies, check whether the NBFC has passed a board resolution to the effect that the company has invested or would invest/hold its investments in share and securities of group companies specifying the names of the companies. In addition to the above, group holding investment companies are required to give a further undertaking that it would not trade in such shares/securities and that it has neither accepted nor would it accept any public deposits during the year.

(5) NBFC Prudential Norms -

(i) Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad and doubtful debts, capital adequacy norms, prohibition on granting of loans by NBFC against its own shares, prohibition on loans and investments for failure to repay public deposits and norms for concentration of credit/investments.

(ii) An auditor should ensure that the Board of Directors of every NBFC granting/intending to grant demand/call loans shall frame and implement a policy for the company.

(iii) An auditor should assess on the basis of examinations conducted by him whether the NBFC has complied with the prudential norms. In particular, he should verify that advances and other credit facilities have been properly classified as standard/substandard/doubtful/loss and that proper provision has been made in accordance with the Directions.

(iv) In respect of Non-Performing Assets, an auditor should check whether the unrealised income in respect of such assets has not been taken to the Profit & Loss Account on an accrual basis. Income from NPAs should be accounted for on realisation basis only.

(v) Check whether all accounts which have been classified as NPAs in the previous year also continue to be shown as such in the current year also. If the same is not treated as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.

TEST YOUR UNDERSTANDING 1

"Fin crazy" is a P2P online platform owned by Future Technologies Pvt. Limited which is registered with RBI as NBFC. Peer to Peer Platform (P2P) means an intermediary providing the services of loan facilitation via online medium or otherwise to the participants.

Participants have to enter into an arrangement with NBFC-P2P to lend on its platform or avail loan facilitation services provided by it. It provides only as a medium connecting lenders and borrowers. It also carries out the credit assessment and risk profiling of the participants on the platform. It also provides services relating to loan documentation and loan recovery. The company falls outside purview of upper layer.

Where does such NBFC fit in accordance with scale-based regulations? Suggest a few audit procedures for above NBFC-P2P.

5. CLASSIFICATION OF FRAUDS BY NBFC

In order to have uniformity in reporting, frauds have been classified as under based mainly on the provisions of the Indian Penal Code:

(a) Misappropriation and criminal breach of trust.

(b) Fraudulent encashment through forged instruments, manipulation of books of account or through fictitious accounts and conversion of property.

(c) Unauthorised credit facilities extended for reward or for illegal gratification.

(d) Negligence and cash shortages.

(e) Cheating and forgery.

(f) Irregularities in foreign exchange transactions.

(g) Any other type of fraud not coming under the specific heads as above.

Cases of 'negligence and cash shortages' and 'irregularities in foreign exchange transactions' referred to in items (d) and (f) above are to be reported as fraud if the intention to cheat/ defraud is suspected/ proved. However, the following cases where fraudulent intention is not suspected/ proved, at the time of detection, will be treated as fraud and reported accordingly:

(a) cases of cash shortages more than ₹ 10,000/- and

(b) cases of cash shortages more than ₹ 5000/- if detected by management/ auditor/ inspecting officer and not reported on the occurrence by the persons handling cash.

NBFCs, covered in Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016, having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the prescribed format and procedures.

6. AUDIT CHECK-LIST

Some important points that may be covered in the audit of NBFCs, in addition to the audit points that may be covered for companies in general, are given below:

(eg. NBFC - Investment and Credit Company (NBFC-ICC)

i. Physically verify all the shares and securities held by NBFC. Where any security is lodged with an institution or a bank, a certificate from the bank/institution to that effect must be verified.

ii. Verify whether the NBFC has not advanced any loans against the security of its own shares.

iii. Verify that dividend income wherever declared by a company, has been duly received by an NBFC and interest wherever due [except in case of NPAs] has been duly accounted for. NBFC Prudential Norms require dividend income on shares of companies and units of mutual funds to be recognised on cash basis. However, the NBFC has an option to account for dividend income on accrual basis, if the same has been declared by the body corporate in its Annual General Meeting and its right to receive the payment has been established. Income from bonds/debentures of corporate bodies is to be accounted on accrual basis only if the interest rate on these instruments is predetermined and interest is serviced regularly and not in arrears.

iv. Test check bills/contract notes received from brokers with reference to the prices vis-à-vis the stock market quotations on the respective dates.

v. Verify the Board Minutes for purchase and sale of investments. Ascertain from the Board resolution or obtain a management certificate to the effect that the investments so acquired are current investments or Long-Term Investments.

vi. Check whether the investments have been valued in accordance with the NBFC Prudential Norms and adequate provision for fall in the market value of securities, wherever applicable, have been made there against, as required by the Directions.

vii. Obtain a list of subsidiary/group companies from the management and verify the investments made in subsidiary/group companies during the year. Ascertain the basis for arriving at the price paid for the acquisition of such shares and whether the Valuation is as per Prudential norms.

viii. Check whether investments in unquoted debentures/bonds have not been treated as investments but as term loans or other credit facilities for the purposes of income recognition and asset classification.

ix. An auditor will have to ascertain whether the requirements of AS 13 "Accounting for Investments" or other accounting standard, as applicable, (to the extent they are not inconsistent with the Directions) have been duly complied with by the NBFC.

x. In respect of shares/securities held through a depository, obtain a confirmation from the depository regarding the shares/securities held by it on behalf of the NBFC.

xi. Verify that securities of the same type or class are received back by the lender/paid by the borrower at the end of the specified period together with all corporate benefits thereof (i.e. dividends, rights, bonus, interest or any other rights or benefit accruing thereon).

xii. Verify charges received or paid in respect of securities lend/borrowed.

xiii. Obtain a confirmation from the approved intermediary regarding securities deposited with/borrowed from it as at the year end.

xiv. An auditor should examine whether each loan or advance has been properly sanctioned. He should verify the conditions attached to the sanction of each loan or advance i.e. limit on borrowings, nature of security, interest, terms of repayment, etc.

xv. An auditor should verify the security obtained and the agreements entered into, if any, with the concerned parties in respect of the advances given. He must ascertain the nature and value of security and the net worth of the borrower/guarantor to determine the extent to which an advance could be considered realisable.

xvi. Obtain balance confirmations from the concerned parties.

xvii. As regards bill discounting, verify that proper records/documents have been maintained for every bill discounted/rediscounted by the NBFC. Test check some transactions with reference to the documents maintained and ascertain whether the discounting charges, wherever, due, have been duly accounted for by the NBFC.

xviii. Check whether the NBFC has not lent/invested in excess of the specified limits to any single borrower or group of borrowers as per NBFC Prudential Norms.

xix. An auditor should verify whether the NBFC has an adequate system of proper appraisal and follow up of loans and advances. In addition, he may analyse the trend of its recovery performance to ascertain that the NBFC does not have an unduly high level of NPAs.

xx. Check the classification of loans and advances (including bills purchased and discounted) made by NBFC into Standard Assets, Sub-Standard Assets, Doubtful Assets and Loss Assets and the adequacy of provision for bad and doubtful debts as required by NBFC Prudential Norms.

(Note: The above checklist is not exhaustive. It is only illustrative. There could be various other audit procedures which may be performed for audit of an NBFC. Based on the nature and size of the NBFC, the auditor will have to perform specific audit techniques in that regard)

7. AUDITOR'S DUTY

The following are the important duties of an auditor -

7.1 Compliance with NBFC Auditor's Report - RBI Directions

The RBI Directions have considerably increased the responsibility of auditors of NBFCs. A very onerous task of reporting to the Board of Directors on certain specified matters and to the RBI on an exception basis has been imposed upon him. This reporting requirement is in addition to the normal reporting requirements to the shareholders under section 143 of the Companies Act, 2013.

Auditors will, thus, have to be very careful whilst carrying out audits of NBFCs to ensure that all matters which they are required to take into consideration for the purposes of reporting to the RBI have been taken due care of.

Section 45MA of the Reserve Bank of India Act, 1934 was introduced with effect from 13.12.1974. Under this provision the auditor of a non-banking financial company or a non-banking miscellaneous company which has accepted public deposits, has to inquire whether or not the company has furnished to the Reserve Bank of India statements, information of particulars relating to the deposits as are required to the furnished under Chapter IIIB of the Reserve Bank of India Act, 1934. The provision further states that if on inquiry the auditor is not satisfied about the compliance by the company, it is his duty to make to the Reserve Bank of India giving the aggregate amount of deposits held by the company. The auditor is also required to incorporate the report or intended to be made to the Reserve Bank of India in his report to the company under Section 143 of the Companies Act, 2013.

Report to Board of Directors under RBI Directions as per Master Direction – Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024

(1) The Reserve Bank of India (RBI) has issued Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the Directions) to auditor of every non-banking financial companies.

(2) The Directions shall apply to every auditor of a non-banking financial company as defined in section 45 I(f) of the Reserve Bank of India Act, 1934.

Auditors to submit additional Report to the Board of Directors: In addition to the Report made by the auditor under Section 143 of the Companies Act, 2013 or section 227 of the Companies Act, 1956 (Act 1 of 1956) on the accounts of a non-banking financial company examined for every financial year ending on any day on or after the commencement of these Directions, the auditor shall also make a separate report to the Board of Directors of the Company on the matters specified in paragraphs 3 and 4 below.

(3) **Material to be included in the Auditor's report to the Board of Directors:** The auditor's report on the accounts of a non-banking financial company shall include a statement on the following matters, namely –

(A) In the case of all non-banking financial companies:

I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.

II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in ***Master Direction*** – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 and Deposit taking Company (Reserve Bank) Directions, 2016.

Note: Every non-banking financial company shall submit a Certificate from its Statutory Auditor that it is engaged in the business of non-banking financial institution requiring it to hold a Certificate of Registration under Section 45-IA of the RBI Act and is eligible to hold it. A certificate from the Statutory Auditor in this regard with reference to the position of the company as at end of the financial year ended March 31st may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, ***within 5 working days from the date of signing of the Auditor's report in terms of section 134 of the Companies Act, 2013, but not later than December 31st of same year, in any case.***

The format of Statutory Auditor's Certificate (SAC) to be submitted by NBFCs has been issued vide Master Direction – Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024.

(B) In the case of non-banking financial companies accepting/holding public deposits

Apart from the matters enumerated in (A) above, the auditor shall include a statement on the following matters, namely-

(i) Whether 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;

(b) from its shareholders (if it is a public limited company); and

(c) from entities 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) Whether 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) Whether the non-banking financial company is accepting "public deposit" without 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) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023*** has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;

(v) In respect of non-banking financial companies referred to in clause (iii) above,

(a) whether the credit rating, for each of the fixed deposits schemes that has been assigned by one of the Credit Rating Agencies listed in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 is in force; and

(b) whether the aggregate amount of deposits outstanding as at any point during the year has exceeded the limit specified by the such Credit Rating Agency;

(vi) Whether the company has violated any restriction on acceptance of public deposit as provided in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(vii) Whether the company has defaulted in paying to its depositors the interest and/or principal amount of the deposits after such interest and/or principal became due;

(viii) Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;***

(ix) 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 RBI Act and whether the details of the designated bank in which the approved securities are held is communicated to the office concerned of the RBI in terms of NBS 3; Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016;

(x) Whether the company has furnished to the RBI within the stipulated period the return on deposits as specified in the ***DNBS 01*** to ***– Master Direction – Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024***;

(xi) Whether the company has furnished to the RBI within the stipulated period the quarterly return on prudential norms as specified in the ***Master Direction – Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024;***

(xii) Whether, 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.

(C) In the case of a non-banking financial company not accepting public deposits

Apart from the aspects enumerated in (A) above, the auditor shall include a statement on the following matters, namely: -

(i) Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;

(ii) Whether the company has accepted any public deposits during the relevant period/year;

(iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of ***Master***

Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;

(iv) (a) Whether the capital adequacy ratio as disclosed in the return submitted to the RBI in form NBS - 7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the RBI;

(b) Whether the company has furnished to the RBI the annual statement of capital funds, risk assets/exposures and risk asset ratio (NBS-7) within the stipulated period.

(v) whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.***

(D) In the case of a company engaged in the business of non-banking financial institution not required to hold CoR subject to certain conditions

Apart from the matters enumerated in (A)(I) above where a company has obtained a specific advice from the RBI that it is not required to hold CoR from the RBI, the auditor shall include a statement that the company is complying with the conditions stipulated as advised by the RBI.

(4) **Reasons to be stated for unfavourable or qualified statements:** Where, in the auditor's report, the statement regarding any of the items referred to in paragraph 3 above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred to in paragraph 3 above, his report shall indicate such fact together with reasons therefor.

(5) **Obligation of auditor to submit an exception report to the RBI**

(I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with:

(a) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or

(b) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or

(c) ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.***

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

7.2 Compliance with CARO 2020

As per CARO 2020, the auditor is required to report that –

I. Whether during the year the company has made investments in, provided any guarantee or security or granted any loans or advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, If so,

(a) whether the investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are not prejudicial to the company's interest;

(b) in respect of loans and advances in the nature of loans, whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(d) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, if so, specify the aggregate amount, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013; [Paragraph 3(iii)]

(II) (a) Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

(b) Whether the company has conducted any Non-Banking Financial or Housing Finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934;

(c) Whether the company is a Core Investment Company (CIC) as defined in the regulations made by the Reserve Bank of India, if so, whether it continues to fulfil the criteria of a CIC, and in case the company is an exempted or unregistered CIC, whether it continues to fulfil such criteria;

(d) Whether the Group has more than one CIC as part of the Group, if yes, indicate the number of CICs which are part of the Group; [Paragraph 3(xvi)]

(**Note: Students are required to refer Guidance Note on CARO, 2020 for more details**).

TEST YOUR UNDERSTANDING 2

Sugam Housing Finance Limited is in the business of housing finance activities having asset size of ₹ 800 crores. Its principal business is of providing finances for housing mainly to individuals. It is not identified by RBI in upper layer. Under scale-based regulations introduced by RBI, what should be appropriate classification for such a company?

Is there any specific reporting requirement under CARO, 2020 for statutory auditor of a company engaged in housing finance activities?

8. INDIAN ACCOUNTING STANDARDS (IND AS)

8.1 Applicability of Indian Accounting Standards (Ind AS) on NBFCs

NBFCs are required to comply with Indian Accounting Standards (Ind AS) as per Rule 4 (1)(iv) of the Companies (Indian Accounting Standards) Rules, 2015 and as amended by the Companies (Indian Accounting Standards) (Amendment) Rules, 2023.

8.2 Format for Preparation of Financial Statements by NBFCs under Ind- AS

The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind AS has been prescribed.

Every NBFC required to comply with Ind AS shall prepare its financial statements as per below format:

Illustrative format of Balance Sheet under Division III of Schedule III-

Particulars	Note No.	Figures as at the end of current reporting period (₹)	Figures as at the end of previous reporting period (₹)
ASSETS			
(1) Financial Assets			
(a) Cash and cash equivalents			
(b) Bank balance other than (a) above			
(c) Derivative financial instruments			
(d) Receivables			
(1) Trade Receivables			
(2) Other Receivables			
(e) Loans			
(f) Investments			
(g) Other Financial assets			
(2) Non-Financial Assets			
(a) Inventories			
(b) Current tax assets (net)			
(c) Deferred tax assets (net)			
(d) Investment property			
(e) Biological assets other than bearer plants			
(f) Property, Plant and Equipment			
(g) Capital work-in-progress			
(h) Intangible assets under development			
(i) Goodwill			
(j) Other intangible assets			
(k) Other non-financial assets (to be specified)			
Total Assets			

Particulars	Note No.	Figures as at the end of current reporting period (₹)	Figures as at the end of previous reporting period (₹)
LIABILITES AND EQUITY			
LIABILITIES			
(1) Financial Liabilities			
(a) Derivative financial instruments			
(b) Payables			
(I) Trade Payables			
(i) total outstanding dues of micro enterprises and small enterprises			
(ii) total outstanding dues of creditors other than micro enterprises and small enterprises			
(II) Other Payables			
(i) total outstanding dues of micro enterprises and small enterprises			
(ii) total outstanding dues of creditors other than micro enterprises and small enterprises			
(c) Debt Securities			
(d) Borrowings (other than debt securities)			
(e) Deposits			
(f) Subordinated liabilities			
(g) Other financial liabilities (to be specified)			
(2) Non-financial Liabilities			
(a) Current tax liabilities (net)			
(b) Provisions			

Particulars	Note No.	Figures as at the end of current reporting period (₹)	Figures as at the end of previous reporting period (₹)
(c) Deferred Tax Liabilities (net) (d) Other non-financial liabilities (to be specified)			
(3) Non-financial Capital (a) Equity share capital (b) Other equity			
Total Liabilities and Equity			

Illustrative format of Statement of Profit and Loss prescribed under Division III of Schedule III

Particulars	Notes No.	Figures for the current reporting period (₹)	Figures for the previous reporting period (₹)
Revenue from operations (a) Interest Income (b) Dividend income (c) Rental income (d) Fee and commission income (e) Net gain on fair vale changes (f) Net gain on derecognition of financial instruments under amortised category (g) Sale of products (including Excise duty) (h) Sale of services (i) Others (to be specified)			
Total revenue from operations (I)			
Other income (to be specified) (II)			
Total Income (III= I + II)			

Particulars	**Notes No.**	**Figures for the current reporting period (₹)**	**Figures for the previous reporting period (₹)**
Expenses (a) Finance costs (b) Fees and commission expense (c) Net loss on fair vale changes (d) Net loss on derecognition of financial instruments under amortised category (e) Impairment on financial instruments (f) Cost of material consumed (g) Purchases of stock-in-trade (h) Changes in Inventories of finished goods, stock-in-trade and work-in-progress (i) Employee Benefits Expenses (j) Depreciation, amortization and impairment (k) Other expenses (to be specified			
Total Expenses (IV)			
Profit / (loss) before exceptional items and tax (V= III - IV)			
Exceptional items (VI)			
Profit / (loss) before tax (VII= V - VI)			
Tax Expense (VIII): (1) Current tax (2) Deferred tax			
Profit / (loss) for the period from continuing operations (IX= VII - VIII)			
Profit / (loss) for the period from discontinued operations (X)			
Tax Expense of discontinued operations (XI)			

Particulars	Notes No.	Figures for the current reporting period (₹)	Figures for the previous reporting period (₹)
Profit / (loss) for the period from discontinued operations after tax (XII= X - XI)			
Profit / (loss) for the period (XIII= IX + XII)			
Other Comprehensive Income (XIV)			
(A) (i) Items that will not be reclassified to profit or loss (specify items and amounts) (ii) income tax relating to items that will not be reclassified to profit or loss SUB-TOTAL (A)			
(B) (i) Items that will be reclassified to profit or loss (specify items and amounts) (ii) income tax relating to items that will be reclassified to profit or loss SUB-TOTAL (B)			
Other Comprehensive Income (A+B)			
Total Comprehensive Income for the period (XV = XIII + XIV) (Comprising Profit (Loss) and other Comprehensive Income for the period)			
Earnings per equity share (for continuing operations) (XVI) Basic (₹) Diluted (₹)			
Earnings per equity share (for discontinued operations) (XVII) Basic (₹) Diluted (₹)			

Particulars	Notes No.	Figures for the current reporting period (₹)	Figures for the previous reporting period (₹)
Earnings per equity share (for continuing and discontinued operations) (XVIII) Basic (₹) Diluted (₹)			

Note : Student may also refer illustrative format of Statement of Changes in Equity prescribed under Division III of Schedule III for more understanding.

8.3 Difference between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(a) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II.

(b) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of *the revenue from operations or ₹10 lakhs, whichever is higher.*

(c) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.

(d) NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of showing those only as part of the notes.

(e) Separate disclosure of trade receivable which have significant increase in credit risk & credit impaired

(f) The conditions or restrictions for distribution attached to statutory reserves have to be separately disclose in the notes as stipulated by the relevant statute.

TEST YOUR UNDERSTANDING 3

You are auditor of a deposit taking NBFC (NBFC-D). The NBFC is identified by RBI in its upper layer and its financial statements are required to be prepared in accordance with requirements of Ind AS. The following is extract of statement of profit and loss for year ending 31st March, 2024 in accordance with Division III of Schedule III of the Companies Act, 2013. Previous year figures are ignored.

Particulars	Note No.	Figures for year ended 31st March, 2024 (in ₹ Crores)
Revenue from Operations		
(i) Interest income	15	9500
(ii) Dividend income		-
(iii) Rental Income		150
(iv) Fees and commission income	16	100
(v) Net gain on fair value changes	17	150
(vi) Net gain on derecognition of financial instruments under amortised category		
(I) Total revenue from operations		9900
(II) Other Income	18	100
(III) Total Income		10000

On going through details of head "other expenditure" in expenses side of statement of profit and loss, it is noticed that there is an expenditure relating to manpower outsourcing cost amounting to ₹ 99.50 crores included under "other expenditure".

Does it meet the requirements of Division III of Schedule III of the Companies Act, 2013?

Key Takeaways

- A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45–IA of the RBI Act, 1934 can apply to the Reserve Bank of India in prescribed form along with necessary documents for registration. The RBI issues Certificate of Registration after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

- A non-banking company is defined under RBI Act 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.

  Further, in order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

- RBI has issued directions to non-banking financial companies on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

- RBI has introduced scale based regulations for NBFCs based on four layers that are defined based on their size, activity, and perceived riskiness. The four layers are- Base layer, middle layer, upper layer and top layer.

- NBFCs lend like banks. However, such entities cannot accept demand deposits although some can accept term deposits. These also do not form part of payment and settlement system. DICGC cover is not available to depositors of NBFCs. No minimum exposure to priority sector is required by NBFCs.

- Every applicable NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets in accordance with prescribed norms.

- Audit procedures for NBFCs have to be tailored in accordance of nature of business of NBFC and regulatory directions.

- Besides issuing a report in accordance with requirements of section 143(3) of the Companies Act, 2013 and covering matters specified under CARO, 2020, statutory auditor of NBFC is also required to submit an additional report to Board of Directors of the company.
- The Reserve Bank of India (RBI) has issued Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the Directions) to auditor of every non-banking financial company in this regard. Under these directions, the auditor of an NBFC has to submit an additional report to the Board of Directors of the company covering matters specified in these directions.

Circular on Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCS: SCAN ME !

TEST YOUR KNOWLEDGE

Theoretical Questions

1. *Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs.*
2. *Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.*

3. *Satyam Pvt Ltd is a company engaged in trading activities, it also has made investments in shares of other Companies and advanced loans to group companies amounting to more than 50% of its total assets. However, trading income constitutes majority of its total income. Whether the Company is an NBFC?*

4. *Shivam & Co LLP are the auditors of NBFC (Investment and Credit Company). Some of the team members of the audit team who audited this NBFC have left the firm and the new team members are in discussion with the previous team members who are still continuing with the firm regarding the verification procedures to be performed. In this context, please explain what verification procedures should be performed in relation to the audit of NBFC - Investment and Credit Company (NBFC-ICC).*

5 *You are appointed as the auditor of an NBFC registered with the RBI and which is accepting and holding public deposits. You are considering your reporting requirement in addition to your report made under Section 143 of the Companies Act, 2013 on the accounts of this NBFC as per the prescribed Directions.*

   Please explain what points are required to be known in respect of the separate report to be given by you to the Board of Directors of this NBFC.

6. *Kamna & Co LLP, a firm of Chartered Accountants, was appointed as auditor of an NBFC. The audit work has been completed. The audit team which was involved in the fieldwork came across various observations during the course of audit of this NBFC and have also limited understanding about the exceptions which are required to be reported in the audit report. They would like to understand in detail regarding the obligations on the part of an auditor in respect of exceptions in his report so that they can conclude their work. Please explain.*

7. *The Statutory Auditor of the NBFC company is required to give a report to the Board of Directors. What shall be the content of the Auditor's Report to the Board.*

8. *Krishna Pvt Ltd is primarily into the business of selling computer parts. However, the company is fulfilling the Principal Business Criteria as at the balance sheet date i.e. Financial Assets are more than 50% of total assets and Financial Income is more than 50% of Gross Income. What shall be the obligation of the Statutory Auditor in such a scenario?*

9. *Mr. G. has been appointed as an auditor of LMP Ltd., an NBFC company registered with RBI. Mr. G is concerned about whether the format of financial statements prepared by LMP Ltd. is as per notification issued by the Ministry of Corporate Affairs (MCA) dated October 11, 2018. The notification prescribed the· format in Division III under Schedule III of the Companies Act, 2013 applicable to NBFCs complying with Ind-AS. Mr. G wants to know the*

differences in the presentation requirements between Division II and Division III of Schedule III of the Companies Act, 2013. Guide Mr. G.

10. *Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company had net owned funds of ₹ 1,50,00,000/-(one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2024. The company appointed Mr. Kabra as its statutory auditor for the year 2023-24. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?*

11. ***Yo-Yo Finance Limited is NBFC-ML as per the revised categorisation of NBFC done by RBI. YAK & Associates, a firm of chartered accountants, are appointed as Statutory Auditors of the Company for the year 2023-24.***

    The audit team consists of CA Y, 1 Audit Manager and 3 junior assistants. The Audit Manager has been recently appointed, who does not have much exposure in the field of Auditing of NBFCs. During the engagement team meeting, the Audit Manager asked CA Y, regarding the audit procedures to be undertaken to verify whether the aforesaid Company has followed Prudential Norms? As an Engagement partner suggest any four procedures to the Audit Manager.

12. **Singh Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by government or local authorities. For the year ended 31st March 2024, the following are some extracts from the financial statements:**

(i)	**Paid-up share capital**	**₹ 50 Cr.**
(ii)	**Non-Current Assets - Loans & Advances**	**₹ 61.75 Cr.**
(iii)	**Current Assets - Loans and advances**	**₹ 312.25 Cr.**
(iv)	**Total assets of the company**	**₹ 620 Cr.**
(v)	**Intangible assets**	**₹ 12 Cr.**
(vi)	**Profit for the Year**	**₹ 7.25 Cr.**
(vii)	**Income from interest and dividends**	**₹ 68 Cr.**
(viii)	**Gross income**	**₹ 118.75 Cr.**

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.

Answers to Test Your Understanding.

1. NBFC-P2P falls in base layer in accordance with scale-based regulations of RBI. Few audit procedures for NBFC-P2P are as under: -

- Gaining an understanding of business conducted by NBFC-P2P. It should be verified that the company undertakes only permissible activities applicable to such type of NBFCs like providing online market place to participants for lending and borrowing. It should not be engaged in the business of lending funds on its own.
- Verifying certificate of registration obtained from RBI for carrying business of P2P platform.
- Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.
- Verifying board approved policy for pricing of services provided by P2P platform
- Verification of adherence to lending and borrowing guidelines prescribed by RBI
- Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
- Compliance with reporting requirements of RBI
- Verifying board approved policy for grievance redressal and complaints

2. The said company is not identified in upper layer by RBI. Under scale-based regulations introduced by RBI, NBFCs undertaking housing finance activities constitute "middle layer". The asset size is not relevant in such a case. All housing finance companies not identified in upper layer would constitute middle layer due to nature of such activities undertaken by them.

There is specific reporting requirement under CARO, 2020 under clause 3 (xvi)(b) which requires auditor to report whether the company has conducted any non-Banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India as per the Reserve Bank of India Act, 1934.

3. An NBFC is preparing financial statements in accordance with requirements of Division III of Schedule III of the Companies Act, 2013 has to separately disclose by way of note any item of "other expenditure" exceeding 1% of total income.

The said expenditure of ₹ 99.50 crore does not exceed 1% of total income. Hence, it meets requirements of Division III of Schedule III of the Companies Act, 2013.

Answers to Theoretical Questions

1. Refer Para 1 – Definition and Types of NBFCs.

2. **An auditor should know following points regarding registration and regulation of NBFCs:** Under Section 45–IA of the RBI Act, 1934, no NBFC shall commence or carry on the business of a non-banking financial institution without

   - obtaining a certificate of registration issued by the RBI; and
   - having a net owned fund (NOF) of ₹ 25 lakhs (₹ Two crore since April 1999) not exceeding two hundred lakhs rupees, as the RBI may, by notification in the Official Gazette, specify.

   (The RBI (Amendment) Act (1997) provided an entry point norm of ₹ 25 lakh as the **minimum NOF** which was revised upwards to ₹ 2 crore for new NBFCs seeking grant of certificate of registration (CoR) on or after 21 April 1999).

   A company incorporated under the Companies Act and desirous of commencing business of non-banking financial institution as defined under Section 45–IA of the RBI Act, 1934 can apply to the RBI in prescribed form along with necessary documents for registration. The RBI issues CoR after satisfying itself that the conditions as enumerated in Section 45-IA of the RBI Act, 1934 are satisfied.

   However, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock Broking Companies registered with SEBI, Insurance Company holding a valid CoR issued by IRDA, Nidhi Companies as notified under Section 406 of the Companies Act, 2013, Chit Companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 or Housing Finance Companies regulated by National Housing Bank.

   The RBI has issued directions to NBFCs on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.

   Directions were also issued to auditors to report non-compliance with the RBI Act and regulations to the Reserve Bank, Board of Directors and shareholders.

3. In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India.

In the given case, though Satyam Pvt Ltd is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.

4. Refer Para 6.

5. Refer Para 7.1(3), (4).

6. Refer Para 7.1(5).

7. Ref Para 7.1.

The statutory auditor of Karma Pvt Ltd, being NBFC is required to submit separate report to the Board of Directors on the matters as specified as below:

I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide the RBI's press release dated April 08, 1999, and directions issued by DNBR, auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.

II. In case of a company holding CoR issued by the RBI, whether that company is entitled to continue to hold such CoR in terms of its Principal Business Criteria (Financial asset/income pattern) as on March 31 of the applicable year.

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.***

Apart from the aspects enumerated above, the auditor shall include a statement on the following matters, namely: -

(i) Whether the Board of Directors has passed a resolution for non- acceptance of any public deposits;

(ii) Whether the company has accepted any public deposits during the relevant period/year;

(iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of ***Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;***

Where, in the auditor's report, the statement regarding any of the items referred to matters specified above is unfavourable or qualified, the auditor's report shall also state the reasons for such unfavourable or qualified statement, as the case may be. Where the auditor is unable to express any opinion on any of the items referred above, his report shall indicate such fact together with reasons thereof.

8. Ref Para 7.1.

In the given case, Krishna Pvt Ltd is fulfilling the Principal Business Criteria i.e. Financial Assets are more than 50 % of total assets and Financial Income is more than 50 % of Gross Income. The company which fulfils both these criteria shall qualify as an NBFC and hence is required to obtain Certificate of Registration (CoR) with Reserve Bank of India. In such a scenario, the statutory auditor has an obligation to submit exception report to the RBI on the following matters :

(I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016, is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:

(a) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or

(b) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or

(c) Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023.

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

(II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

9. Refer Para 8.3.

10. As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report that "whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained."

The auditor is required to examine whether the company is engaged in the business which attract the requirements of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restricts companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

Audit Procedures and Reporting:

(i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.

(ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.

(iii) Whether the company has net owned funds as required for the registration as NBFC.

(iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.

(v) The auditor should report incorporating the following:-

(1) Whether the registration is required under section 45-IA of the RBI Act, 1934.

(2) If so, whether it has obtained the registration.

(3) If the registration not obtained, reasons thereof.

In the instant case Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹ 1,50,00,000/-(one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2024). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO, 2020.

11. **Refer Para 4.5.**

12. **In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the audited balance sheet of the previous year to decide its principal business. The company will be treated as NBFC when**

    (i) **Financial assets of the company constitute more than 50 percent of the total assets (netted off by intangible assets) and**

    (ii) **Income from financial assets of the company constitutes more than 50 percent of the gross income.**

    A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by RBI.

    In the given case of Singh Ltd, its financial assets are ₹ 374 Crore i.e., (₹ 61.75 + ₹ 312.25)

    Total Assets (netted off by intangible assets) = ₹ 608 Crore

    Income from financial assets = ₹ 68 Crore

    Gross Income = ₹ 118.75 Crore

    From the above, it can be concluded that financial assets of Singh Ltd. constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets of Singh Ltd. constitutes more than 50 per cent of the gross income. Hence, Singh Ltd. fulfills both the criteria to qualify as an NBFC.

    Thus Singh Ltd. can apply for registration under Section 45-IA of the Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.