

Technical Guide on Audit of Non-Banking Financial Companies



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

**Technical Guide on Audit of
Non-Banking Financial Companies
(Revised Edition 2012)**



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FOREWORD

Non-banking financial companies (NBFCs) are an important segment of the Indian financial sector. They raise funds from the public and provide loans to various entrepreneurs, not only in the corporate sector and organized sector but also in the unorganised sector, especially, to the small-scale industries and the self-employed. NBFCs are playing a significant role in the financial sector by broadening and diversifying the range of services provided by the financial sector to the public.

However, NBFCs are also prone to misuse of public funds, irregularities in functioning, unsustainability of operations, bankruptcies. Therefore, the role of statutory audits of NBFCs is very important to bring discipline in the functioning of NBFCs. Audit of NBFCs involves many peculiarities which can be addressed through a technical audit guide dealing with various aspects of audit of NBFCs.

I am happy that the Auditing and Assurance Standards Board of ICAI has brought out this Revised Edition of the Technical Guide on Audit of Non-Banking Financial Companies whose first edition was issued in the year 2010. I am also happy that the Technical Guide is quite comprehensive in its coverage, dealing with various aspects of audit of NBFCs, including the various circulars/notifications, guidelines issued by the RBI relating to NBFCs.

At this juncture, I wish to place my appreciation for CA. Abhijit Bandyopadhyay, Chairman, Auditing and Assurance Standards Board for continuing his proactive initiatives to help the members in conducting audits in real life situations in various industries in the form of such industry specific Technical Guides. I am sure the members would find this Technical Guide immensely useful. I also eagerly look forward to more such Technical Guides and other technical publications from the Auditing and Assurance Standards Board.

June 25, 2012
New Delhi

CA. Jaydeep Narendra Shah
President, ICAI

PREFACE

A sound financial sector is important for financial stability and higher economic growth in the country. Financial intermediaries like Non Banking Financial Companies (NBFCs) play very important role in the financial sector, particularly in a developing economy like ours. NBFCs, particularly, the Micro Finance Institutions (MFIs) are an important link in bridging the funding requirements of the people living in the remotest corner of the country. Given their importance in the financial sector, the NBFCs are recognized as being complementary to the banking sector.

Given the large quantum of public money that is handled by them and spread of their client base, NBFCs operate under strict regulatory regime of the Reserve Bank of India (RBI). RBI, in turn, has issued detailed registration requirements as well as a number of prudential guidelines to ensure proper functioning of NBFCs and, above all, protect the public interest. Compliance with these registration requirements and also the prudential guidelines, particularly, those that are critical to the continuity of operations and the financial reporting framework of the NBFCs is, therefore, a prime focus area in audit of NBFCs.

It, therefore, gives me immense pleasure to place in your hands the 2012 edition of the Guide to Audit of Non Banking Financial Companies, which is completely revised version of its 2010 edition. This revised Guide has heightened focus on aspects such as knowledge of the operating and the financial reporting environment, including how the requirements of the revised Schedule VI to the Companies Act, 1956 would apply to NBFCs. It also contains comprehensive guidance on areas of concern for auditors of NBFCs, especially, the balances with other banks, money market instruments, etc. The Guide also extensively deals with areas of accounting and regulatory concern in respect of NBFCs, viz., investments and income recognition and related aspects such as securities held for trading, portfolio investments, treasury operations, credit function, loans, accounts with depositors, capital and reserves, income recognition, prudential guidelines of RBI, etc. The Appendices to the Guide contain illustrative audit report / certificate templates, illustrative audit checklist, etc., that I am sure will come handy to the auditors of NBFCs.

At this juncture, I wish to place on record, my sincere gratitude to CA. Harinderjit Singh, Gurgaon and his team comprising CA. A Jayashankar and CA Ridhima

Dubey squeezing time out of their pressing preoccupations for developing this 2012 revised Guide.

I also wish to express my sincere thanks to, CA. Jaydeep N. Shah, President, ICAI as well as, CA. Subodh Kumar Agrawal, Vice President, ICAI whose vision, guidance and support I have been privileged to receive in the activities of the Board.

Many thanks are also due to my Council colleagues at the Board, viz., CA. Shiwaji Bhikaji Zaware, Vice Chairman, CA. Amarjit Chopra, CA. Anuj Goyal, CA. G. Ramaswamy, CA. Jayant P. Gokhale, CA. J. Venkateswarlu, CA. Naveen N.D. Gupta, CA. Nilesh S. Vikamsey, CA. Pankaj Inderchand Jain, CA. Pankaj Tyagee, CA. Rajendra Kumar P., CA. S. Santhanakrishnan, CA. V. Murali, and Central Government nominee, Shri Gautam Guha and also to the co-opted members at the Board, viz., CA. Raj Agrawal, CA. Vinay Balse, CA. Purshotam Gaggar, CA. Pramod S. Shingte, CA. Partha Sarathi De for their dedication and support to the work plan of the Board and bringing them to fruition. I also wish to place on record my thanks to the special invitees to the Board, viz., Prof. Manoj Anand, CA. B. Padmaja, CA. Amit Roy, Shri S. Ravindran, CA. Khurshed Pastakia, CA. Gopal Mahadevan, CA. Anil Sharma, CA. N. D. Gupta, CA. Raj Kumar Aggarwal, CA. Jaideep Bhargava, CA. Shashi Gupta and CA. Santosh Gupta for their support to the Board. I also wish to thank the Secretariat of the Auditing and Assurance Standards Board for their efforts in giving the Guide its final shape.

I am confident that this Revised Technical Guide would be well received by not only the members carrying out audits of NBFCs but also other interested readers.

July 6, 2012
Kolkata

CA. Abhijit Bandyopadhyay
Chairman,
Auditing and Assurance Standards Board

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Chapter 1

Introduction

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

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

What is an NBFC?

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

1.3 Section 45-I(f) of Reserve Bank of India Act, 1934 defines non-banking financial company as

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

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

Need for Registration of NBFC

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

- (a) obtaining a certificate of registration issued under Chapter IIIB of the said Act; and
- (b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding two hundred lakh rupees, as the Bank may, by notification in the Official Gazette, specify.

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

1.6 Reserve Bank of India vide its Notification No. DNBS 132 / CGM (VSNM)–99, dated 20/04/1999 has increased the requirement of “net owned fund” from Rs. 25 lakh to Rs.200 Lakh for the NBFC which commences business of a non-banking financial institution on or after April 21, 1999.

Meaning of Business of a Non-banking Financial Institution

1.7 Section 45-I(a) of the Reserve Bank of India Act, 1934 provides

“Business of a non-banking financial institution” means carrying on of the business of a financial institution referred to in clause (c) and includes business of a non-banking financial company referred to in clause (f). Clause (f) defines an NBFC.

Meaning of Financial Institution

1.8 Section 45-I(c) of the Reserve Bank of India Act, 1934 provides

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

- (i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
- (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- (iii) letting or delivering of any goods to a hirer under a hire- purchase agreement as defined in clause (c) of section 2 of the Hire Purchase Act, 1972 (26 of 1972);
- (iv) the carrying on of any class of insurance business;
- (v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;
- (vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, but does not include any institution, which carries on as its principal business
 - (a) agricultural operations; or
 - (aa) industrial activity; or
 - (b) the purchase or sale of any goods (other than securities) or the providing of any services; or
 - (c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

Explanation- For the purposes of this clause, "industrial activity" means any activity specified in sub-clauses (i) to (xviii) of clause (c)

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of section 2 of the Industrial Development Bank of India Act, 1964 (18 of 1964).

Effect of Non Registration

1.9 Sub-section (4A) of Section 58B of the Reserve Bank of India Act, 1934 provides as follows:

“If any person contravenes the provisions of sub-section (1) of section 45-IA, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.”

1.10 Section 58C provides as follows:

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

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

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

Regulatory Environment

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

Introduction

1.12 RBI issued the Non Banking Financing Companies (Reserve Bank) Directions, 1977, guidelines on prudential norms and various other directions and clarifications, from time to time for governing the activities of NBFCs. Central Government, during 1974, introduced 58A in the Companies Act, 1956 which empowered Central Government to regulate acceptance and renewal of deposits and to frame rules in consultation with Reserve Bank of India prescribing (a) the limit up to, (b) the manner and (c) the conditions subject to which deposits may be invited or accepted / renewed by companies. The Central Government in consultation with RBI framed the Companies (Acceptance of Deposits) Rules, 1975.

1.13 The RBI Act, 1934 was amended in 1997 authorising the Reserve Bank to determine policies, and issue directions to NBFCs regarding income recognition, accounting standards, NPAs, capital adequacy etc. In addition to above, the listed NBFCs are required to adhere to the listing agreement and rules framed by SEBI on Corporate Governance.

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

1.15 A list of regulatory requirements (circulars) and the issues that need to be considered by the auditor are given in **Appendix C** to the Guide. The auditor should check the link for full text of the circular and related updates from RBI.

Type of NBFCs- Compliance and Regulatory Perspective

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

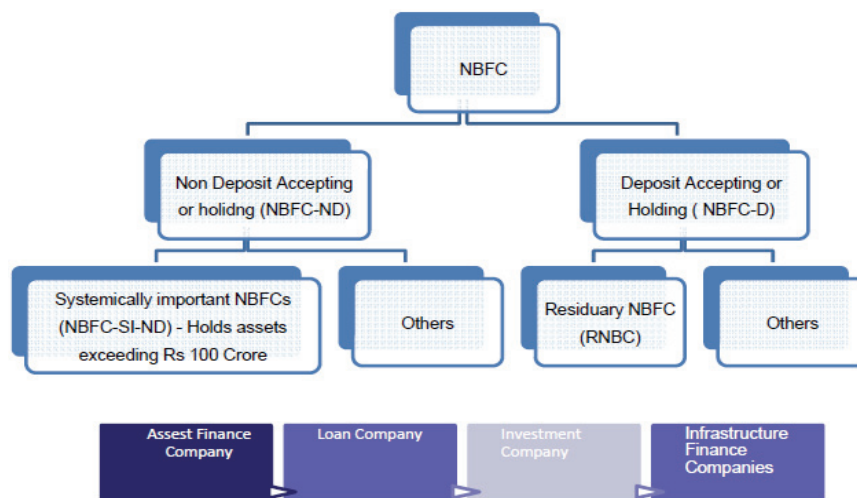
- *Asset Finance Company (AFC)* - The main activity of an AFC is financing of physical assets supporting productive / economic activity. These may be in the areas such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments and general purpose industrial machines.
- *Investment Company (IC)* which mainly deal in acquisition of shares and securities of other companies. A core investment company would be a company which acquires shares and securities of Group companies.

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- *Loan Company (LC):* Loan companies primarily provide finance (whether by making loans or advances or otherwise for any activity), other than its own activity.
- *Infrastructure Finance Companies:* This category of NBFCs deploys a minimum of three-fourths of their total assets in infrastructure loans. The net owned funds of this category of NBFCs are more than Rs 300 crores and they should have a minimum credit rating of 'A' or equivalent and the Capital to Risk-Weighted Assets Ratio (CRAR) is 15% (with a minimum Tier I Capital of 10%).
- *Core Investment Company (CIC):* These are NBFCs which carry on the business of acquisition of shares and securities in group companies and satisfies four conditions stated in the regulatory framework for Core Investment Companies issued by RBI.
- *Infrastructure Debt Fund- Non- Banking Financial Company (IDF-NBFC) -* Infrastructure Debt Funds (IDFs) are funds set up to facilitate the flow of long-term debt into infrastructure projects. The IDF will be set up either as a trust or as a company. A trust based IDF would normally be a Mutual Fund (MF) while a company based IDF would normally be a NBFC.
- *Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI) -* An NBFC-MFI is defined as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils certain conditions.

The above type of companies may be further classified into those accepting deposits or those not accepting deposits.

Introduction



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

Others

Housing Finance Companies

1.17 National Housing Board set up by the Government of India is the Apex authority regulating the housing finance companies. The Housing Finance Companies (NHB) Directions, 2010 deals with matters relating to acceptance of deposits by housing finance companies, prudential norms for income recognition, accounting standards, asset classification, provision for bad and doubtful assets, capital adequacy and concentration of credit/ investments to be observed by the housing finance companies and matters to be included in the auditors report by the auditors of such housing finance companies and matters ancillary and incidental thereto and amended the said directions from time to time.

Scope of the Technical Guide

1.18 The Guide is applicable to all kinds of NBFCs. The purpose of this Guide is to provide practical assistance to auditors and to promote good practice in applying Standards on Auditing (SAs) to the audit of financial statements of NBFCs. It is not, however, intended to be an exhaustive listing of the procedures and practices to be used in such an audit. In conducting an audit in accordance with SAs, the auditor is required to comply with all the

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requirements of all the SAs. Further this Guide may not be applicable where there is a specific requirement imposed by the regulatory authorities governing the NBFCs/ Investment companies.

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

Chapter 2

Audit of NBFCs – Points for Consideration

Business Understanding

2.1 NBFCs are required to register under the following three broad categories, viz.

- (i) NBFCs accepting public deposit
- (ii) NBFCs not accepting / holding public deposit
- (iii) Core investment companies

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

Exemptions

2.2 Certain categories of Companies (other than banking companies) are exempt from all or some of the requirements of Chapter IIIB of RBI Act, 1934. They are

- (a) Housing Finance Institutions
- (b) Merchant Banking Companies
- (c) Micro finance Institutions
- (d) Mutual Benefit companies
- (e) Government Companies
- (f) Venture Capital Fund Companies
- (g) Nidhi Companies
- (h) Chit Fund Companies
- (i) Mortgage Companies
- (j) Securitisation and reconstruction companies.
- (k) Insurance Companies

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

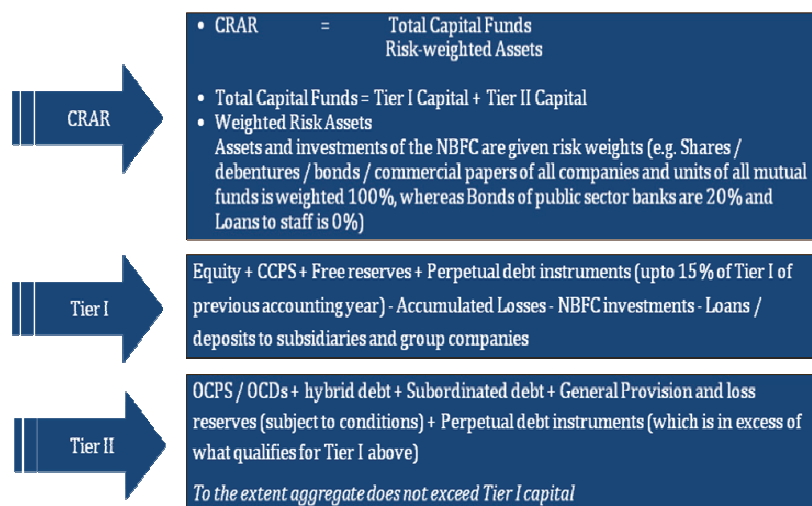
- A loan company or an investment company shall have finance assets and finance income in excess of 50% of the total assets and total income respectively.
- In the case of an asset finance company, the aggregate of financing real / physical assets supporting economic activity should be greater than 60% of total assets and the income arising therefrom should be greater than 60% of total income.
- For an infrastructure company, a minimum of 75% of the total assets are to be deployed in infrastructural loans and finance income should be greater than 50% of total income.

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

Capital Risk-Weighted Asset Ratio (CRAR)

2.4 Every systematically Important Non Deposit taking NBFC should maintain a CRAR of 12% which shall be increased to 15% by March 2011. RBI has also made this rate of 15% applicable to all deposit taking NBFCs through a notification dated February 17, 2011.

Computation of CRAR (illustrative)



Audit of NBFCs – Points for Consideration

Computation of Net Owned Funds

- Any NBFC seeking registration as NBFC with RBI should have a minimum Net Owned Fund of Rs 2 crores
- The Net Owned Fund can be computed by the following step by step process (illustrative):

| | | |
|--------|---|----|
| Step 1 | Paid-up equity capital and Free reserves (A) | XX |
| Step 2 | Less: Accumulated balance of loss, Deferred revenue expenditure and book value of other intangible assets (B) | X |
| Step 3 | (C) = (A) minus (B) | XX |
| Step 4 | Sum up the figures, if any, under the following items: a) Investments in shares of Subsidiaries, companies in the same group, other NBFCs b) Book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to Subsidiaries, companies in the same group c) Deposits with Subsidiaries, companies in the same group If the resultant figure exceeds 10% of (C), find out the excess = (D) | X |
| Step 5 | NOF = (C) minus (D) | XX |

Compulsory Convertible Preference Shares (CCPs)/Compulsory convertible debentures (CCDs) are not considered for calculation of Net Owned Funds.

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Credit Concentration Norms for Systemically Important Non-Deposit accepting NBFC (NBFC-ND-SI) (% of Owned Funds) (Illustrative)

| Single / Group* Exposure Limits | Lending | Investment | Both |
|---|-----------|------------|-----------|
| Single Borrower | 15% | 15% | 25% |
| Single Group of Borrowers | 25% | 25% | 40% |
| <u>Infrastructure Loan / Investment</u> | | | |
| Single borrower | Addl. 5% | Addl. 5% | Addl. 5% |
| Single group of borrowers | Addl. 10% | Addl. 10% | Addl. 10% |

2.5 Group companies are to be determined as per Companies Act, 1956 and limits are to be computed as percentage of owned funds.

- Additional limit of 5% is available to Asset Finance Company.
- Ceiling applicable for funding to NBFC's own group as well as borrower group.
- An Investment in Debentures is treated as loan and not investment.
- NBFCs not accepting 'public funds' or 'not issuing guarantees' may apply to RBI for modification in above limits.
- Definition of 'public funds' includes bank borrowings, debentures, guarantees, Optionally Convertible Preference Shares / Optionally Convertible Debentures / OCPS / OCDs / CCDs do not form a part of the 'owned funds' definition.

Computation of Owned Funds (Illustrative)

| | | |
|-----|--|----|
| | Paid up Equity Capital | XX |
| Add | Compulsorily Convertible Preference Shares | XX |
| Add | Free Reserves | XX |
| Add | Share Premium | XX |

Audit of NBFCs – Points for Consideration

| | | |
|------|--|----|
| Add | Capital Reserves (representing surplus arising out of sale proceeds of assets) (other than reserves created by revaluation of asset) | XX |
| Less | Accumulated loss balance | X |
| Less | Book value of intangible assets | X |
| Less | Deferred Revenue expenditure | X |

Group Company Investments

2.6 Exemption from Prudential Norms is available to NBFCs whose principal business is of acquisition of securities; and satisfying following conditions:

- Holding investments in securities of its group / holding / subsidiary companies with book value of such holding not less than 90% of its total assets and does not trade in such securities; and
- Not accepting /holding any Public Deposits and
- Not a NBFC-ND-SI

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

- Following activities are not eligible for Bank Credit:
 - For Bills discounted/rediscounted by NBFCs.
 - Investments by NBFCs in any company/entity by way of shares, debentures, etc.
 - For unsecured loans/inter-corporate deposits by NBFCs to/in any company.
 - All types of loans and advances by NBFCs to their subsidiaries, group companies.
 - Finance to NBFCs for further lending to individuals for subscribing to Initial Public Offerings.
 - Bridge loans or interim finance against capital/debenture issues and/or in form of loans of a bridging nature pending raising of long term funds from market by way of capital, deposit, etc.

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2.8 The auditor should plan his work to meet the overall audit objective of expressing an opinion on the truth & fairness of the financial statements. In the planning stage the auditor should gather relevant organisational information for creating his audit plan. The preliminary study would help the auditor in the following:

- Understand the business issues and the associated risks.
- Help in communication with the management and where required, with those charged with governance on timely basis.
- It would help the auditor to identify the issues that may require special attention in the audit.
- The auditor would be able to develop an audit scope that may add value to the entity by focussing on areas more meaningful to the management.

Financial Reporting Framework

2.9 The Non-banking Financial (Deposit Accepting) Directions, 2007 in clause 5 states that Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (ICAI) shall be followed in so far as they are not inconsistent with any of these directions. Subsequent to notification of Central Government (Accounting Standard) Rules, 2006, same needs to be complied with by the NBFC if it is a company, However, in absence of any available guidance therein, they may consider applicability of various guidance issued under the authority of ICAI.

Compliance with Revised Schedule VI to the Companies Act, 1956

2.10 Ministry of Corporate Affairs *vide* its Notification No. S.O.447(E) dated February 28, 2011 (As amended by Notification no.F.No.2/6/2008-CL-V dated March 30, 2011) has revised the existing Schedule VI to the Companies Act, 1956 and made it applicable to all companies for the financial statements to be prepared for the financial year commencing on or after April 1, 2011. In this regard ICAI has also published a guidance note –“Guidance Note on The Revised Schedule VI to the Companies Act, 1956”. Reference should be made to these authoritative pronouncements.

Chapter 3

Auditing Framework

3.1 Auditors are required to ensure compliance with the Standards on Auditing issued by the Institute of Chartered Accountants of India while discharging their audit obligation. Certain important standards that are considered by the auditor are as follows.

Objective and Scope of the Audit of Financial Statements

3.2 The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements of the NBFC are prepared, in all material respects, in accordance with an identified financial reporting framework. The auditor's report indicates the financial reporting framework that has been used to prepare the NBFC's financial statements.

Agreeing to the Terms of Engagement

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

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

- The need for sufficient expertise in the aspects of financing relevant to the audit of the NBFC's business activities.
- The need for expertise in the context of the IT systems and communication networks the NBFC uses.

Audit Planning

3.5 A well designed audit plan is necessary for the auditor to conduct an effective and efficient audit.

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3.6 The audit plan gives details of the audit objectives and steps the auditor should consider, to ensure that all important issues in the audit are covered. A well designed audit plan includes the following:

- Obtaining a sufficient knowledge of the entity's business and governance structure, and a sufficient understanding of the accounting and internal control systems, including risk management and internal audit functions;
- Considering the assessments of inherent and control risks i.e. the risk that material misstatements occur (inherent risk) and the risk that the NBFC's system of internal control does not prevent or detect and correct such misstatements on a timely basis (control risk);
- Determining the nature, timing and extent of the audit procedures to be performed; and
- Considering the appropriateness of the going concern assumption regarding the entity's ability to continue its operation for the foreseeable future, which will be the period used by management in making its assessment under the financial reporting framework. This period will ordinarily be for a period of at least one year after the balance sheet date.

Table A: Obtaining Knowledge of the NBFC's Business

| | |
|----------------------------------|--|
| The auditor needs to understand: | |
| • | <i>Corporate governance structure:</i> Corporate governance plays a particularly important role in NBFCs; many regulators set out requirements for NBFCs to have effective corporate governance structures. Accordingly the auditor should obtain an understanding of the NBFC's corporate governance structure and how those charged with governance discharge their responsibilities for the supervision, control and direction of the NBFC. |
| • | The economic and regulatory environment prevailing in the principal countries in which the NBFC operates. |
| • | The market conditions existing in each of the significant sectors in which the NBFC operates. |
| • | <i>Products and Services:</i> In obtaining and maintaining that knowledge, the auditor is aware of the many variations in the basic deposit, loan and treasury services that are offered by NBFCs in response to market conditions. The auditor should obtain an understanding of the |

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nature of services rendered or financial transactions undertaken through instruments such as letters of credit, acceptances, interest rate futures, forward and swap contracts, options and other similar instruments in order to understand the inherent risks and the auditing, accounting and disclosure implications thereof.

- *Service Organisation:* If the NBFC uses service organizations to provide core services or activities, such as cash and securities settlement, back office activities or internal audit services, the responsibility for compliance with rules and regulations and sound internal controls remains with those charged with governance and the management of the outsourcing NBFC. The auditor should consider legal and regulatory restrictions, and obtains an understanding of how the management and those charged with governance monitor that the system of internal control (including internal audit) operates effectively. SA 402, "Audit Considerations Relating to an Entity Using a Service Organization" gives further guidance on this subject.
- *Risk:* There are a number of risks associated with financing activities that are important in that, they serve to shape financing operations. The auditor should obtain an understanding of the nature of these risks and how the NBFC manages them. This understanding allows the auditor to assess the levels of inherent and control risks associated with different aspects of a NBFC's operations and to determine the nature, timing and extent of the audit procedures.

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

- The complexity of the transactions undertaken by the NBFC and the documentation in respect thereof;
- The extent to which any core activities are provided by service organizations;
- Regulatory considerations;
- The extent of IT and other systems used by the NBFC;
- The expected assessments of inherent and control risks;
- The work of internal auditor;
- The assessment of audit risk;
- The assessment of materiality;

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- Management's representations;
- The involvement of other auditors;
- Contingent liabilities and off-balance sheet items;
- The geographic spread of the NBFC's operations and the co-ordination of work between different audit teams;
- Transactions with related parties; and
- Going concern considerations.

Audit Evidence

3.8 The auditor should review the NBFC's sources of revenue, and obtain sufficient appropriate audit evidence regarding the following:

- (a) The accuracy and completeness of the NBFC's accounting records relating to such transactions.
- (b) The existence and operating effectiveness of key controls to limit the risks arising from such transactions.
- (c) The adequacy of provisions, if any, for loss which may be required.
- (d) The adequacy of financial statement disclosures and presentation.

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

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

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

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

The Auditor's Responsibility to Consider, Detect Fraud and/or Error in an Audit of Financial Statements

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

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

3.15 Frauds may include:

- fraudulent financial reporting without the motive of personal gain, (for example, to conceal trading losses), or
- misappropriation of the assets for personal gain that may or may not involve the falsification of records.

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

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

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Risk Assessment and Internal Controls

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

Using the Work of an Expert

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

- Valuations of certain types of assets, for example, land and buildings, plant and machinery etc.
- Legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc.

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

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

Table B: Evaluating the Work of an Expert

| | |
|-----|---|
| (a) | Evaluate the professional competence, objectivity and experience of the expert by considering the following: |
| (i) | the expert's professional qualifications, for example, professional certification, license or other recognition of the competence of the expert in the field, as appropriate; |

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- (ii) the experience and reputation of the expert in the field in which the auditor is seeking audit evidence;
 - (iii) the expert's objectivity or relationship, if any, to the client, including but not limited to financial interests or employment relationships.
- (b) Obtain sufficient appropriate evidence that the expert's work is adequate for the purposes of the audit (i.e. it constitutes appropriate audit evidence in support of the financial statement assertions being considered), by considering:
 - (i) the objectives and the scope of the expert's work;
 - (ii) the source data used;
 - (iii) the assumptions and methods used and if appropriate, their consistency with the prior period;
 - (iv) when the expert carried out the work;
 - (v) the reasons for any changes in assumptions and methods compared with those used in the prior period; and
 - (vi) the results of the expert's work in the light of both the overall knowledge of the business and the results of the audit procedures.
- (c) Consider obtaining, in conjunction with the entity or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert.
- (d) Where the expert's work should be subject to a recognised methodology, for example published by organisation to which expert belongs, confirm this has been used. The risk that an expert's objectivity will be impaired increases when the expert is:
 - (i) employed by the entity; or
 - (ii) related in some other manner to the entity, for example, by being financially dependent upon or having an investment in the entity.
- (e) Considering the results of assessment of the expert's work
 - (i) If the findings of the expert support the related assertions in the financial statements, it may be reasonably concluded that sufficient competent evidential matter has been obtained. In these circumstances, no reference to the use of expert should be included in the auditor report.

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

While considering the competence or objectivity of the expert, it is necessary to discuss any reservations with management and consider whether sufficient appropriate audit evidence can be obtained concerning the work of an expert. If the results of the expert's work do not provide sufficient appropriate audit evidence, or if the results are not consistent with other audit evidence, there is need to resolve the matter and consider the possibility to modify audit report.

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

- (a) the objectives and scope of the expert's work;
- (b) clarification of the expert's representations as to his relationship, if any, to the client;
- (c) confidentiality of the client information;
- (d) the methods or assumptions to be used, for example, if property is involved, the client's plans and intentions for the property;
- (e) the extent of the expert's access to appropriate records and files;
- (f) a comparison of the methods or assumptions to be used with those used in the preceding period;
- (g) the expert's understanding of the auditor's use of the expert's findings in relation to the representations in the financial statements;
- (h) the form and content of the expert's report in relation to the representations in the financial statements; and

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

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

- (a) making inquiries of the expert to determine how the expert has obtained satisfaction that the source data is sufficient, relevant and reliable; and
- (b) performing audit procedures, based on materiality and inherent risk, on the data provided by the client to the expert to obtain reasonable assurance that the data is appropriate, including:
 - (i) verify the completeness of the information provided to the expert;
 - (ii) examine listing of transactions, account balances or other information provided to the expert; and
 - (iii) consider discussing the work performed with the expert.

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

Representations by Management

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

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

Responsibility of Joint Auditors

3.23 In many cases the auditor may conduct the audit of an NBFC jointly with another independent auditor. In such situations the auditor is required to

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comply with the requirements of the auditing standard on responsibility of joint auditors.

Consideration of Laws and Regulations in an Audit of Financial Statements

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

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

Documentation

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

3.27 The documentation is not limited to records prepared by the auditor but may include other appropriate records such as minutes of meetings prepared by the entity's personnel and agreed by the auditor. Others with whom the auditor may discuss significant matters may include other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

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

Reporting

3.29 Apart from the reporting under Section 227 (4A) of the Companies Act, 1956, the RBI, through Section 45MA of the RBI Act (Part of Chapter III B of RBI Act) lays out the powers and duties of the auditors of an NBFC.

- Section 45 MA(1) - Casts duty on auditors to inquire if NBFC has submitted to the RBI, the requisite information, statements or particulars regarding deposits accepted by it. On exception, the auditors need to report to RBI the “aggregate of such deposits held” by NBFC.
- Section 45 MA(2) - Where auditors report or intend to report to RBI under Section 45 MA (1) above, the matter should also be included in his report u/s 227 (2) of Companies Act, 1956.
- Section 45 MA(1A) - Empowers RBI to issue directions to NBFCs or auditors of NBFCs relating to Balance Sheet, Profit and Loss Account, disclosures or other matters.

3.30 RBI had also issued a revised Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008, which has been notified on July 1, 2009. The auditor, in addition to the report under Section 227 of the Companies Act, 1956, should also make a separate report to the Board of Directors on specific matters. Where the report is modified, the reasons therefore needs to be given by the auditor.

3.31 While the auditors need to report on whether the NBFC has obtained a Certificate of Registration, some of the matters to be reported to Board of Directors of Non Deposit taking NBFCs are as follows:

- Whether the Board of Directors has passed a resolution for non-acceptance of any public deposits;
- Whether the Company has accepted any public deposit during the year/period ; and
- Whether the Company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts etc.

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

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

- Whether public deposits (including unsecured non convertible debentures/bonds and deposits from shareholders in case of a public limited company) accepted are within the limits prescribed under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. (Referred to as Public Deposits Directions) ;
- If the deposits accepted are in excess of limits prescribed above, whether the same has been regularized as per Public Deposit Directions;
- Whether an Assets Finance Company (AFC) having a CRAR less than 15% or an Investment Company or Loan Company is accepting deposits without Minimum Investment Grade Credit Rating from an approved credit rating agency.
- 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 RBI in terms of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
- Whether the credit rating is in force and deposits outstanding at any point of time during the year was within the limit prescribed by rating agency;
- Whether the company has defaulted in payment of interest and principal to depositors when such interest and/or principal became due. asset classification, provisioning for bad and doubtful debts and so on have been complied with;
- Whether the company has complied with the liquid assets requirement as prescribed by the RBI in exercise of powers under section 45-IB of the Act.
- Whether there has been any non-compliance with Chapter III- B of RBI Act, the Non- Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions 1998 and the Non- Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

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3.34 In addition, Exception Reporting i.e. reporting only on Instances of non compliances is required to be made to the RBI for modified audit opinions, or comments on the specified matters. The auditor of NBFC should also be familiar with Chapter IIIB of the RBI Act and the notifications issued thereon. The auditor should be aware of the above circular and any amendments therein.

3.35 While issuing certificates and reports other than the audit report, the auditor should consider the requirements of the Guidance Note on Audit Reports and Certificates for Special Purposes issued by the ICAI.

Appendix A to the Guide contains specified audit report and other reporting templates for the benefit of users.

Chapter 4

Areas of Audit Concern

4.1 The auditor has to identify the assertions that are ordinarily of particular importance in relation to the typical items in a NBFC's financial statements. The following paragraphs describe some of the audit considerations that help the auditor to plan substantive procedures and suggest some of the techniques that could be used in relation to the items selected by the auditor for testing. The procedures do not represent an exhaustive list of procedures that need to be performed, nor do they represent a minimum requirement that should always be performed.

4.2 Following are the key areas which the auditor must be aware while conducting the audit of NBFCs.

Balances with Other Banks

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

4.4 The auditor should understand and evaluate key controls in place to assess the operating effectiveness of key controls, on sample basis test check bank reconciliations and perform cut-off procedures.

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

Money Market Instruments

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

4.7 The auditor should consider the feasibility of checking for receipt of the related income as a means of establishing ownership. The auditor must pay particular attention to establishing the ownership of instruments held in

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bearer form. The auditor also should consider whether there are any encumbrances on the title to the instruments.

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

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

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

4.11 The auditor also should consider whether:

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

Other Financial Assets

4.12 The auditor should examine the underlying documentation supporting the purchase of such assets/sale in order to determine whether all rights and obligations, such as warranties and options, have been properly accounted for. Additionally, the auditor should consider the appropriateness of the valuation techniques employed. Since there may not be established markets for such assets, it may be difficult to obtain independent evidence of value. Additionally, even where such evidence exists, there may be a question as to whether there is sufficient depth to existing markets to rely on quoted values for the asset in question and for any related offsetting hedge transactions that the NBFC has entered into in those markets. The auditor should also consider the nature and extent of any impairment reviews that management has carried out and whether their results are reflected in the assets' valuations.

Investments

A. Securities Held-for-Trading Purposes

4.13 In respect of investments held for trading, the auditor needs to consider the internal control considerations and audit procedures in respect

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of trading operations. Another important consideration would be to ensure that these are consistent with the investment policy of the company.

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

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

B. Portfolio Investments

4.16 In many cases the audit of a NBFC's portfolio investments does not differ from the audit of portfolio investments held by any other entity. However, there are some special aspects that need to be considered in respect of NBFCs. The auditor should verify whether the NBFC has any statutory requirement for maintenance of certain portfolio of Investments.

4.17 The auditor should consider the value of the assets supporting the security value, particularly in respect of securities that are not readily marketable. The accounting norms of the investment may require that the depreciation, if any, in each scrips shall be fully provided for and appreciation, if any shall be ignored in accordance with RBI regulation and IGAAP. Rather, the auditor should also consider the nature and extent of any impairment reviews that management has carried out and whether their results are reflected in the assets' valuations.

C. Accounting for Investments

4.18 The auditor should consider the RBI prudential norms guidelines with regard to accounting for investments. The requirements are summarised below:

- i) The Board of the Company should frame investment policy and implement the same.
- ii) The criteria to classify the investments as current investments and long term investments should be clearly spelt out.
- iii) The aforesaid classification should be made at the time of making the investments

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- iv) There should not be inter-class transfer on adhoc basis and if necessary, it should be done only at the beginning of each half year with the approval of the Board and the transfer should be scrip wise at book value or market value, whichever is lower. Depreciation, if any, in each scrip shall be provided and appreciation, if any, should be ignored and there should not be netting off of any gain in one scrip against depreciation in another scrip.
- v) Quoted current investments should be grouped under the following categories:
 - (a) Equity shares,
 - (b) Preference shares,
 - (c) Debentures and bonds,
 - (d) Government securities including treasury bills,
 - (e) Units of mutual fund, and
 - (f) Others.
- vi) Quoted current investments for each category shall be valued at cost or market value whichever is lower. For this purpose, investments in each category shall be considered scrip-wise and cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than aggregate cost for that category, net depreciation shall be provided for or charged to the profit and loss account. If aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.
- vii) Unquoted equity shares in the nature of current investments shall be valued at cost or break up value, whichever is lower. However, non-banking financial companies may substitute fair value for the break up value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one Rupee only.
- viii) Unquoted preference shares in the nature of current investments shall be valued at cost or face value, whichever is lower.
- (ix) Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.

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- (x) Unquoted investments in the units of mutual funds in the nature of current investments shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
- (xi) Commercial papers shall be valued at carrying cost.
- (xii) A long term investment shall be valued in accordance with the Accounting Standard issued by ICAI.
- (xiii) Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

Table C: Valuation of Securities

Financial reporting frameworks often prescribe different valuation bases for securities depending on whether they are held for trading purposes, held as portfolio investments, or held for hedging purposes. For example, a financial reporting framework might require trading securities to be carried at market value, portfolio investments at historic cost subject to impairment reviews, and hedging securities on the same basis as the underlying assets they hedge.

Management's intentions determine whether any particular security is held for a given purpose, and hence the valuation basis to be used. If management's intentions change, the valuation basis changes too. Accordingly, when securities have been transferred from one category to another, the auditor obtains sufficient appropriate audit evidence to support management's assertions as to their revised intentions. The possibility of changing an asset's categorization provides management with an opportunity for fraudulent financial reporting, as it would be possible to recognize a profit or avoid recognizing a loss by changing the categorization of particular security/securities.

The auditor also should consider whether to re-perform the valuation calculations and the extent of tests of the controls over the NBFC's valuation procedures. Additionally, the auditor should also consider whether:

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

Areas of Audit Concern

D. Investments in Subsidiaries and Associated Entities

4.19 In many cases the audit of a NBFCs investments in subsidiaries and associated entities does not differ from the audit of such investments held by any other entity.

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

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

Table D: Impairment/Estimates

| | |
|-----------|--|
| A. | Factors that may indicate an impairment condition |
| a) | the decline in fair value is attributable to specific adverse conditions affecting a particular investment. |
| b) | the decline in fair value is attributable to specific conditions, such as conditions in an industry or in a geographic area, rather than to general market conditions. |
| c) | management does not possess both the intent and the ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value. |
| d) | the decline in fair value has existed for an extended period of time. |
| e) | dividends have been reduced or eliminated, or scheduled interest payments on debt securities have not been made. |
| f) | the financial condition of the issuer has deteriorated. |
| g) | market values have declined. Consider performing the following, if available. |
| i. | test, to an extent based on materiality and inherent risk, the market values of investments by comparing the market value to their sources. Sources for market values include: |
| | <ul style="list-style-type: none">• obtain market quotations for investments listed |

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| | |
|-----------|--|
| | <p>on national exchanges or over-the-counter markets from sources such as financial publications or the exchanges;</p> <ul style="list-style-type: none">• for certain other investments, market quotations may be obtained from broker-dealers who are market makers in those investments; and• if quoted market prices are not available, the estimate of fair value should be based on the best information available in the circumstances. The estimate of fair value should consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. <p>ii. determine whether any decline in value below cost is properly reflected in the financial statements where appropriate; and</p> <p>iii. if appropriate, consider the need for use of specialists to determine the market value of certain investments. Consider steps in the audit area "Use of the work of experts."</p> |
| B. | Valuation and Disclosure of Long Term Investments |
| 1. | The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence for valuation and disclosure of long term investments in accordance with the financial reporting framework. |
| 2. | When long-term investments are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding their valuation and disclosure. |
| 3. | Other procedures would ordinarily include: |
| a) | In the case of quoted securities, considering related financial |

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statements and other information, such as market quotations, which provide an indication of value and comparing such values to the carrying amount of the investments up to the date of the auditor's report.

- b) In case of unquoted securities, ascertaining the method adopted by the entity for determining the value of such securities as at the year end. The auditor should examine whether the method adopted by the entity is one of the recognised methods of valuation of securities such as Profit Earning Capacity Value method [PECV], Break-up value method, Capitalization of yield method, Yield to maturity method, etc.
- c) In the case of investments other than in the form of securities, ensuring that the market value has been ascertained on the basis of authentic market reports, and /or based on expert's opinion, if warranted.
- d) If such values do not exceed the carrying amounts, the auditor should consider whether a write-down is required. If there is an uncertainty as to whether the carrying amount will be recovered, the auditor should consider whether appropriate adjustments and/or disclosures have been made.

C. Management Representations

The auditor should obtain written representation from management concerning:

- (a) The completeness of information provided regarding valuation and disclosure of long term investments.
- (b) The valuation of long term investments in the financial statements including adequacy of provision for diminution in such values, wherever required.

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

4.23 Presently RBI, *vide* its circular for prudential norms, has imposed following restrictions on investments:

- a) Restriction on investments in land and building and unquoted shares: This restriction is in respect of an asset finance company accepting public deposits. The regulations prohibit the asset finance company

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from investing in land and buildings as well as unquoted shares beyond 10% of its owned fund. Those which were acquired in satisfaction of debts shall be disposed off within a period of three years or within such period as extended by RBI. However investment in an insurance company is not considered in the restriction imposed by RBI.

- b) No NBFC shall lend to any single borrower exceeding fifteen percent of its owned fund and any single group of borrowers exceeding twenty five percent of its owned fund.
- c) No non-banking financial company shall,
 - (i) lend to
 - (a) any single borrower exceeding fifteen per cent of its owned fund; and
 - (b) any single group of borrowers exceeding twenty five per cent of its owned fund;
 - (ii) invest in
 - (a) the shares of another company exceeding fifteen per cent of its owned fund; and
 - (b) the shares of a single group of companies exceeding twenty five per cent of its owned fund;
 - (iii) lend and invest (loans/investments taken together) exceeding
 - (a) twenty five per cent of its owned fund to a single party; and
 - (b) forty per cent of its owned fund to a single group of parties.

Provided that the ceiling on credit/investment concentration shall not be applicable to a residuary non-banking company in respect of investments in approved securities, bonds, debentures and other securities issued by a Government company or a public financial institution or a scheduled commercial bank under the provisions of paragraphs 6(1)(a) and 6(1)(b) of the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

Provided further that the ceiling on the investment in shares of another company shall not be applicable to a non-banking financial company in

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respect of investment in the equity capital of an insurance company upto the extent specifically permitted, in writing, by the Reserve Bank of India.

Provided further that any non-banking financial company, classified as Asset Finance Company by the Reserve Bank of India, may in exceptional circumstances, exceed the above ceilings on credit/investment concentration to a single party or a single group of parties by 5 per cent of its owned fund, with the approval of its Board.

Notes:

- (1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as explained in paragraph 16.
- (2) The investments in debentures for the purposes specified in this paragraph shall be treated as credit and not investment.
- (3) These ceilings shall be applicable to the credit/investment by such a non-banking financial company to companies/firms in its own group as well as to the borrowers/ investee company's group.

Loans

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

4.25 The major audit concern is the adequacy of the recorded provision for loan losses. In establishing the nature, extent and timing of the work to be performed, the auditor should consider the following factors:

- Know Your Client/Customer (KYC) procedures performed.
- Credit approval process including authorisation.
- Loan documentation obtained from the existing/prospective borrower, test check the documents for borrower's financial position/ credit worthiness.

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- Internal credit rating assigned to borrower.
- Credit monitoring by credit committee.
- Scope and extent of work performed by internal audit department.
- Collateral coverage (if any).
- Given the relative importance of foreign lending, the auditor should ordinarily examine:
 - The information on the basis of which the NBFC assesses and monitors the country risk and the criteria (for example, specific classifications and valuation ratios) it uses for this purpose; and
 - Whether and, if so, by whom credit limits are set for the individual countries, what the limits are and the extent to which they have been reached.
- The auditor is also required to verify whether there has been any window dressing, i.e., sanction of new loans to repay an existing doubtful loan. This method may be resorted to by the NBFC to cover up bad loans.

Accounts with Depositors

A. General

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

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

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

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

B. Deposits in Transit

4.30 The auditor should determine whether items in transit between branches, between the NBFC and its consolidated subsidiaries, and between

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the NBFC and counterparties, are eliminated and that reconciling items have been appropriately addressed and accounted for.

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

Capital and Reserves

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

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

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

Income Recognition

4.33 The financial reporting framework i.e. recognised accounting principles would guide the income recognition. For instance:

- ***Income including interest/discount or any other charges on NPA:*** shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

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- ***Hire purchase assets***, where instalments are overdue for more than 12 months, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.
- ***Leased assets***: where lease rentals are overdue for more than 12 months, the income shall be recognised only when lease rentals are actually received. The net lease rentals taken to the credit of profit & loss account before the asset became non-performing and remaining unrealised shall be reversed.
- ***Income from investments***: Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis. Provided where dividend has been declared by the corporate in its AGM, income can be recognised on accrual basis. However, income from securities, bonds, and debentures of corporate bodies and from Government securities/bonds has to be accounted on accrual basis.
- ***Securitisation/Factoring/Assignment Transactions***: The company is a registered NBFC-ND-SI engaged in micro-finance activities which involves lending of micro loans. The company primarily funds its operations through external term loans from banks and financial institutions. As a means of financing, the company enters into transactions like factoring, securitisation and assignment, with certain banks and financial institutions. The accounting in the instant case would be driven by the ICAI guidance note on 'Securitisation' and in case of factorisation, reference can be made to the principles laid down in the Expert Advisory Committee Opinion. The 'assignment' transactions are usually different from both securitisation and factoring and are largely driven by the industry practice and the agreement. Some of the entities are in the practice of deferring the upfront gain/loss arising on the 'assignment of portfolio of receivables', at the same time others may be recognising it upfront. The assignment agreement plays an important role in determining the appropriate accounting and thus auditors are required to closely monitor those supplemented with a high level of documentation.

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Table E: Complexity of Transaction

Perform the following with regard to the revenue recognition policies (perform in conjunction with sales/revenue audit area):

- update understanding of the company's accounting policies for recording revenue;
- for judgmental areas within client's policies, assess reasonableness of judgments and obtain supporting documentation, as appropriate; and
- determine whether the policy is consistent with prior years and is reasonable in light of the industry.

Where limited or no comfort has been obtained from controls, test deferred revenue balances at year-end in order to obtain the desired level of assurance by performing the following:

- a) for selected account balances, examine supporting invoices and/or contracts and determine the products sold and/or services provided;
- b) based on the company's revenue recognition policies, verify the amount of revenue that should be deferred and amortized at year-end for the particular products sold and/or services provided; and
- c) test to ensure that the deferred revenue balance was recorded at the appropriate amount by tracing to the detailed deferred revenue listing.

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

In case of complex transaction, where no financial reporting guidelines exist, auditor needs to be extra careful while discharging its obligation and they may resume to following approach:

- Exercise due care in evaluating the terms of the agreement entered between the Banks/FIs and the company to understand vesting of the rights, title and interest of the loan portfolio is assigned to the purchaser (i.e. the Bank/FI) by the company. Understanding the roles & responsibilities of the company post assignment agreement i.e. whether the company is acting only as a "Collection Agent".
- Giving due consideration to diverse industry practices.

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- In absence of any reporting guidelines prescribed, it would be appropriate to draw reference to the existing generally accepted accounting principles.
- Evaluating whether based on the agreement it would be appropriate to de-recognise the portfolio on the assignment as the company transfer the associated risk and reward and show the collateral amount as “receivable” under “current asset”.
- In case where the company does not retain any effective control and substantial risk/reward has been transferred to the assignee and is acting as collection agent, whether income or loss arising on assignment of portfolio have been recognised upfront.
- Extent of disclosures given in the financial statement and whether it can be concluded to be appropriate.

RBI Prudential Norms for Income Recognition, Classification as NPAs

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

4.35 The auditor is required to be fully aware of the provisions of the Prudential Norms directions of RBI. Some of such RBI’s prudential norms directions are given below:

1. Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008.
2. Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
3. Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

The aforesaid circulars are given in the Appendix at the end of this Guide. These circulars can also be downloaded from RBI website (www.rbi.org.in)

The Appendix also contains other circulars for easy reference together with link through which full text of the circulars can be accessed.

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Foreign Direct Investment & External Commercial Borrowings

a. Foreign Direct Investment

Link: http://dipp.nic.in/English/Policies/FDI_Circular_01_2012.pdf

4.36 NBFCs can avail 100% FDI through automatic route subject to the following conditions:

- a) Minimum capitalization norms for fund based NBFCs - US\$ 0.5 million to be brought upfront for FDI up to 51%; US\$ 5 million to be brought upfront for FDI above 51% and up to 75%; and US\$ 50 million out of which US\$ 7.5 million to be brought upfront and the balance in 24 months, for FDI beyond 75% and up to 100%.
- b) Minimum capitalization norms for non-fund based NBFC activities- US\$ 0.5 million, subject to the condition that such company would not be allowed to set up any subsidiary for any other activity nor it can participate in the equity of NBFC holding / operating company. Non-fund based activities would include Investment Advisory services, Financial consultancy, Forex Broking, Money changing Business and Credit Rating Agencies.
- c) Foreign investors can set up 100% operating subsidiaries without the condition to disinvest a minimum of 25% of its equity to Indian entities subject to bringing in US\$ 50 million without any restriction on number of operating subsidiaries without bringing additional capital.
- d) Joint venture operating NBFCs that have 75% or less than 75% foreign investment will also be allowed to set up subsidiaries for undertaking other NBFC activities subject to the subsidiaries also complying with the applicable minimum capital inflow.
- e) Compliance with the guidelines of the RBI.

b. External Commercial Borrowings

Link: http://rbi.org.in/scripts/BS_ViewMasCircularDetails.aspx?id=5786

Automatic route

4.37 Non-Banking Financial Companies (NBFCs) except Infrastructure Finance Companies are not eligible to raise ECB through automatic route.

4.38 Infrastructure Finance Companies (IFCs) i.e. Non Banking Financial Companies (NBFCs) categorized as IFCs by the Reserve Bank are permitted

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to avail of ECBs, including the outstanding ECBs, up to 50 per cent of their owned funds, for on-lending to the infrastructure sector as defined under the ECB policy, subject to their complying with the following conditions:

- i) compliance with the norms prescribed in the DNBS Circular DNBS.PD.CCNo.168 / 03.02.089 / 2009-10 dated February 12, 2010
- ii) hedging of the currency risk in full. Designated authorised dealer should ensure compliance with the extant norms while certifying the ECB application.

4.39 Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted.

Approval route

4.40 The following types of proposals for ECB are covered under the approval route:

- a) ECB beyond 50 per cent of the owned funds by financial institutions which are classified as Infrastructure Finance Companies are considered on a case to case basis.
- b) NBFCs, through approval route, are eligible borrowers for ECB with minimum average maturity of 5 years from multilateral financial institutions, reputable regional financial institutions, official export credit agencies and international banks to finance import of infrastructure equipment for leasing to infrastructure projects.
- c) Infrastructure Finance Companies (IFCs) i.e. Non-Banking Financial Companies (NBFCs), categorized as IFCs, by the Reserve Bank, are permitted to avail of ECBs, including the outstanding ECBs, beyond 50 per cent of their owned funds, for on-lending to the infrastructure sector as defined under the ECB policy, subject to their complying with the following conditions: (i) compliance with the norms prescribed in the DNBS Circular DNBS.PD.CCNo.168 / 03.02.089 / 2009-10 dated February 12, 2010 (ii) hedging of the currency risk in full. Designated authorised dealer should ensure compliance with the extant norms while certifying the ECB application.

Chapter 5

Operations of an NBFC

Treasury Operations

5.1 Treasury operations, in this context, represent all activities relating to the purchase, sale, borrowing and lending of financial instruments. Financial instruments may be securities, money market instruments or derivative instruments. Investment companies/NBFCs usually enter into such transactions for their own use (for example, for the purpose of hedging risk exposures) or for meeting customers' needs. They also carry out, to a larger or smaller extent, trading activities. Trading may be defined as the purchase and sale (or origination and closing) of financial instruments (including derivatives) with the intention of deriving a gain from the change in market price parameters (for example, foreign exchange rates, interest rates, equity prices) over time. NBFCs manage and control their treasury activities on the basis of the various risks involved rather than on the basis of the particular type of financial instrument dealt with. The auditor is required to consider the audit implications of derivatives acquired by the entities.

5.2 The auditor needs to check that the NBFC/ Investment companies have well documented investment policy describing the nature of treasury operations proposed to be undertaken by the company as well as setting out the limits / authorisation for such operations.

Internal Controls in Treasury Operations

5.3 Generally, treasury operations involve transactions that are recorded by IT systems. The risk of processing error in such transactions is ordinarily low provided they are processed by reliable systems. Consequently, the auditor should test whether key processing controls and procedures are operating effectively before assessing the level of inherent and control risks as low. Typical controls in a treasury environment are listed below. These include controls that address business risks of entities and do not necessarily represent controls that address audit risks and that are tested by the auditor in order to assess the levels of inherent and control risks.

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General Audit Procedures

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

5.5 Once the auditor has obtained this understanding and has performed tests of controls with satisfactory results, the auditor should ordinarily assess the accuracy of the recording of transactions entered into during the period and related profits and losses:

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

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

Changes in Products or Activities

5.6 Particular risks often arise where new products or activities are introduced. To address such risks the auditor should initially seek to confirm that predefined procedures are in place for these cases. Generally, the entity should commence such activities only when the smooth flow of the new transactions through the controls system is ensured, the relevant IT systems are fully in place (or where adequate interim system support is in place) and

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the relevant procedures are properly documented. Newly traded instruments are ordinarily subject to careful review by the auditor, who should initially obtain a list of all new products traded during the period (or a full list of all instruments transacted). Based on this information, the auditor should establish the associated risk profile and seeks to confirm the reliability of the internal control and accounting systems.

Reliance on Computer Experts

5.7 Due to the volume of transactions, virtually all NBFCs/investment companies support the treasury transactions cycle using IT systems. Due to the complexity of systems in use and the procedures involved, the auditor should ordinarily seek the assistance of IT experts to supply appropriate skills and knowledge in the testing of systems and relevant account balances.

Purpose for which Transactions are Undertaken

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

Valuation Procedures

Table F: Determination of value of instruments

The auditor might test all portfolio valuations as of the date of the financial statements. The auditor might test transactions on dates selected from the period under audit for agreement with the values computed by the company. The extent of those tests should be based on the auditor's judgment after considering the tolerable misstatement, the assessed risk of material misstatement, and the degree of assurance the auditor plans to obtain.

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

- controls over the process used to determine fair value

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measurements, including, for example, controls over data and the segregation of duties between investment management functions and those responsible for undertaking the valuations;

- the expertise and experience of those determining fair value measurements;
- the role of information technology in the valuation process, including the integrity of change controls and security procedures for valuation models and information systems;
- significant assumptions used in determining fair value, as well as the process used to develop and apply management's assumptions, including whether management used available market information in order to develop the assumptions;
- documentation supporting management's assumptions; and
- controls over the consistency, timeliness, completeness and reliability of data used in valuation models.

The role of the company's board of directors in establishing valuation policies, and the conformity of the model with those policies and the rules or regulatory authorities should be considered.

5.9 Where the entity has adopted AS 30, both the balance sheet items and off-balance sheet financial instruments are ordinarily valued at market or fair value, except for those financial instruments which are used for hedging purposes, which, under many financial reporting frameworks, are valued on the same basis as the underlying item being hedged. Where market prices are not readily available for an instrument, financial models that are widely used by the banking industry may be used to determine the fair value. In addition to disclosure of the notional amounts of open positions, the disclosure may be required of the potential risk arising, as for example, the credit risk equivalent and replacement value of such outstanding instruments.

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

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

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

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

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

The Credit Function

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

- Origination and disbursement
- Monitoring
- Collection
- Periodic review and evaluation

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Origination and Disbursement

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

5.16 The auditor has to verify whether the NBFC has procedures in use to ensure that related party lending has been identified.

Planning

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

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

The NBFC's Lending Practices and Customer Base

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

5.19 The auditor should consider the qualifications of the personnel involved in the credit review function. The industry is changing rapidly and fundamentally creating a lack of qualified lending expertise. The auditor should consider whether credit review personnel possess the knowledge and skills necessary to manage and evaluate lending activities.

5.20 The auditor should consider, through information previously generated, the causes of existing problems or weaknesses within the system. The auditor should consider whether these problems or weaknesses present the potential for future problems.

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5.21 The auditor should review management reports and should consider whether they are sufficiently detailed to evaluate risk factors.

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

Tests of Controls

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

- The portfolio exposure and the various features and characteristics of the exposures;
- The exposure documentation used by the investing company;
- What constitutes appropriate exposure documentation for different types of exposures; and
- The entity's procedures and authority levels for granting an exposure.

5.24 The auditor should review the lending policies and consider:

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

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

- Identification of problem credits;
- Current information regarding portfolio risk; and
- Information concerning emerging trends in the portfolio and lending areas

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

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

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

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

Substantive Procedures

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

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

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

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

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

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

- The exposure and security documentation files.
- Arrears listings or reports.
- Activity summaries.

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- Previous doubtful accounts listings.
- The non-current exposure report.
- Financial statements of the borrower.
- Security valuation reports.

5.31 Using the exposure documentation file, the auditor should:

- Ascertain the exposure type, interest rate, maturity date, repayment terms, security and stated purpose of the exposure;
- Consider whether security documents bear evidence of registration as appropriate, and that the NBFC has received appropriate legal advice about the security's legal enforceability;
- Consider whether the fair value of the security appears adequate (particularly for those exposures where a provision may be required) to secure the exposure and that where applicable, the security has been properly insured. Critically evaluate the collateral appraisals, including the appraiser's methods and assumptions;
- Evaluate the collectability of the exposure and consider the need for a provision against the account;
- Determine whether the appropriate authority levels within the NBFC have approved the exposure application or renewal;
- Review periodic financial statements of the borrower and note significant amounts and operating ratios (that is, working capital, earnings, shareholders' equity and debt-to-equity ratios); and
- Review any notes and correspondence contained in the exposure review file. Notes the frequency of review performed by the NBFC's staff and considers whether it is within NBFC guidelines.

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

Chapter 6

Governance

6.1 The need of best practices and greater transparency, to protect the interests of the stake-holders in the corporate sector has led to the specification of Corporate Governance guidelines by RBI. Its universal applicability has no exception to the Non-Banking Financial Companies (NBFCs) which too are essentially corporate entities. Listed NBFCs which are required to adhere to listing agreement and rules framed by SEBI on Corporate Governance are already required to comply with SEBI prescriptions on Corporate Governance.

6.2 In order to enable NBFCs to adopt best practices and greater transparency in their operations certain guidelines have been proposed for consideration of the Board of Directors of the class of NBFCs.

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

Table G: Auditor may consider following with regard to internal governance and reporting

| Audit Committee | |
|------------------------|--|
| • | Review written audit committee charter. |
| | Sufficiency of length of audit committee meetings and level of discussion to accomplish the committee's objectives. |
| | Understanding among audit committee, management, fund's chief compliance officer, internal auditors and independent auditors to provide constructive feedback on each other's performance, and identify improvements that can be made to enhance each party's effectiveness. |
| | Means used to keep current with fund industry, regulatory and auditing/accounting/tax developments affecting responsibilities of audit committee members (continuing education). |
| | Sufficiency of audit committee's relationships and meetings (general |

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and private session) and other interactions with management, fund's chief compliance officer and internal and independent auditors.

- Mutual understanding among the audit committee, fund's chief compliance officer, internal and external auditors of expected communication about matters requiring special or immediate attention.
- Review/approve any written report/disclosure made in public filings of audit committee activities.
- Internal auditor's observations concerning:
 - internal control over financial reporting, including management's procedures for monitoring service providers' controls;
 - management's and service providers' ability to maintain adequate internal control over financial reporting during periods of higher growth and activity or increase in the number of funds or complexity of their investments; or, alternatively, due to cost reduction programs resulting from declining revenues and profitability;
 - communication protocols between fund accounting and reporting functions and other service providers;
 - errors in NAV/per share, their causes, and any corrective actions taken as a result;
 - areas where alternative or extended audit procedures were required because of inadequate records or controls; and
 - sufficiency and timeliness of improvements to internal control over financial reporting made as a result of recommendations provided in current or prior audits.

Internal Control over Compliance with Laws and Regulations

- Non-compliance with laws and regulations could have a material effect on financial statements:
 - scope of work performed or oversight or advice provided in such areas by management, compliance staff, internal and external counsel.
- Significant elements of the annual review of the fund's compliance program administered by its chief compliance officer, including (i) those elements pertaining to service providers; (ii) the nature and

Governance

| | |
|---|--|
| | extent of forensic testing performed; and (iii) findings and any corrective actions taken or necessary to take. |
| • | Significant changes in compliance policies and procedures. |
| • | Status of any legal matters (if any) that could have a material effect on the financial statements. |
| • | Procedures used to identify potential conflicts of interest and ways in which such circumstances are managed and disclosed. |
| • | Unusual or nonrecurring transactions affiliates, and/or other related parties, including nature and extent of related disclosures: <ul style="list-style-type: none">- procedures for identifying and recording unusual revenue items, such as litigation settlements. |
| • | Identification and review of related party transactions and adequacy of disclosures. |
| • | Nature and extent of information appearing in shareholder report outside of financial statements. |
| • | Assurance that independent auditor received full cooperation from all parties relevant to audit and no restrictions were placed on his work. |

Chapter 7

Miscellaneous

Applicability of Other Laws

7.1 The auditor should consider the applicability of other laws while checking the transactions entered into by the NBFC. These laws include the Indian Contracts Act 1872, Sale of Goods Act 1930, Indian Stamp Act 1899, Negotiable Instruments Act 1881, Motor Vehicles Act 1961, Limitation Act 1963.

Opening and Closing of Branches

7.2 NBFCs are to comply with the provisions contained in Non Banking Financial Companies Acceptance of Deposits (Reserve Bank) Directions, 1998 regarding opening and closing of branches/ offices by NBFCs which are entitled to accept public deposits. As per the directions applicable to all NBFCs except Residuary Non Banking Companies and Miscellaneous Non Banking Companies, NBFC shall open its branch or appoint agents to collect deposits only on fulfilling following criteria:

- NBFC should have a certificate of registration from RBI.
- If Net Owned Funds (NOF) is upto Rs 50 Crore it can open branch within the State where its registered office is situated. For NOF more than Rs 50 Crore and with a credit rating AA and above, NBFC is permitted to open branch anywhere in India.
- NBFC shall notify RBI about its proposal to open the branch.

While closing its branch, NBFC should publish such intention in newspaper and should notify RBI, 90 days before the proposed closure.

Inspection by RBI

7.3 NBFCs are subject to inspection by RBI under section 45N of the Reserve Bank of India Act, 1934. Where any exceptions are noted NBFCs are required to rectify the same and report compliance. The auditor should examine the report and consider the exceptions noted in such inspection reports.

Miscellaneous

ICAI Announcement on NBFCs dated September 18, 2007

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

KYC Norms

7.5 RBI from time to time issues guidelines requiring NBFC to apply enhanced due diligence measures on high risk customers. Any contravention or non compliance of the guidelines would attract penalties imposed by RBI.

Appendix A

Illustrative Audit Report/Certificate Templates

**Certificate/Report that may be required to be issued for
Registration as NBFC**

Appendix A - IA

Board of Directors

[Name & Address of the Company]

Auditor's Report

- 1) This report is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying Statement of the capital funds, risk assets/ exposures and risk asset ratio etc. (the "Annex II Statement") as on [month] [date], [year] of [name of the Company] (the "Company") has been prepared by Company's Management and certified by the [Managing Director/ Chief Executive Officer of the Company or his authorised representative], pursuant to the requirements of 'Requirements to be complied with and documents to be submitted to Reserve Bank of India (RBI) by Non Banking Financial Companies for obtaining Certificate and Registration from RBI under Section 45-IA of the Reserve Bank of India Act, 1934 ("the Act") (the 'Requirement Checklist'), which we have initialled for identification purposes only.

Management's Responsibility

- 3) The preparation of the Annex II Statement is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Annexure II Statement and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances.
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Appendices

Auditors' Responsibility

- 5) Pursuant to the Requirements Checklist it is our responsibility to obtain reasonable assurance and report that the amounts in Parts A, B, C, D, E, F, G, H and I of the Annex II Statement are in accordance with the books of account and other records of the Company produced to us for our examination.
- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Conclusion

- 7) Based on our examination as above, and the information and explanations given to us, we report that, the amounts in Parts A, B, C, D, E, F, G, H and I of the Annex II Statement are in accordance with the books of account and other records of the Company produced to us for our examination.

Restrictions on Use

- 8) This report has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the Company's application for registration as a Non-Banking Financial Company with the Reserve Bank of India under Section 45-IA of the Reserve Bank of India Act, 1934, and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing

For [Insert Firm's name]
Firm Registration Number: [Insert Firm's Registration number]
Chartered Accountants

Signature
[Insert Partner's Name]
Partner
Membership Number:
[Place of the Signature]
[Date]

Technical Guide on Audit of NBFCs

Appendix A – I-B

Board of Directors

[Name of the Company]

[Address]

Auditors' Report

- 1) This report is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying declaration by [Name of the Company] (hereinafter referred to as "the Company") certifying that the Company is not carrying on any Non Banking Financial Company activity for the period [Date] to [Date] (herein after referred to as the "NBFC Activity Declaration"), has been prepared by the Company's Management and certified by [Name of MD/CEO of the Company or his authorized representative) pursuant to the requirement of 'Requirements to be complied with and documents to be submitted to Reserve Bank of India(RBI) by Non Banking Financial Companies for obtaining Certificate and Registration from RBI under Section 45-IA of the Reserve Bank of India Act,1934 (Act) (the 'Requirement Checklist'), which we have initialed for identification purpose only.

Management's Responsibility

- 3) The preparation of the NBFC Activity Declaration is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the NBFC Activity Declaration, and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances.
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Auditors' Responsibility

- 5) Pursuant to the Requirements Checklist it is our responsibility to examine the books and other records of the Company and obtain reasonable assurance and form an opinion that the NBFC Activity

Appendices

Declaration is in compliance with the requirements of the Company's registration as a Non-Banking Financial Company as set out in Requirement's Checklist.

- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Opinion

- 7) Based on our examination as above, and the information and explanations given to us, in our opinion, the accompanying NBFC Activity Declaration is in compliance with the requirements of the Company's registration as a Non-Banking Financial Company as set out in the Requirements Checklist.

Restrictions on Use

- 8) This report has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the Company's application for registration as a Non-Banking Financial Company with the Reserve Bank of India under Section 45-IA of the Reserve Bank of India Act, 1934, and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Appendix A – I-C

Board of Directors

[Name of the Company]

[Address]

Auditors' Certificate

- 1) This certificate is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying Declaration by [Name of the Company] (herein after referred to as "the Company") certifying that the Company is not holding / shall not accept Public Deposit for the period [date] to [Date] (herein after referred to as the "Public Deposits Declaration") has been prepared by the Company's Management and certified by [Name of MD/CEO of the Company or his authorized representative], pursuant to the requirements of 'Requirements to be complied with and documents to be submitted to Reserve Bank of India (RBI) by Non Banking Financial Companies for obtaining Certificate and Registration from RBI under Section 45-IA of the Reserve Bank of India Act, 1934 (the 'Act') (the 'Requirement Checklist'), which we have initialed for identification purposes only.

Management's Responsibility

- 3) The preparation of the Public Deposits Declaration is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Public Deposits Declaration, and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

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Auditors' Responsibility

- 5) Pursuant to the Requirements Checklist it is our responsibility to examine the books and other records of the Company and certify that the accompanying Public Deposits Declaration is in compliance with the requirements of the Company's registration as a Non-Banking Financial Company as set out in Requirement's Checklist.
- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Conclusion

- 7) Based on our examination as above, and the information and explanations given to us, we certify that the accompanying Public Deposits Declaration is in compliance with the requirements of the Company's registration as a Non-Banking Financial Company as set out in the Requirements Checklist.

Restrictions on Use

- 8) This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the Company's application for registration as a Non-Banking Financial Company with the Reserve Bank of India under Section 45-IA of the Act, and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

Appendix A - I-D

Board of Directors

[Name of the Company]

[Address]

Auditors' Certificate

- 1) This certificate is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying Statement of Computation of Net Owned Funds ("the Statement") as on [month] [date], [year] of [Name of the Company] (the "Company") has been prepared by Company's Management and certified by the [Managing Director/ Chief Executive Officer of the Company or his authorised representative] pursuant to the requirements as specified in circular DNBS (PD) C.C. No. 114 /03. 02.059/2007-08 dated June 17, 2008, as amended ("the Circular") and which we have initialled for identification purposes only.

Management's Responsibility

- 3) The preparation of the Statement is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement, and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Auditors' Responsibility

- 5) Pursuant to the Circular it is our responsibility to examine the books and other records of the Company and certify that the accompanying Statement is in accordance with the requirements of the Circular.

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- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Conclusion

- 7) Based on our examination as above, and the information and explanations given to us, we certify that :
- a) the Statement is computed in accordance with the requirements as specified in the Circular and
 - b) the computation therein is arithmetically correct.

Restrictions on Use

- 8) This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India in connection with the Company's planned activities as a Non Banking Financial Company and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

Appendix A - 1-E

Board of Directors

[Name of the Company]

[Address]

Auditors' Certificate

- 1) This certificate is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying statement of foreign direct investment in [Name of the Company] (hereinafter referred to as "the Company") as at [date] (the "FDI Statement") contains the details [] has been prepared by the Company's Management and certified by the [Managing Director/ Chief Executive Officer of the Company or his authorised representative] , pursuant to the requirements of FEMA Notification 94/2003-RB dated June 18, 2003 (the "RBI Circular"), which have been initialled by us for identification purpose only.

Management's Responsibility

- 3) The preparation of the FDI Statement is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the FDI Statement, and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Auditors' Responsibility

- 5) Pursuant to the RBI Circular it is our responsibility to examine the books and other records of the Company and certify that the Company is in compliance with the RBI Circular.

Appendices

- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Conclusion

- 7) Based on our examination as above, and the information and explanations, we certify that, to the best of our knowledge, the Company, is in compliance with the terms and conditions contained within FEMA Notification 94/2003-RB dated June 18, 2003 and as consolidated by Reserve Bank of India's Master Circular No.[*] dated [*].

Restrictions on Use

- 8) This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the Company's application for registration as a Non-Banking Financial Company with the Reserve Bank of India under Section 45-IA of the Reserve Bank of India Act, 1934 and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

Appendix A - 1F

Board of Directors

[Name of the Company]

[Address]

Auditors' Certificate

- 1) This certificate is issued in accordance with the terms of our agreement dated [date].
- 2) The accompanying declaration by [Name of the Company] (herein after referred to as "the Company") certifying whether the Company has engaged in any capital market activity for the period [Date] to [Date] (the "Capital Market Activity Declaration") has been prepared by the Company's Management and certified by [Name of MD/CEO of the Company or his authorized representative) pursuant to the requirements as set out in item number 24 of the 'Requirements to be complied with and documents to be submitted to Reserve Bank of India (RBI) by Non Banking Financial Companies for obtaining Certificate and Registration from RBI under Section 45-IA of the Reserve Bank of India Act, 1934('the Act') (the "Requirements Checklist"), which we have initialled for identification purpose only.

Management's Responsibility

- 3) The preparation of the Capital Market Activity Declaration is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Capital Markets Activity Declaration, and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Auditors' Responsibility

- 5) Pursuant to the RBI Circular it is our responsibility to examine the books and other records of the Company and certify that the Company is in compliance with the Requirements Checklist.

Appendices

- 6) We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India

Conclusion

- 7) Based on our examination as above, and the information and explanations (including Management representations) given to us, we certify that, to the best of our knowledge, the accompanying Capital Market Activity Declaration is in compliance with the requirements of the Company's registration as a Non-Banking Financial Company as set out in the Requirements Checklist

Restrictions on Use

- 8) The certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission to the Reserve Bank of India pursuant to the Company's application for registration as a Non-Banking Financial Company with the Reserve Bank of India under Section 45-IA of the Reserve Bank of India Act, 1934, and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

Report with NBS 1 Quarterly Return

Appendix A - II

Auditor's Report

- 1) This report is issued in accordance with the terms of our engagement dated [*]
- 2) The accompanying declaration in Form- NBS 1 Annual Return on Deposits (the "Return") prepared by [Name of the Company] (the "Company") to obtain reasonable assurance as to whether financial information in Parts 1 to 11 of the Return are in accordance with the audited financial statements of the Company as at and for the year ended [month][date], [year] and the books of account and other records of the Company. The Return has been prepared by the Company pursuant to the terms and conditions contained in Notification No.DFC.118/DG(SPT)-98 dated January 31, 1998 (the "Notification") issued by the Reserve Bank of India. We have initialled the Return for identification purposes only.

Management's responsibility

- 3) The preparation of the Return is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Return and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
- 4) The Management is also responsible for ensuring that the Company complies with the requirements of the Act (including the legal and statutory formalities) with respect to obtaining Certificate and Registration from RBI under Section 45 IA of the Act and for providing all relevant information to RBI.

Auditors' Responsibility

- 5) Pursuant to the Notification, it is our responsibility to report on the matters furnished in the Parts 1 to 11 of the Return based on our examination of the matters in the Return with reference to the audited financial statements as at and for the year ended [month][date], [year] ¹

¹ As applicable

Appendices

on which we have issued an unmodified audit opinion vide our audit report dated [month][date][year] and the books of account and other records maintained by the Company.

- 6) Our audits of the above mentioned financial statements of the Company was conducted in accordance with the generally accepted auditing standards in India and other applicable authoritative pronouncements issued by the Institute of Chartered Accountants of India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit were not planned and performed in connection with any transactions to identify matters that may be of potential interest to third parties.²
- 7) We conducted our examination of the Return in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Opinion

- 8) Based on our examination as above and the information and explanations given to us, to the best of our knowledge and according to the information and explanations given to us and as shown by the records examined by us, in our opinion, the financial information disclosed in Parts 1 to 11 of the Return is in agreement with audited financial statements of the Company as at and for the year ended [month][date], [year] and the books of account and other records of the Company.

Restrictions on Use

- 9) This report is addressed to and provided to the Company solely for the purpose of enabling it to comply with its obligations under the Notification to submit the statutory auditors' certificate , and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any liability or any duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come without our prior consent in writing.

² To be included only where the books and records of the Company include its audited financial statements.

Technical Guide on Audit of NBFCs

For [Firm Name]

Firm Registration Number: []

Chartered Accountants

[Name of Signing Partner]

Partner

Membership Number: []

Place:

Date:

Appendices

Appendix A III

Certificate on Monthly Return

Board of Directors

[Address]

Auditor's Certificate

1. This certificate is issued in accordance with the terms of our agreement dated [Date]
2. The accompanying monthly return (the "Return") of *[Name of the Company]* comprising important financial parameters of non banking financial companies has been prepared by the Company's Management and certified by *[Name of MD/CEO of the Company or his authorized representative]* pursuant to the requirements of DNBS (RID) C.C. No. 57/02.05.15/2005-06 dated September 6, 2005 issued by the Reserve Bank of India as compiled in Reserve Bank of India's Master Circular DNBS.PD.CC. No.[*]dated July 1, [*] (the "RBI Circular") which we have initialled for identification purpose only.

Management's Responsibility

3. The preparation of the Return is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Return and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
4. The Management is also responsible for ensuring that the Company complies with the requirements of the RBI Circular (including the legal and statutory formalities) with respect to filing of the Return and for providing all relevant information to RBI.

Auditors' Responsibilities

5. Pursuant to the RBI Circular it is our responsibility to examine the books and other records of the Company and certify whether:
 - a) The data furnished in Monthly Return is correct

Technical Guide on Audit of NBFCs

- b) The Company has accepted any public deposits
 - c) Company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts prescribed by the Reserve Bank of India for non banking financial companies as applicable to it.³
6. We conducted our examination in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India.

Conclusion

7. Based on our examination as above and the information and explanations given to us, we certify that, to the best of our knowledge and according to the information and explanations given to us and as shown by the records examined by us:
- (a) The data furnished in the attached return are correct.
 - (b) The Board of Directors of the company have passed a resolution in its meeting held on [month, day, year] for non-acceptance of any public deposits.⁴
 - (c) The company has not accepted any public deposits during the year ended March 31, [year].⁵
 - (d) The Company has complied with prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts prescribed by the Reserve Bank of India for non banking financial companies as applicable to it.⁶

Restrictions on Use

8. This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission of the Return to the Reserve Bank of India pursuant to RBI Circular and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability

³ As applicable

⁴ As applicable

⁵ As applicable

⁶ As Applicable

Appendices

for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

Certificate on Statement of Assets and Income Pattern

Appendix A-IV

Board of Directors

Company

Address

Auditors' Certificate

1. This certificate is issued in accordance with the terms of our agreement dated [Date]
2. The accompanying Statement of assets and income pattern (the "Statement") of [Name of the Company] (the "Company"), as on [month] [date], [year], has been prepared and certified by the [Managing Director/ Chief Executive Officer of the Company or his authorised representative] pursuant to Master Circular No. DNBS (PD) CC No.[*] dated July 1, [*] as amended from time to time issued by Reserve Bank of India ["RBI Master Circular"]. We have initialled the Statement for identification purposes only.

Management's Responsibility

3. The preparation of the Statement is the responsibility of the Management of the Company including the creation and maintenance of all accounting and other records supporting its contents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances
4. The Management is also responsible for ensuring that the Company complies with the requirements of the RBI Circular (including the legal and statutory formalities) with respect to filing of the Return and for providing all relevant information to RBI.

Auditors' Responsibility

5. Pursuant to RBI Master Circular, it is our responsibility to examine the books and other records of the Company and certify whether :
 - i) The Statement is in accordance with the books and records of the Company, and
 - ii) The Company continues to undertake the business of a Non Banking Financial Institution requiring it to hold the certificate of registration under section 45 IA of Reserve Bank of India Act, 1934 for the financial year ended [month][date][year].

Appendices

6. We conducted our engagement in accordance with the 'Guidance Note on Audit Reports and Certificates for Special Purposes' issued by the Institute of Chartered Accountants of India

Conclusion

7. Based on our examination as above, and the information and explanations given to us, we certify that:
- a. the Statement is in accordance with the books and records and the information and explanations given to us and
 - b. the Company continues to undertake the business of a Non Banking Financial Institution (NBFI) requiring it to hold Certificate of Registration under Section 45 IA of Reserve Bank of India Act, 1934 for the financial year ended [month] [date] [year].

Restriction on Use

8. This certificate has been issued for the sole use of the Board of Directors of the Company, to whom it is addressed, for submission of the Statement to the Reserve Bank of India pursuant to RBI Master Circular and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Technical Guide on Audit of NBFCs

For Systemically Important Non Deposit taking NBFCs

Appendix A- V

Auditor's Additional Report

Board of the Directors

[Name of the Company]

[Address]

1. This report is issued in accordance with the terms of our agreement dated [Date].
2. We have audited the Balance Sheet of [Name of the Company] (hereinafter referred to as the "Company") as at March 31, [] and the related Profit and Loss Account and Cash Flow Statement for the year ended on that date, issued our report dated [].

Management's Responsibility for the Financial Statements

3. The Company's Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of 'the Companies Act, 1956' of India (the "Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

4. Pursuant to the requirements of Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008 (the "Directions") it is our responsibility to examine the books and records of the Company and report on the matters specified in the Directions to the extent applicable to the Company:
5. We conducted our examination in accordance with the Guidance Note on Special Purpose Audit reports and Certificates issued by Institute of Chartered Accountants of India.

Conclusion

6. Based on our examination of the books and records of the Company as produced for our examination and the information and explanations given to us we further report that:
- 6.1 The Company is engaged in the business of non-banking financial institution and has obtained a certificate of registration [*Certificate Reference*] dated [*month, day, year*] from the Reserve Bank of India ('the Bank'), Department of Non-Banking Supervision, Mumbai Regional Office.
 - 6.2 The company is entitled to continue to hold such CoR in terms of its asset/income pattern as on March 31, [*year*].
 - 6.3 Based on the criteria set forth by the Bank in Company Circular No. DNBS.PD. CC No. 85 / 03.02.089 /2006-07 dated December 6, 2006 for classification of NBFCs as Asset Finance Company (AFC), the non-banking financial company has been correctly classified as AFC as defined in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 with reference to the business carried on by it during the applicable financial year.⁷
 - 6.4 Based on the criteria set forth by the Bank in the Notification viz; Non-Banking Financial Company- Micro Finance Institutions (Reserve Bank) Directions, 2011 dated December 02, 2011 (MFI Directions) for classification of NBFCs as NBFC-MFIs, the non-banking financial company has been correctly classified as NBFC-MFI as defined in the aforesaid MFI Directions with reference to the business carried on by it during the applicable financial year⁸
 - 6.5 The Board of Directors of the Company has passed a resolution in its meeting held on [*month, day, year*] for non-acceptance of public deposits
 - 6.6 The Company has not accepted any public deposits during the year ended [*month, day, year*].
 - 6.7 The Company has complied with the prudential norms relating to income recognition, accounting standards, asset

⁷ Delete this paragraph if not found applicable

⁸ Delete this paragraph if not found applicable

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classification and provisioning for bad and doubtful debts as applicable to it in terms of Non-Banking Financial (Non – Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

- 6.8 The annual statement of capital funds, risk assets / exposures and risk asset ratio (NBS – 7) has been furnished to the Bank on *[month, day, year]* within the stipulated period based on the unaudited books of account. The Company had correctly arrived at and disclosed the capital adequacy ratio, based on the unaudited books of account, in the return submitted to the Bank in Form NBS – 7 and such ratio is in compliance with the minimum CRAR prescribed by the Bank.

Restriction on Use

7. This report is issued pursuant to our obligations under Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008 to submit a report on exceptions, noted while issuing our report dated [] on additional matters as stated in the above directions, to Reserve Bank of India and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into whose hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Exception Reporting

Appendix A-VI

Board of the Directors

[Name of the Company]

[Address]

1. This report is issued in accordance with the terms of our agreement dated [Date].
2. We have audited the Balance Sheet of [Name of the Company] (hereinafter referred to as the "Company") as at March 31, [] and the related Profit and Loss Account and Cash Flow Statement for the year ended on that date, issued our report dated [].

Management's Responsibility for the Financial Statements

3. The Company's Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of 'the Companies Act, 1956' of India (the "Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

4. As required by the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008 (the "Directions") and on the basis of such checks of the books and records of the Company as we considered appropriate and the information and explanations given to us during the course of our audit, we give below a statement on the matters specified in paragraphs 5 of the said Directions to the extent applicable to the Company:
5. We conducted our examination in accordance with the Guidance Note on Special Purpose Audit reports and Certificates issued by the Institute of Chartered Accountants of India.

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Basis for exception reporting

6. [Provide brief background of requirement]

Exception Report

7. *We draw your attention to Note [*] of Schedule [*] of the financial statements for the year ended March 31,[], regarding [qualification]*

Restriction on Use

8. This report is issued pursuant to our obligations under Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008 to submit a report on exceptions, noted while issuing our report dated [] on additional matters as stated in the above directions, to Reserve Bank of India and should not be used by any other person or for any other purpose. [Name of the Firm] neither accepts nor assumes any duty or liability for any other purpose or to any other party to whom our report is shown or into *whose* hands it may come without our prior consent in writing.

For [Insert Firm's name]

Firm Registration Number: [Insert Firm's Registration number]

Chartered Accountants

Signature

[Insert Partner's Name]

Partner

Membership Number:

[Place of the Signature]

[Date]

Independent Auditor's Report (As per SA 700 (Revised))

To the Members of [Company Name]

Report on the Financial Statements

1. We have audited⁹ the accompanying financial statements of [Name of the company] (the "Company"), which comprise the Balance Sheet as at [Month Date, Year], and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information, which we have signed under reference to this report.

Management's¹⁰ Responsibility for the Financial Statements

2. The Company's Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of 'the Companies Act, 1956' of India (the "Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

3. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence, about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the

⁹ If the opinion is being disclaimed, replace "We have audited" with "We were engaged to audit"

¹⁰ The auditor's report shall describe management's responsibility for the preparation of the financial statements in the manner in which that responsibility is described in the terms of the audit engagement. The description shall include an explanation that management is responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error."

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assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

5. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion¹¹.

Basis for Qualified/ Adverse/ Disclaimer of Opinion¹²

6. [If issuing a qualified or adverse opinion or if the opinion is being disclaimed provide a clear description of all of the substantive reasons and, unless impracticable, a quantification of the possible effect(s) on the financial information.]

Opinion¹³

7. In our opinion, and to the best of our information and according to the explanations given to us, the accompanying financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:
- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at [Month Date, Year];
 - (b) in the case of the Statement of Profit and Loss, of the profit/ loss¹⁴ for the year ended on that date; and

¹¹ If the audit opinion is qualified or adverse, substitute paragraph 5 with "We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified/ adverse⁴ audit opinion."

If the opinion is being disclaimed, substitute paragraph 5 with "Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

¹² As applicable

¹³ If the audit opinion is qualified or adverse, "Opinion" should be substituted with "Qualified Opinion" or "Adverse Opinion" and if the opinion is being disclaimed, substitute "Opinion" with "Disclaimer of Opinion". The text in paragraph 7 is for an unmodified opinion.

¹⁴ As applicable

Appendices

- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Emphasis of Matter

8. [If including an emphasis of matter paragraph in the report, include a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements, and indicate that the opinion is not modified in respect of the matter emphasised.]

Other Matter¹⁵

- 9 The financial statements of the Company as at [Month] [Date], [Year] and for the year then ended were audited by another firm of chartered accountants who, vide their report dated [month][day], [year], expressed an unmodified opinion on those financial statements.

Report on Other Legal and Regulatory Requirements

10. As required by 'the Companies (Auditor's Report) Order, 2003', as amended by 'the Companies (Auditor's Report) (Amendment) Order, 2004', issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act (hereinafter referred to as the "Order"), and on the basis of such checks of the books and records of the Company as we considered appropriate and according to the information and explanations given to us, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.

OR

This report does not contain a statement on the matters specified in paragraphs 4 and 5 of 'the Companies (Auditor's Report) Order, 2003', as amended by 'the Companies (Auditor's Report) (Amendment) Order, 2004', issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act as, in our opinion, and according to the information and explanations given to us, the Order is not applicable in the case of the Company.

11. As required by section 227(3) of the Act, we report that:
- (a) We have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purpose of our audit;
 - (b) In our opinion, proper books of account as required by law have been kept by the Company so far as appears from our

¹⁵ To be included in the first year of appointment as statutory auditors.

Technical Guide on Audit of NBFCs

examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]¹⁶;

- (c) The Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]¹⁷;
- (d) In our opinion, the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this report comply with the Accounting Standards referred to in sub-section (3C) of section 211 of the Act;
- (e) On the basis of written representations received from the directors as on [balance sheet date], and taken on record by the Board of Directors, none of the directors is disqualified as on [balance sheet date], from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.

For [Name of the Firm]

Firm Registration Number:

Chartered Accountants

.....

[Name]

[Place of the Signature]

Partner

[Date]

Membership Number

The footnotes contain guidance relating to the preparation of the report and should not appear in the report issued to the client.

¹⁶ Applicable if the Company has branch offices. In case branch offices are audited by other auditors, whose reports have been forwarded to you, include the following as (c); and the remaining subparagraphs in this template – (c) through (e) – will need to be renumbered (d) through (f)

“(c) The report(s) on the accounts of the Branch office(s) audited under Section 228 by other auditors has/ have been forwarded to us in accordance with Section 228(3)(c) and has/ have been considered in preparing this Report;

¹⁷ As Applicable

Appendix B

Illustrative Audit Checklist

COMPLIANCES FOR NBFC

| Reference | Particulars | Frequency | Applicability |
|--|---|----------------|---|
| Under Reserve Bank of India Act, 1934 | | | |
| Section 45-IA | NBFC have to make application for registration with RBI and shall not commence or carry on business of a non-banking financial institution without obtaining registration from RBI and maintaining NOF. NOF requirement for NBFC registered Before 21/04/1999 = Rs. 25 lacs On or after 21/04/1999 = Rs. 200 lacs | One time | All NBFC |
| Section 45-IB | Maintenance of percentage of assets Invest and continue to invest 5% to 25% (specified by RBI) of deposits outstanding on the last working day of the second preceding quarter in unencumbered approved securities. Notification No. DFC.121/ED(G)-98 dated 31.01.1998 and No. DFC(COC) NO.108-ED(JRP)-97 dated 30.04.1997 | Ongoing | NBFC accepting / holding Public Deposit |
| Section 45-IC | Reserve Fund Every NBFC shall create a reserve fund and transfer therein a sum not less than 20% of its net profit every year as disclosed in the profit and loss account and before any dividend is declared. | Yearly | All NBFC |
| Section 45-M | Duty of NBFC to furnish statements etc., required by Bank | When asked for | All NBFC |

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Under Non-Banking Financial Companies (non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

Master circular: RBI 2011-12/19 DNBS (PD) CC No.225/ 03.02.001 / 2011-12 dated July 1, 2011

| Reference | Particulars | Frequency | Applicability |
|------------------|---|------------------|----------------------|
| Para 3, 4, 5, 6 | Income recognition Income from NPA shall be recognized only when actually realised. All unrealised income on NPA shall be reversed. | Ongoing | All NBFC |
| | Income from investment Dividend income on shares and units of Mutual Funds shall be taken on cash basis. Income from Bonds and Debentures from Govt. Securities may be taken on accrual basis. Income from securities (guaranteed by Central Govt. or State Govt.) may be taken on accrual basis. | | |
| | Accounting Standards Accounting standards and guidance notes issued by ICAI shall be followed | | |

Appendices

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|--------|--|---------|---------------------------|
| | Accounting of investment 1. Board of Directors shall frame Investment Policy and implement the same. 2. Classify the investments into Current and Long Term Investment 3. No inter-class transfer on ad hoc basis 4. Inter-class transfer, if warranted, shall be effected only on April 1 or October 1, with the approval of Board of Directors 5. Investment shall be transferred scrip wise, from Current Investment to long –term investment or <i>vice versa</i> at book value or market value, whichever is lower. 6. Quoted Current Investment shall, for the purpose of valuation, shall be valued at cost or market value, whichever is lower. 7. Unquoted equity shares in the nature of current investment shall be valued at cost or break-up value, whichever is lower. 8. Long term Investment shall be valued in accordance with Accounting Standard issued by ICAI. | | |
| Para 7 | Need for Policy on Demand / Call Loans Policy for demand / call loan shall be framed | Ongoing | All NBFC giving loan etc. |

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| | | | |
|------------------|---|---------|--|
| Para 8, 9 and 10 | Asset classification Assets shall be classified as Standard, Sub-standard, Doubtful and Loss assets. | Ongoing | All NBFC |
| | Provisioning requirements Provision for assets (i.e. loans, advances or other credit facilities including bills purchased & discounted, Leased and hire purchased assets) shall be made Disclosure in the Balance Sheet Separately disclosure the provisions made as per para 9, without netting them from the income or against the value of assets. Unlike deposit taking NBFCs, systematically important non deposit taking NBFCs are required to disclose following particulars Capital to Risk Assets Ratio (CRAR) Exposure to real estate sector, both direct and indirect; and Maturity pattern of assets and liabilities." | Yearly | All NBFC |
| Para 11 | Constitution of Audit Committee Company having assets of Rs.50 crore and above shall constitute an Audit Committee. | Ongoing | NBFC having assets of Rs. 50 crore and above |
| Para 12 and 13 | Accounting Year Every NBFC shall prepare its B/S and P/L as on 31 st March | Yearly | All NBFC |

Appendices

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|---------|---|---|---|
| | Schedule to the Balance Sheet Every NBFC shall append to its B/S particulars in the format as set in schedule | | |
| Para 14 | Transaction in Government Securities NBFC shall hold investment in approved securities in a dematerialised form only. | Ongoing | All NBFC |
| Para 15 | Submission of Auditors Certificate That the Company is engaged in the business of NBFI requiring it to hold a Certificate of Registration u/s 45IA of RBI Act indicating income and assets pattern of the company making it eligible for classification as Asset Finance, loan or Investment Company. | Latest by 30 th June every year. | All NBFC |
| Para 16 | Requirement as to Capital adequacy Company shall maintain a minimum capital ratio (consisting of Tier I and Tier II capital) which shall not be less than 10% of its weighted asset and the risk adjusted value of off-balance sheet items. | Ongoing | Systemically important – ND taking NBFC |
| Para 17 | Loan against NBFC's own shares prohibited No loan against own shares shall be given | Ongoing | All NBFC |
| Para 18 | Concentration of credit / investment Restriction has been specified (Lend or invest to single person 15% and group 25%) (Both lend | Ongoing | Systemically important – ND taking NBFC |

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| | | | |
|---------|---|--|-------------------------------------|
| | and invest 25% and 40% respectively) | | |
| Para 19 | Information in regard to change of address, directors, auditors, Principal officer, etc. Information to be submitted by every NBFC company within 30 days from the date of occurrence of any change | Within 30 days of occurrence of any change | All NBFC |
| Para 20 | Norms relating to Infrastructure Loan Restructuring of Infrastructure Loan. | | All NBFC giving Infrastructure Loan |
| Para20A | NBFCs are not to be partners in partnership firms Should opt for early retirement if already a partner | | All NBFCs |

Under various Notification / Press release issued by Reserve Bank

| Reference | Particulars | Frequency | Applicability |
|-----------|---|---|---------------|
| | Notification : RBI/2011-12/21 DNBS.PD.CC. No.227/03.10.042/ 2011-12 dated July 1, 2011 RBI/2011-12/195 DNBS(PD).CC. No.243/03.02.02/2011-12 dated September 22, 2011 Returns to be submitted by NBFCs | Monthly/ quarterly /half yearly/ Annual | All NBFCs |
| | Master Circular: RBI/2011-12/23 DNBS.PD.CC. No.229/03.10.042/2011-12 July 1, 2011 Frauds – Future approach towards monitoring of frauds in NBFC. Report on actual/suspected | Form | All NBFC |

Appendices

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|--|--|--|----------|
| | <p>Frauds</p> <p>Quarterly report on frauds outstanding</p> <p>Quarterly progress report on frauds of Rs 1 Lakh and above.</p> | <p>FMR-1</p> <p>Form</p> <p>FMR-2</p> <p>Form</p> <p>FMR-3</p> | |
| | <p>RBI/2011-12/25 DNBS (PD) CC No.231/03.10.42/2011-12 dated July 1, 2011</p> <p>NBFC is required to formulate a policy on Know your customer (KYC) and Anti Money Laundering measures and put in place with the approval of Board of Directors within 3 months of the date of circular.</p> | | All NBFC |
| | <p>Appointment of Principal officer- Maintenance of record under rule 3 of Money Laundering Act (PMLA), 2002 (cash/suspicious transactions)</p> <p>Report information relating to cash and suspicious transactions to the Director Financial Intelligence Unit , New Delhi</p> | | All NBFC |
| | <p>RBI/2011-12/26 DNBS (PD) CC No. 232/03.10.042/2011-12 dated July 1, 2011</p> <p>Fair Practice Code to be framed and approval of the same by the Board of Directors of the Company within one month from the date of circular.</p> <p>Board of Directors of NBFC to lay out appropriate internal principles and procedures in determining interest rates, processing and other charges on the guidelines indicated in fair practice code.</p> | | All NBFC |

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| | | | |
|--|--|--|---|
| | To ensure that excessive interest, beyond a certain level are not charged (interest rates are not regulated by RBI) | | |
| | <p>Notification No. DNBS(PD)CC. No. 94/03.05.002/2006-07 dated 08.05.2007</p> <ul style="list-style-type: none"> - Rotation of audit partner every three years - Guidelines on Corporate Governance. <ol style="list-style-type: none"> 1. Constitution of Audit Committee 2. Constitution of Nomination Committee 3. Constitution of Risk Management Committee 4. Framing internal guidelines on corporate governance 5. Information to be placed before the Board at regular interval, prescribed by the Board: <ul style="list-style-type: none"> - progress made in putting in place a progressive risk management system, and risk management policy and strategy followed - conformity with corporate governance standards, viz, in the composition of various committees, their role and functions, periodicity of the meeting and compliance with coverage and review functions etc | | <p>Assets Size of Rs. 20 crore and above</p> <p>And</p> <p>Systemically important –ND taking NBFC</p> |

Appendices

| | | | |
|--|---|---|--|
| | Connected Lending The NBFC should comply with the instructions on connected lending relationship, as detailed in Annexure. <i>Note: These directions are put on hold)</i> | | Systemically important –ND taking NBFC |
| | GUIDELINES FOR ASSET – LIABILITY MANAGEMENT (ALM) /2011-12/30 DNBS (PD) CC No.236 /03.02.001/2011-12 dated July 1, 2011 | | |
| | Half-yearly Return for the period ended 31 st March and 30 th September, in three parts: (i) Statement of structural liquidity (ii) Statement of Short term dynamic liquidity (iii) Statement of Interest Rate Sensitivity | Within one month of ending of half-year | All NBFCs |
| | Constitution of Asset Liability Management Committee (ALCO) | | All NBFCs |
| | Board of Directors should oversee the implementation of the system and review its functioning periodically. | | All NBFCs |

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Under Non-Banking Financial Companies (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007

Master circular: RBI/2011-12/18 DNBS (PD) CC No.224/ 03.02.001/ 2011-12 dated July 1, 2011

| Reference | Particulars | Frequency | Applicability |
|------------------|---|------------------|----------------------|
| Para 3, 4, 5, 6 | Income recognition Income from NPA shall be recognized only when actually realised. All unrealised income on NPA shall be reversed. | Ongoing | All NBFC |
| | Income from investment Dividend income on shares and units of Mutual Funds shall be taken on cash basis. Income from Bonds and Debentures from Govt. Securities may be taken on accrual basis. Income from securities (guaranteed by Central Govt. or State Govt.) may be taken on accrual basis. | | |
| | Accounting Standards Accounting standards and guidance notes issued by ICAI shall be followed | | |
| | Accounting of investment 1. Board of Directors shall frame Investment Policy and implement the same. 2. Classify the investments into Current and Long Term Investment 3. No inter-class transfer on ad hoc basis 4. Inter-class transfer, if warranted, shall be effected only on April 1 or October 1, with the approval of Board of Directors 5. Investment shall be transferred scrip wise, from Current Investment to long –term investment or vice | | |

Appendices

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|------------------|---|---------|---------------------------|
| | <p>versa at book value or market value, whichever is lower.</p> <p>6. Quoted Current Investment shall, for the purpose of valuation, shall be valued at cost or market value, whichever is lower.</p> <p>7. Unquoted equity shares in the nature of current investment shall be valued at cost or break-up value, whichever is lower.</p> <p>8. Long term Investment shall be valued in accordance with Accounting Standard issued by ICAI.</p> | | |
| Para 7 | <p>Need for Policy on Demand / Call Loans</p> <p>Policy for demand / call loan shall be framed</p> | Ongoing | All NBFC giving loan etc. |
| Para 8, 9 and 10 | <p>Asset classification</p> <p>Assets shall be classified as Standard, Sub-standard, Doubtful and Loss assets.</p> | Ongoing | All NBFC |
| | <p>Provisioning requirements</p> <p>Provision for assets (i.e. loans, advances or other credit facilities including bills purchased & discounted, Leased and hire purchased assets) shall be made</p> | Ongoing | |

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| | | | |
|----------------|--|---|---|
| | Disclosure in the Balance Sheet Separately disclosure the provisions made as per para 9, without netting them from the income or against the value of assets. Unlike deposit taking NBFCs, systematically important non deposit taking NBFCs are required to disclose following particulars Capital to Risk Assets Ratio (CRAR) Exposure to real estate sector, both direct and indirect; and Maturity pattern of assets and liabilities." | Yearly | |
| Para 11 | Constitution of Audit Committee Company having assets of Rs.50 crore and above shall constitute an Audit Committee. | Ongoing | NBFC having assets of Rs.50 crore and above |
| Para 12 and 13 | Accounting Year Every NBFC shall prepare its B/S and P/L as on 31 st March Schedule to the Balance Sheet Every NBFC shall append to its B/S particulars in the format as set in schedule | Yearly | All NBFC |
| Para 14 | Transaction in Government Securities NBFC shall hold investment in approved securities in a dematerialised form only. | Ongoing | All NBFC |
| Para 15 | Submission of Auditors Certificate - That the Company is engaged in the business of NBFI requiring it | Latest by 30 th June every year. | All NBFC |

Appendices

| | | | |
|---------|---|----------|--|
| | to hold a Certificate of Registration u/s 45IA of RBI Act indicating income and assets pattern of the company making it eligible for classification as Asset Finance, loan or Investment Company. | | |
| Para 16 | Requirement as to Capital adequacy Company shall maintain a minimum capital ratio (consisting of Tier I and Tier II capital) which shall not be less than 10% of its weighted asset and the risk adjusted value of off-balance sheet items. | Ongoing. | All NBFC |
| Para 17 | Loan against NBFC's own shares prohibited No loan against own shares shall be given | Ongoing | All NBFC |
| Para 18 | NBFC not to lend or invest if it failed to repay the deposits as long as the default exists | Ongoing | All NBFC |
| Para 19 | Restriction on investment in land and building and unquoted shares Investment should not exceed 10% of its owned fund (exception – investment in buildings for own use) (exception for loan or investment company-investment in unquoted shares should not exceed 20% of owned funds) Asset acquired in satisfaction of debts to be disposed off within three years and not included in the ceiling. | | Asset Finance company and Loan or Investment company |

Technical Guide on Audit of NBFCs

| | | | |
|---------|---|--|---|
| Para 20 | Concentration of credit / investment Restriction has been specified (Lend or invest to single person 15% and group 25%) (Both lend and invest 25% and 40% respectively) | Ongoing | Not applicable to residuary NBFC and Asset finance company can exceed the limit by 5% with board approval |
| Para20A | NBFCs are not to be partners in partnership firms | | All NBFCs |
| Para 21 | Submission of half yearly returns Form NBS 2 | Within 3 months of the end of the half year | All NBFC |
| Para 22 | Exposure to Capital market Submission of Form NBS 6 | Monthly return within 7 days from the end of the month | All NBFC with total assets over Rs 100 crore |
| Para 23 | Norms relating to Infrastructure loan Applicable to restructuring /reschedulement/renegotiation in the terms of agreement for loan | Ongoing | All NBFC which has lent infrastructure loan |

Controls Check-list

Strategic controls

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

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

Operational controls

- Is there appropriate segregation of duties between the front office and back office?
- Are the following activities conducted independently of the front office/business unit:
 - i. Confirmation of trades;
 - ii. Recording and reconciliation of positions and results;
 - iii. Valuation of trades or independent verification of market prices; and
 - iv. Settlement of trades
 - v. Does the NBFC have a code of conduct for its dealers that addresses the following:
 - o Prohibiting dealers from trading on their own account;

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- Restricting acceptance of gifts and entertainment activities;
- Confidentiality of customer information;
- Identification of approved counterparties; and
- Procedures for the review of dealers' activities by management?
- Are remuneration policies structured to avoid encouraging excessive risk taking?
- Are new products entered only after appropriate approvals are obtained and adequate procedures and risk control systems are in place?

Limits and trading activity

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

Risk measurement and management

- Is there an independent risk management function (sometimes referred to as Middle Office) for measuring, monitoring and controlling risk? Does it report directly to those charged with governance and senior management? Assess if there are any independence related issues.
- Which method is employed to measure the risk arising from trading activities (for example, position limits, sensitivity limits, value at risk limits, etc.)? Is the method employed is in line with treasury risk management policy.
- Are the risk control and management systems adequately equipped to handle the volume, complexity and risk of treasury activities?

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

Confirmations

Does the NBFC have written procedures in use:

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

Settlement of transactions

- Are settlement instructions exchanged in writing with counterparties by the use of inward and outward confirmations?

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

Recording

- Are exception reports generated for excesses in limits; sudden increases in trading volume by any one trader, customer or counterparty; transactions at unusual contract rates, etc? Are these monitored promptly and independently of the dealers?
- The daily reconciliation of dealer's positions and profits with the accounting records and the prompt investigation of all differences; and
- Regular reports to management in appropriate detail to allow the monitoring of the limits referred to above?
- Does the NBFC have an accounting system that allows it to prepare reports that show its spot, forward, net open and overall positions for the different types of products, for example:
 - By purchase and sale, by currency;
 - By maturity dates, by currency; and
 - By counterparty, by currency?
 - Are open positions revalued periodically (for example, daily) to current values based on quoted rates or rates obtained directly from approved independent sources?

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Credit Function Checklist

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

Monitoring

- Are trial balances prepared and reconciled with control accounts by employees who do not process or record loan transactions?
- Are reports prepared on a timely basis of loans on which principal or interest payments are in arrears?
- Are these reports reviewed by employees independent of the lending function?
- Are there procedures in use to monitor the borrower's compliance with any loan restrictions (for example, covenants) and requirements to supply information to the NBFC?

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- Are there procedures in place that require the periodic reassessment of collateral values?
- Are there procedures in place to ensure that the borrower's financial position and results of operations are reviewed on a regular basis?
- Are there procedures in place to ensure that key administrative dates, such as the renewal of security registrations, are accurately recorded and acted upon as they arise?

Collection

- Are the records of principal and interest collections and the updating of loan account balances maintained by employees independent of the credit granting function?
- Is there a control to ensure that loans in arrears are followed up for payment on a timely basis?
- Are there written procedures in place to define the NBFC's policy for recovering outstanding principal and interest through legal proceedings, such as foreclosure or repossession?
- Are there procedures in place to provide for the regular confirmation of loan balances by direct written communication with the borrower by employees independent of the credit granting and loan recording functions, as well as the independent investigation of reported differences?

Periodic review and evaluation

- Are there procedures in place for the independent review of all loans on a regular basis, including:
- The review of the results of the monitoring procedures referred to above; and
- The review of current issues affecting borrowers in relevant geographic and industrial sectors?
- Are there appropriate written policies in effect to establish the criteria for:
- The establishment of loan loss provisions;
- The cessation of interest accruals (or the establishment of offsetting provisions);
- The valuation of collateral security for loss provisioning purposes;

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- The reversals of previously established provisions;
- The resumption of interest accruals; and
- The writing off of loans?
- Are there procedures in place to ensure that all required provisions are entered into the accounting records on a timely basis?

Appendix C

Illustrative List of Circulars/Notifications issued by RBI

A list of important master circulars issued by RBI upto May 29, 2012 is given below for reference. Readers may note that the full text of circulars is not given in this appendix and only relevant extracts from the circulars have been taken. A link to the website is also given wherefrom full text of the circular can be accessed.

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| S.No | Circular / Notification Reference |
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| 2 | Compliance with FDI norms- Half yearly certificate from Statutory Auditors of NBFCs |
| 3 | Submission of certificate from Statutory Auditor to the Bank |
| 4 | Returns to be submitted by NBFCs |
| 5 | Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 |
| 6 | Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 |
| 7 | Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 |
| 8 | Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977 |
| 9 | Miscellaneous Instructions to All Non-Banking Financial Companies |
| 10 | Master Circular - Miscellaneous Instructions to NBFC- ND-SI |
| 11 | Introduction of New Category of NBFCs - Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) – Directions |
| 12 | Non Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) - Provisioning Norms- Extension of time |
| 13 | Mortgage Guarantee Companies Investment (Reserve Bank) Directions, 2008 |
| 14 | Notification as amended up to June 30, 2011 – Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008 |

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| 15 | Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008 |
| 16 | Directions/instructions issued to the Securitisation Companies/ Reconstruction Companies |
| 17 | The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 |
| 18 | Regulatory Framework for Core Investment Company (CICs) |
| 19 | Infrastructure Finance Companies |
| 20 | Know Your Customer' (KYC) Guidelines – Anti Money Laundering Standards (AML) -'Prevention of Money Laundering Act, 2002 - Obligations of NBFCs in terms of Rules notified there under |
| 21 | Corporate Governance |
| 22 | Fair Practice Code |
| 23 | Frauds – Future approach towards monitoring of frauds in NBFCs |
| 24 | Exemptions from RBI Act, 1934 |
| 25 | Notification of change in or take over of management of the business of the borrower by securitisation and reconstruction companies (Reserve Bank) Guidelines, 2010 |
| 26 | Allied activities- entry into insurance business, issue of credit card and marketing and distribution of certain products |
| 27 | NBFCs-ND-SI issuing guarantees - Applicability of exemption from Concentration norms |
| 28 | Opening of Branch-Subsidiary-Joint Venture-Representative office or Undertaking Investment Abroad by NBFCs |
| 29 | Implementation of Green Initiative of the Government |
| 30 | NBFCs - Infrastructure Debt Funds(IDFs) |
| 31 | Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs |
| 32 | Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs-Clarification |
| 33 | Monitoring of frauds - All Non-Deposit taking NBFCs with asset size of Rs.100 crore and above and Deposit taking NBFCs |
| 34 | Non- Reckoning Fixed Deposits with Banks as Financial Assets |
| 35 | Lending Against Security of Single Product – Gold Jewellery |
| 36 | Foreign Investment in NBFC Sector under the FDI Scheme – Clarification |

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1. Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008

Master Circular: RBI/2011-12/20 DNBS (PD) CC No. 226/03.02.001/2011-12 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6565

The Reserve Bank of India had issued Directions to the auditors of Non-Banking Financial Companies under Section 45 MA of the RBI Act, 1934, vide Notification No. DFC. 117 /DG (SPT)-98 dated January 2, 1998.

The Directions have been consolidated and in supersession of said Directions viz. the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 the new Directions are being issued vide Notification No. DNBS(PD)201/DG(VL)/2008 dated September 18, 2008, for meticulous compliance.

Auditors to submit additional Report to the Board of Directors

In addition to the Report made by the auditor under Section 227 of the Companies Act, 1956 (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 following matters.

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

I. Whether the company is engaged in the business of non-banking financial institution and whether it has obtained a Certificate of Registration (CoR) from the Bank.

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

Note: A reference in this regard is invited to paragraph 15 of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 in respect of deposit taking NBFCs and paragraph 15 of Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 in respect of non-deposit taking NBFCs.

III. Based on the criteria set forth by the Bank in Company Circular No. DNBS.PD. CC No. 85/03.02.089 /2006-07 dated December 6, 2006 for

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classification of NBFCs as Asset Finance Company (AFC), whether the non-banking financial company has been correctly classified as AFC as defined in Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 with reference to the business carried on by it during the applicable financial year.

(B) In the case of a non-banking financial company 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) which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 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, 1998;
- (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, 1998 are regularised in the manner provided in the said Directions;
- (iii) Whether an Asset Finance Company having Capital to Risk Assets Ratio (CRAR) less than 15% or an Investment Company or a Loan Company as defined in paragraph 2(1)(ia), (vi) and (viii) Respectively of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency;
- (iv) In respect of NBFCs referred to in clause (iii) above, 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

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Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998

- (a) 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;
- (v) In case of NBFCs having Net Owned Funds of Rs 25 lakh and above but less than Rs 200 lakhs, whether the public deposit held by the companies is in excess of the quantum of such deposit permissible to it in terms of Notification No. DNBS. 199/CGM (PK) - 2008 dated June 17, 2008 and whether such company :
 - (a) has frozen its level of deposits as on the date of that Notification; or
 - (b) has brought down its level of deposits to the level of revised ceiling of deposits in terms of that Notification.
- (vi) 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;
- (vii) 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 Reserve Bank of India in terms of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
- (viii) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed therein;
- (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 Bank in terms of NOTIFICATION NO.DNBS.172/CGM(OPA)-2003 dated July 31, 2003;

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- (x) Whether the company has furnished to the Bank within the stipulated period the return on deposits as specified in the NBS 1 to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998;
- (xi) Whether the company has furnished to the Bank within the stipulated period the half-yearly return on prudential norms as specified in the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- (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, 1998.

(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 Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
- (iv) In respect of Systemically Important Non-deposit taking NBFCs as defined in paragraph 2(1)(xix) of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007
 - (a) whether the capital adequacy ratio as disclosed in the return submitted to the Bank in form NBS-7, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the Bank;

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

(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, the auditor shall include a statement on the following matters, namely:

Where a Company has obtained a specific advice from the Bank that it is not required to hold CoR from the Bank whether the company is complying with the conditions stipulated as advised by the Bank.

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.

Obligation of auditor to submit an exception report to the Bank

(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 unfavourable or qualified, or in the opinion of the auditor the company has not complied with the provisions of Chapter III B of Reserve Bank of India Act, 1934 (Act 2 of 1934); or the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998; or Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007; or Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007; 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 Bank under whose jurisdiction the registered office of the company is located as per Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

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(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.

Repeal and saving

The Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1998 shall stand repealed by these Directions. Notwithstanding such repeal,

- (a) any action taken, purported to have been taken or initiated under the Directions hereby repealed shall, continue to be governed by the provisions of said Directions
- (b) any reference in other Notifications issued by the Bank containing reference to the said repealed Directions, shall mean reference to these Directions, namely, Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2008 after the date of repeal.

| |
|--|
| 2. Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs |
|--|

RBI/2009-10/304 DNBS (PD).CC.No.167 /03.10.01 /2009-10 dated February 4, 2010

Link: <http://rbi.org.in/scripts/NotificationUser.aspx?Id=5488&Mode=0>

NBFCs are required to adhere to FEMA provisions with regard to FDI investments. NBFCs having FDI whether under automatic route or under approval route have to comply with the stipulated minimum capitalisation norms and other relevant terms and conditions, as amended from time to time under which FDI is permitted.

As such these NBFCs are required to submit a certificate from their Statutory Auditors on half yearly basis (half year ending September and March) certifying compliance with the existing terms and conditions of FDI. Such certificate may be submitted not later than one month from the close of the half year to which the certificate pertains, to the Regional Office in whose jurisdiction the head office of the company is registered.

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3. Submission of certificate from Statutory Auditor to the Bank

RBI/2009-10/187 DNBS (PD) CC. No. 162/03.05.002/2009-2010 dt October 22, 2009

Link : http://www.rbi.org.in/scripts/BS_NBFCNotificationView.aspx?Id=5322

Certificate to the effect that NBFC 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. This circular forms part of prudential norms directions.

4. Returns to be submitted by NBFC

Master Circular : RBI/2011-12/21 DNBS.PD.CC. No.227/ 03.10.042/ 2011-12 dated July 1, 2011

Link : http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6'578

NBFCs are required to submit various returns to RBI w.r.t. their deposit acceptance, prudential norms, compliance

NBFCs are required to submit various returns to RBI with respect to their deposit acceptance, prudential norms compliance, ALM etc. Detailed instructions regarding submission of returns by NBFCs have been issued through various company circulars. A list of such returns to be submitted by NBFCs-D, NBFCs-ND-SI and others is as under:

A. Returns to be submitted by deposit taking NBFCs

1. **NBS-1** Annual Returns on deposits in First Schedule (Inserted vide Notification No.DFC.118/DG (SPT)-98 dated January 31, 1998).
2. **NBS-2** Half-yearly return on Prudential Norms is required to be submitted by NBFC accepting public deposits (Inserted vide Notification No. DNBS.192 /DG (VL)-2007 dated February 22, 2007)
3. **NBS-3** Quarterly return on Liquid Assets by deposit taking NBFC (Inserted vide Notification No DFC(COC) No.108.ED(JRP)/97 dated April 30, 1997).
4. **NBS-4** Monthly return of critical parameters by a rejected company holding public deposits (Inserted vide DNBS (PD) CC. No. 19/02.01/2001-02 dated April 22, 2002)

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5. **NBS-5** Monetary and supervisory return by NBFC having public deposits of Rs.20 crore and above (Inserted vide DNBS (PD) CC. No.19/02.01/2001-02 dated April 22, 2002)
6. **NBS-6** Monthly return on exposure to capital market by deposit taking NBFC with total assets of Rs 100 crore and above (Inserted vide Notification No. DNBS. 192 / DG (VL)-2007 dated February 22, 2007)
7. **Half-yearly ALM return** by NBFC holding public deposits of more than Rs.20 crore or asset size of more than Rs. 100 crore (Inserted vide DNBS (PD).CC.No.15 /02.01 / 2000-2001 dated June 27, 2001).
8. Audited Balance sheet and Auditor's Report by NBFC accepting public deposits (Inserted vide Notification No.DFC.118/DG (SPT)-98 dated January 31, 1998.

B. Returns to be submitted by NBFCs-ND-SI

1. **NBS-7** An annual statement of capital funds, risk weighted assets, risk asset ratio etc., as at end of March every year for NBFC-ND-SI (Inserted vide DNBS.PD/ CC.No. 93 / 03.05.002 /2006-07 dated April 27, 2007)
2. **Monthly Return on Important Financial Parameters of NBFCs-ND-SI** (Inserted vide DNBS (RID) C.C. No. 57/02.05.15/2005-06 dated September 6, 2005) **ALM returns:**
 3. Statement of short term dynamic liquidity in format ALM [NBS-ALM1] -Monthly,
 4. Statement of structural liquidity in format ALM [NBS-ALM2] Half Yearly
 5. Statement of Interest Rate Sensitivity in format ALM -[NBS-ALM3], Half yearly (Inserted vide Notification No. DNBS. 200 / CGM(PK)-2008 dated August 1, 2008) .

C. Quarterly return on important financial parameters of non deposit taking NBFCs having assets of more than Rs, 50 crore and above but less than Rs 100 crore

Basic information like name of the company, address. NOF, profit / loss during the last three years has to be submitted quarterly by non-deposit taking NBFCs with asset size between Rs 50 crore and Rs 100 crore (Inserted vide DNBS.PD/ CC.No.130 / 03.05.002 /2008-09 dated September 24, 2008).

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D. Other Returns

1. As at the end of March every year, all NBFCs are required to submit an annual certificate duly certified by the Statutory Auditors that the company is engaged in the business of NBFI requiring it to hold the CoR. The certificate shall also indicate the asset / income pattern of the NBFC for making it eligible for classification as AFC, Investment Company, or Loan Company (Inserted vide DNBS (PD) C.C. No. 79 /03.05.002/ 2006-07 September 21, 2006 and DNBS (PD) C.C. No. 81 / 03.05.002/ 2006-07 dated October 19, 2006).

2. NBFC with FDI has to submit a half yearly (half year ending March and September) certificate to the effect that it has complied with the minimum capitalisation norms and that its activities are restricted to the activities prescribed under FEMA (Inserted vide DNBS (PD).CC. No 167 /03.10.01 /2009-10 dated February 04, 2010)

| Sr. No | Name of the Return | Short Name | Period-icity | Refere-nce Date | Repor-ting Time | Due on | Purpose | To be submitted by |
|--------|--|------------|--------------|------------------------|-----------------|----------------------|--|--------------------|
| 1 | Annual Returns By deposit taking NBFCs (As required by "Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998".) | NBS1 | Annual | 31st March | 6 months | 30th Sept | Details of Assets And Liabilities | NBFCs-D |
| 2 | Half-Yearly Statement of Capital Funds, Risk Assets etc as required under the Non-Banking Financial | NBS2 | Half Yearly | 31st March / 30th Sept | 3 months | 30th June / 31st Dec | Capital Funds, Risk Assets, Asset Classification etc | NBFCs-D |

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|---|--|------|-----------|--|---------|---|---|---|
| | Companies Prudential Norms (Reserve Bank) Directions 2007 By deposit taking NBFCs | | | | | | | |
| 3 | Quarterly Return on Statutory Liquid Assets as per Section 45 IB of the Act By Deposit Taking NBFCs | NBS3 | Quarterly | 31st March/ 30th June/ 30th Sept/ 31st Dec | 15 days | 15th April/ 15th July/ 15th Oct/ 15th Jan | Statutory Liquid Assets | NBFCs-D |
| 4 | Quarterly Return on Repayment of Deposits by the Rejected Companies holding Public Deposits (The return was subsequently simplified for better response) | NBS4 | -do- | -do- | -do- | -do- | Details of Public Deposits, Other Liabilities | NBFCs holding public deposits whose application for Certificate of Registration under Section 45-IA of RBI Act, 1934 have been rejected |
| 5 | Quarterly submission of Monetary and Supervisory Return | NBS5 | Quarterly | 31st March/ 30th June/ 30th Sept/ 31st Dec | 10 days | 10th April/ 10th July/ 10th Oct/ 10th Jan | Components of Assets, Liabilities, Interest Rates, Cash Inflow/Outf | NBFCs-D holding Public Deposits of Rs.20 crore and |

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|----|--|-------|-------------|----------------------------|----------|------------------------|---|--|
| | | | | | | | low etc. | above as per the last audited balance sheet. |
| 6 | Monthly Return on Capital Market Exposure | NBS6 | Monthly | As at the end of the month | 7days | 7th day of next month | Details of Capital Market Exposure | NBFCs-D |
| 7 | Annual Return of Capital Funds, Risk-Asset Ratio from NBFCs-ND-SI (Supervisory Return) | NBS7 | Annual | 31st March | 3 months | 30th June | Capital Funds, Risk Assets, Risk Weighted off-balance sheet items (Non-Funded Exposures), Asset Classification etc. | NBFCs-ND-SI |
| 8 | Asset-Liability Management (ALM) Return | ALM | Half yearly | 31st March/ 30th Sept | 1 month | 30th April / 30th Oct | Structural Liquidity, Short-term dynamic liquidity, Interest Rate sensitivity etc. | NBFCs-D having public deposit of Rs 20 crore |
| 9 | A Statement of short term dynamic liquidity in format ALM - NBS-ALM1 | ALM-1 | Monthly | As at end of the month | 10 days | 10th day of next month | Short-term dynamic liquidity | NBFC-ND-SI |
| 10 | Statement of structural liquidity in format ALM – NBS-ALM2 | ALM-2 | Half yearly | 31st March/ 30th Sept | 20 days | 20th April / 20th Oct | Structural liquidity | NBFC-ND-SI |
| 11 | Statement of Interest Rate Sensitivity in format ALM- | ALM-3 | Half yearly | 31st March/ 30th Sept | 20 days | 20th April / 20th | Interest Rate sensitivity | NBFC-ND-SI |

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|----|---|-----------------------|-----------|---|--|-------------------|---|------------|
| | NBS-ALM3. | | | | | Oct | | |
| 12 | Monthly Return on Important Financial Parameters of NBFCs not accepting/holding public deposits and having asset size of Rs.100 crore and above | 100 Crore NBFCs-ND-SI | Monthly | end of every month | 7days | 7th of next month | Sources and Application of Funds, Profit and Loss Account, Asset Classification, Bank's/Fls exposure on the company, Details of Capital Market Exposure, Foreign Sources etc. | NBFC-ND-SI |
| 13 | Quarterly return to be submitted by non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore | | Quarterly | 31st March/ 30th June/ 30th Sept/ 31st Dec | within a period of one month from the close of the quarter | | Basic information like name of the company, address. NOF, profit / loss during the last three years | |

Note: NBFCs-D -> Deposit taking Non-Banking Financial Companies (NBFCs); NBFCs-ND -> Non-Deposit taking NBFCs. NBFCs-ND-SI -> Non-Banking Financial Companies (NBFCs) not accepting/holding public deposits and having asset sizes of Rs.100 crore and above (also termed as Systemically Important NBFCs or in short NBFCs-ND-SI)

Returns to be submitted by NBFCs - Revised Formats

RBI/2011-12/195 DNBS (PD).CC. No.243/03.02.02/2011-12 dated September 22, 2011

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=672> RBI has decided to rationalize the above mentioned returns to streamline the reporting system and to improve the present method of collecting data. Periodicity of submitting NBS 1 and NBS 2, which has been on annual and half yearly basis, respectively, has been made quarterly. NBS- 5 stands

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withdrawn as submission of NBS 1 has been made quarterly. Periodicity of submitting NBS 7 has been changed from annual to quarterly. Periodicity of submitting the remaining returns, namely, NBS 3, NBS 6, Monthly Return on Important Financial Parameters of NBFCs-ND-SI and Quarterly Return to be submitted by non-deposit taking NBFCs with asset size between ` 50 crore and ` 100 crore has not been changed. NBS-4 has also not been revised and the same format and periodicity continues. The Bank has since hosted the format of the Revised Returns viz., NBS 1, NBS 2, NBS 3, NBS 6, NBS 7 and the Monthly Return of NBFCs-ND-SI on the Bank's website, viz, <https://cosmos.rbi.org.in>. NBFCs shall submit all the returns specified in Para above, online in the revised formats. The first such return in NBS 1, NBS 2 and NBS 7 may be submitted beginning from the quarter ended June 2011, NBS-3, for the quarter ending September 2011. The monthly returns viz, NBS-6 and monthly return of NBFCs-ND-SI may be submitted beginning from September 2011. NBFCs-D which have not submitted the NBS 1 for March 2011 (annual) may also submit the same in the revised format urgently.

| |
|---|
| 5. Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 |
|---|

Master Circular : RBI 2011-12/19 DNBS (PD) CC No.225/ 03.02.001 / 2011-12 dated July 1, 2011

Link : http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6585

- (i) The provisions of these Directions save as provided for in clauses (ii) (iii) and (iv) hereinafter, shall apply to every non-banking financial company not accepting / holding public deposits “including an infrastructure finance company”,
- (ii) The provisions of paragraphs 16 and 18 of these Directions shall not apply to -
 - (a) a loan company;
 - (b) an investment company;
 - (c) an asset finance companywhich is not a systemically important non-deposit taking non-banking financial company.
- (iii) These Directions shall not apply to a non-banking financial company being an investment company;

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Provided that, it is

- (a) holding investments in the securities of its group/ holding/ subsidiary companies and book value of such holding is not less than ninety per cent of its total assets and it is not trading in such securities;
- (b) not accepting/holding public deposit; and
- (c) is not a systemically important non-deposit taking non-banking financial company.

However, the provisions of paragraphs 16 and 18 shall be applicable to such investment companies which are systemically important non-deposit taking non-banking financial company.

- (iv) These Directions except the provisions of paragraph 19 shall not apply to non-banking financial company being a Government company as defined under Section 617 of the Companies Act, 1956 (1 of 1956) and not accepting / holding public deposit.

Income recognition

3. (1) The income recognition shall be based on recognised accounting principles.

(2) Income including interest/discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

(3) In respect of hire purchase assets, where instalments are overdue for more than 12 months, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised, shall be reversed.

(4) In respect of lease assets, where lease rentals are overdue for more than 12 months, the income shall be recognised only when lease rentals are actually received. The net lease rentals taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.

Explanation

For the purpose of this paragraph, 'net lease rentals' mean gross lease rentals as adjusted by the lease adjustment account debited/credited to the

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profit and loss account and as reduced by depreciation at the rate applicable under Schedule XIV of the Companies Act, 1956 (1 of 1956).

Income from investments

4. (1) Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis:

Provided that the income from dividend on shares of corporate bodies may be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the non-banking financial company's right to receive payment is established.

(2) Income from bonds and debentures of corporate bodies and from Government securities/bonds may be taken into account on accrual basis:

Provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.

(3) Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been guaranteed by Central Government or a State Government may be taken into account on accrual basis.

Accounting standards

5. Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these Directions as "ICAI") shall be followed insofar as they are not inconsistent with any of these Directions.

Accounting of investments

6. (1) (a) The Board of Directors of every non-banking financial company shall frame investment policy for the company and implement the same;
- (b) The criteria to classify the investments into current and long term investments shall be spelt out by the Board of the company in the investment policy;
- (c) Investments in securities shall be classified into current and long term, at the time of making each investment;
- (d) (i) There shall be no inter-class transfer on ad-hoc basis;

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- (ii) The inter-class transfer, if warranted, shall be effected only at the beginning of each half year, on April 1 or October 1, with the approval of the Board;
- (iii) The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
- (iv) The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored;
- (v) The depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.

(2) Quoted current investments shall, for the purposes of valuation, be grouped into the following categories, viz.,

- (a) equity shares,
- (b) preference shares,
- (c) debentures and bonds,
- (d) government securities including treasury bills,
- (e) units of mutual fund, and
- (f) others.

Quoted current investments for each category shall be valued at cost or market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.

(3) Unquoted equity shares in the nature of current investments shall be valued at cost or break up value, whichever is lower. However, non-banking financial companies may substitute fair value for the break up value of the shares, if considered necessary. Where the balance sheet of the investee

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company is not available for two years, such shares shall be valued at one Rupee only.

- (4) Unquoted preference shares in the nature of current investments shall be valued at cost or face value, whichever is lower.
- (5) Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.
- (6) Unquoted investments in the units of mutual funds in the nature of current investments shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
- (7) Commercial papers shall be valued at carrying cost.
- (8) A long term investment shall be valued in accordance with the Accounting Standard issued by ICAI.

Note: Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

Need for Policy on Demand/Call Loans

7.(1) The Board of Directors of every non-banking financial company granting/intending to grant demand/call loans shall frame a policy for the company and implement the same.

- (2) Such policy shall, inter alia, stipulate the following, -
 - (i) A cut off date within which the repayment of demand or call loan shall be demanded or called up;
 - (ii) The sanctioning authority shall, record specific reasons in writing at the time of sanctioning demand or call loan, if the cut off date for demanding or calling up such loan is stipulated beyond a period of one year from the date of sanction;
 - (iii) The rate of interest which shall be payable on such loans;
 - (iv) Interest on such loans, as stipulated shall be payable either at monthly or quarterly rests;
 - (v) The sanctioning authority shall, record specific reasons in writing at the time of sanctioning demand or call loan, if no interest is stipulated or a moratorium is granted for any period ;
 - (vi) A cut off date, for review of performance of the loan, not exceeding six months commencing from the date of sanction;

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- (vii) Such demand or call loans shall not be renewed unless the periodical review has shown satisfactory compliance with the terms of sanction.

Asset Classification

8. (1) Every non-banking financial company 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.

Provisioning requirements

9. Every non-banking financial company 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 :-

Loans, advances and other credit facilities including bills purchased and discounted

(1) 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 should 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 non-banking financial company has a valid recourse shall be made. The realizable

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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 % 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% of total outstanding shall be made

Lease and hire purchase assets

- (2) The provisioning requirements in respect of hire purchase and leased assets shall be as under:

Hire purchase assets

- (i) In respect of hire purchase assets, the total dues (overdue and future instalments taken together) as reduced by
- (a) the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges; and
 - (b) the depreciated value of the underlying asset,
- shall be provided for.

Explanation : For the purpose of this paragraph,

- (1) the depreciated value of the asset shall be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of twenty per cent per annum on a straight line method; and
- (2) in the case of second hand asset, the original cost shall be the actual cost incurred for acquisition of such second hand asset.

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Additional provision for hire purchase and leased assets

- (ii) In respect of hire purchase and leased assets, additional provision shall be made as under:
- (a) Where hire charges or lease rentals are overdue upto 12 months Nil
 - (b) Where hire charges or lease rentals are overdue for more than 12 months but upto 24 months 10 percent of the net book value
 - (c) Where hire charges or lease rentals are overdue for more than 24 months but upto 36 months 40 percent of the net book value
 - (d) Where hire charges or lease rentals are overdue for more than 36 but upto 48 months 70 percent of the net book value
 - (e) Where hire charges or lease rentals are overdue for more than 48 months 100 percent of the net book value
- (iii) On expiry of a period of 12 months after the due date of the last instalment of hire purchase/leased asset, the entire net book value shall be fully provided for.

Notes:

- (1) The amount of caution money/margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security available in pursuance to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.
- (2) The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.

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- (3) It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.
- (4) An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xvi) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.
- (5) The balance sheet to be prepared by the NBFC may be in accordance with the provisions contained in sub-paragraph (2) of paragraph 10.
- (6) All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.

Disclosure in the balance sheet

10. (1) Every non-banking financial company shall separately disclose in its balance sheet the provisions made as per paragraph 9 above without netting them from the income or against the value of assets.

(2) The provisions shall be distinctly indicated under separate heads of account as under:-

- (i) provisions for bad and doubtful debts; and
- (ii) provisions for depreciation in investments.

(3) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the non-banking financial company.

(4) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against them.

["(5) Every systemically important non-deposit taking non-banking financial company shall disclose the following particulars in its Balance Sheet Capital

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to Risk Assets Ratio (CRAR)Exposure to real estate sector, both direct and indirect; and Maturity pattern of assets and liabilities."]

Constitution of Audit Committee by non-banking financial companies

11. A non-banking financial company having assets of Rs. 50 crore and above as per its last audited balance sheet shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Explanation I: The Audit Committee constituted by a non-banking financial company as required under Section 292A of the Companies Act, 1956 (1 of 1956) shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 292A of the Companies Act, 1956 (1 of 1956).

Accounting year

12. Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a non-banking financial company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date.

Schedule to the balance sheet

13. Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 1956, the particulars in the schedule as set out in Annex

Transactions in Government securities

14. Every non-banking financial company may undertake transactions in Government securities through its CSDL account or its demat account: provided that no non-banking financial company shall undertake any transaction in government security in physical form through any broker.

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Submission of a certificate from Statutory Auditor to the Bank

15. 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. 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 31 may be submitted to the Regional Office of the Department of Non-Banking Supervision under whose jurisdiction the non-banking financial company is registered, (Inserted vide *Notification No. DNBS. 209 / CGM(ANR)-2009 dated October 22, 2009*) ["within one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year."] Such certificate shall also indicate the asset / income pattern of the non-banking financial company for making it eligible for classification as Asset Finance Company, Investment Company or Loan Company.

Requirement as to capital adequacy

16. (1) Every systemically important non-deposit taking non-banking financial company shall maintain, with effect from April 1, 2007, a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than ten per cent of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items. Such ratio shall not be less than 12% by March 31, 2010 and 15% by March 31, 2011. (Inserted vide Notification No. DNBS. 206 / CGM(ASR)-2009 dated May 26, 2009)

(2) The total of Tier II capital, at any point of time, shall not exceed one hundred per cent of Tier I capital.

Explanations : On balance sheet assets

(1) In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. 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:

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| 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 |
| | (d) Shares of all companies and debentures/bonds/ commercial papers of all companies and units of all mutual funds | 100 |
| (iii) | Current assets | |
| | (a) Stock on hire (net book value) | 100 |
| | (b) Intercompany loans/deposits | 100 |
| | (c) Loans and advances fully secured against deposits held by the company itself | 0 |
| | (d) Loans to staff | 0 |
| | (e) Other secured loans and advances considered good | 100 |
| | (f) Bills purchased/discounted | 100 |
| | (g) Others (To be specified) | 100 |
| (iv) | Fixed Assets (net of depreciation) | |
| | (a) Assets leased out (net book value) | 100 |
| | (b) Premises | 100 |
| | (c) Furniture & Fixtures | 100 |
| (v) | Other assets | |
| | (a) Income tax deducted at source (net of provision) | 0 |
| | (b) Advance tax paid (net of provision) | 0 |
| | (c) Interest due on Government securities | 0 |
| | (d) Others (to be specified) | 100 |

Notes : (1) Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.

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(2) Assets which have been deducted from owned fund to arrive at net owned fund shall have a weightage of 'zero'.

(3) While calculating the aggregate of funded exposure of a borrower for the purpose of assignment of risk weight, such non-banking financial companies may net off the amount of cash margin/caution money/security deposits (against which right to set-off is available) held as collateral against the advances out of the total outstanding exposure of the borrower.

["(4) The counterparty credit risk, arising out of exposure of NBFCs to CCIL on account of securities financing transactions (CBLOs) will carry a risk weight of zero, as it is presumed that the CCP's exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures. The deposits / collaterals kept by NBFCs with CCIL will attract a risk weight of 20%".](Inserted vide Notification No. DNBS. 212 / CGM(ANR)-2009 dated December 1, 2009)

Off-balance sheet items

(2) In these Directions, degrees of credit risk exposure attached to off-balance sheet items have been expressed as percentage of credit conversion factor. Hence, the face value of each item requires to be first multiplied by the relevant conversion factor to arrive at risk adjusted value of off-balance sheet item. The aggregate shall be taken into account for reckoning the minimum capital ratio. This shall have to be again multiplied by the risk weight of 100. The risk adjusted value of the off-balance sheet items shall be calculated as per the credit conversion factors of non-funded items as detailed hereunder : -

| Nature of item | Credit conversion factor – Percentage |
|---|--|
| (i) Financial & other guarantees | 100 |
| (ii) Share/debenture underwriting obligations | 50 |
| (iii) Partly-paid shares/debentures | 100 |
| (iv) Bills discounted/rediscounted | 100 |
| (v) Lease contracts entered into but yet to be executed | 100 |
| (vi) Other contingent liabilities (To be specified) | 50 |

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

Loans against non-banking financial company's own shares prohibited

17. (1) No non-banking financial company shall lend against its own shares.

(2) Any outstanding loan granted by a non-banking financial company against its own shares on the date of commencement of these Directions shall be recovered by the non-banking financial company as per the repayment schedule.

Concentration of credit/investment

18. (1) On and from April 1, 2007 no systemically important non-deposit taking non-banking financial company shall,

- (i) lend to
 - (a) any single borrower exceeding fifteen per cent of its owned fund; and
 - (b) any single group of borrowers exceeding twenty five per cent of its owned fund;
- (ii) invest in
 - (a) the shares of another company exceeding fifteen per cent of its owned fund; and
 - (b) the shares of a single group of companies exceeding twenty five per cent of its owned fund;
- (iii) lend and invest (loans/investments taken together) exceeding
 - (a) twenty five per cent of its owned fund to a single party; and
 - (b) forty per cent of its owned fund to a single group of parties.

Provided that the ceiling on the investment in shares of another company shall not be applicable to a systemically important non-deposit taking non-banking financial company in respect of investment in the equity capital of an insurance company upto the extent specifically permitted, in writing, by the Reserve Bank of India.

Provided further that any systemically important non-deposit taking non-banking financial company, classified as Asset Finance Company by the Reserve Bank of India, may in exceptional circumstances, exceed the above ceilings on credit / investment concentration to a single party or a single group of parties by 5 per cent of its owned fund, with the approval of its Board.

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Provided further that any systemically important non-deposit taking non-banking financial company not accessing public funds, either directly or indirectly, may make an application to the Bank for modifications in the prescribed ceilings.

Explanation: "Public funds" for the purpose of the proviso shall include funds raised either directly or indirectly through public deposits, Commercial Papers, debentures, inter-corporate deposits and bank finance.

(2) Every systemically important non-deposit taking non-banking financial company shall formulate a policy in respect of exposures to a single party / a single group of parties.

Notes :

(1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as explained in paragraph 16.

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

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

Information in regard to change of address, directors, auditors, etc. to be submitted

19. Every non-banking financial company not accepting/holding public deposit shall communicate, not later than one month from the occurrence of any change in:

- (a) the complete postal address, telephone number/s and fax number/s of the registered/corporate office;
- (b) the names and residential addresses of the directors of the company;
- (c) the names and the official designations of its principal officers;
- (d) the names and office address of the auditors of the company; and
- (e) the specimen signatures of the officers authorised to sign on behalf of the company

to the Regional Office of the Department of Non-Banking Supervision of the Reserve Bank of India as indicated in the Second Schedule to the Non-

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Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

Requirements for Infrastructure Finance Company

19A. An Infrastructure Finance Company shall, -

- i. not accept deposits from the public;
- ii. have net owned funds of Rs. 300 crore or above;
- iii. have a minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accredited rating agencies; and
- iv. have a CRAR of 15 percent (with a minimum Tier I capital of 10 percent)].(Inserted vide Notification No. DNBS. 213 / CGM(ASR)-2010 dated February 12, 2010

Norms relating to Infrastructure loan

20. (1) Applicability

- (i) These norms shall be applicable to restructuring and/or rescheduling and/or renegotiation of the terms of agreement relating to infrastructure loan, as defined in paragraph 2(1)(viii) of these Directions which is fully or partly secured standard and sub-standard asset and to the loan, which is subjected to restructuring and/or rescheduling and/or renegotiation of terms.
- (ii) Where the asset is partly secured, a provision to the extent of shortfall in the security available shall be made while restructuring and/or rescheduling and/or renegotiation of the loans, apart from the provision required on present value basis and as per prudential norms.

(2) Restructuring, reschedulement or renegotiation of terms of infrastructure loan

The non-banking financial companies may, not more than once, restructure or reschedule or renegotiate the terms of infrastructure loan agreement as per the policy framework laid down by the Board of Directors of the company under the following stages:

- (a) before commencement of commercial production;
- (b) after commencement of commercial production but before the asset has been classified as sub-standard;

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- (c) after commencement of commercial production and the asset has been classified as sub-standard:

Provided that in each of the above three stages, the restructuring and/or rescheduling and/or renegotiation of principal and / or of interest may take place, with or without sacrifice, as part of the restructuring or rescheduling or renegotiating package evolved.

(3) Treatment of restructured standard loan

The rescheduling or restructuring or renegotiation of the instalments of principal alone, at any of the aforesaid first two stages shall not cause a standard asset to be re-classified in the sub-standard category, if the project is re-examined and found to be viable by the Board of Directors of the company or by a functionary at least one step senior to the functionary who sanctioned the initial loan for the project, within the policy framework laid down by the Board:

Provided that rescheduling or renegotiation or restructuring of interest element at any of the foregoing first two stages shall not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100 per cent provision is made there against.

(4) Treatment of restructured sub-standard asset

A sub-standard asset shall continue to remain in the same category in case of restructuring or rescheduling or renegotiation of the instalments of principal until the expiry of one year and the amount of interest foregone, if any, on account of adjustment, including adjustment by way of write off of the past interest dues, in the element of interest as specified later, shall be written off or 100 per cent provision made there against.

(5) Adjustment of interest

Where rescheduling or renegotiation or restructuring involves a reduction in the rate of interest, the interest adjustment shall be computed by taking the difference between the rate of interest as currently applicable to infrastructure loan (as adjusted for the risk rating applicable to the borrower) and the reduced rate and aggregating the present value (discounted at the rate currently applicable to infrastructure loan, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring or rescheduling or renegotiation proposal.

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(6) *Funded Interest*

In the case of funding of interest in respect of NPAs, where the interest funded is recognized as income, the interest funded shall be fully provided for.

(7) *Income Recognition norms*

The income recognition in respect of infrastructure loan shall be governed by the provisions of paragraph 3 of these Directions;

(8) *Treatment of Provisions held*

The provisions held by the non-banking financial companies against non-performing infrastructure loan, which may be classified as 'standard' in terms of sub-paragraph (3) hereinabove, shall continue to be held until full recovery of the loan is made.

(9) *Eligibility for upgradation of restructured sub-standard infrastructure loan*

The sub-standard asset subjected to rescheduling and/or renegotiation and/or restructuring, whether in respect of instalments of principal amount, or interest amount, by whatever modality, shall not be upgraded to the standard category until expiry of one year of satisfactory performance under the restructuring and/or rescheduling and/or renegotiation terms.

(10) *Conversion of debt into equity*

Where the amount due as interest, is converted into equity or any other instrument, and income is recognized in consequence, full provision shall be made for the amount of income so recognized to offset the effect of such income recognition:

Provided that no provision is required to be made, if the conversion of interest is into equity which is quoted;

Provided further that in such cases, interest income may be recognized at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

(11) *Conversion of debt into debentures*

Where principal amount and/or interest amount in respect of NPAs is converted into debentures, such debentures shall be treated as NPA, ab initio, in the same asset classification as was applicable to the loan just before conversion and provision shall be made as per norms.

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(12) Increase in exposure limits for Infrastructure related loan and investment

The systemically important non-deposit taking non-banking financial companies may exceed the concentration of credit/investment norms, as provided in paragraph 18 of these Directions, by 5 per cent for any single party and by 10 per cent for a single group of parties, if the additional exposure is on account of infrastructure loan and/ or investment.

["(12A) Infrastructure Finance Companies may exceed the concentration of credit norms as provided in paragraph 18 of the aforesaid Directions,

- (i) in lending to
 - (a) any single borrower, by ten per cent of its owned fund; and
 - (b) any single group of borrowers, by fifteen per cent of its owned fund;
- (ii) in lending to and investing in, (loans/investments taken together)
 - (a) a single party, by five percent of its owned fund; and
 - (b) a single group of parties, by ten percent of its owned fund."]
(Inserted vide Notification No. DNBS. 213 / CGM(ASR)-2010 dated February 12, 2010

(13) Risk weight for investment in AAA rated securitized paper

The investment in "AAA" rated securitized paper pertaining to the infrastructure facility shall attract risk weight of 50 per cent for capital adequacy purposes subject to the fulfilment of the following conditions:

- (i) The infrastructure facility generates income / cash flows, which ensure servicing / repayment of the securitized paper.
- (ii) The rating by one of the approved credit rating agencies is current and valid.

Explanation:

The rating relied upon shall be deemed to be current and valid, if the rating is not more than one month old on the date of opening of the issue, and the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and the rating letter and the rating rationale form part of the offer document.

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- (iii) In the case of secondary market acquisition, the 'AAA' rating of the issue is in force and confirmed from the monthly bulletin published by the respective rating agency.
- (iv) The securitized paper is a performing asset.

20A NBFCs not to be partners in partnership firms

(inserted vide notification no. DNBS. 228 / CGM(US)-2011 dated March 30, 2011)

- (1) No non-banking financial company shall contribute to the capital of a partnership firm or become a partner of such firm.
- (2) A non-banking financial company, which had already contributed to the capital of a partnership firm or was a partner of a partnership firm shall seek early retirement from the partnership firm.

Exemptions

21. The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any non-banking financial company or class of non-banking financial companies, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

Interpretations

22. For the purpose of giving effect to the provisions of these Directions, the Reserve Bank of India may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these Directions given by the Reserve Bank of India shall be final and binding on all the parties concerned.

Repeal and Saving

23. (1) The Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 shall stand repealed by these Directions.
- (2) Notwithstanding such repeal, any circular, instruction, order issued under the Directions in sub-section (1) shall continue to apply to non-banking financial companies in the same manner as they applied to such companies before such repeal.

Annexure 1

Schedule to the Balance Sheet of a Non-deposit Taking Non-banking Financial Company

(as required in terms of paragraph 13 of Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007)

(Rs. in lakhs)

| Particulars | | Amount out- standing | Amount overdue |
|---------------------------|--|---------------------------------|---------------------------|
| Liabilities side : | | | |
| (1) | Loans and advances availed by the non-banking financial company inclusive of interest accrued thereon but not paid: (a) Debentures : Secured Unsecured (other than falling within the meaning of public deposits*) (b) Deferred Credits (c) Term Loans (d) Inter-corporate loans and borrowing (e) Commercial Paper (f) Other Loans (specify nature) * Please see Note 1 below | | |
| Assets side | | | |
| 2 | Break-up of Loans and Advances including bills receivables [other than those included in (4) below] : (a) Secured (b) Unsecured | Amount outstanding | |
| 3 | Break up of Leased Assets and stock on hire and other assets counting towards AFC activities | | |
| | (i) Lease assets including lease rentals under sundry debtors : (a) Financial lease (b) Operating lease | | |

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| | | | |
|---|--|--|--|
| | (ii) Stock on hire including hire charges under sundry debtors: (a) Assets on hire (b) Repossessed Assets | | |
| | iii) Other loans counting towards AFC activities (a) Loans where assets have been repossessed (b) Loans other than (a) above | | |
| 4 | Break-up of Investments : Current Investments : 1 Quoted : (i) Shares : (a) Equity (b) Preference (ii) Debentures and Bonds (iii) Units of mutual funds (iv) Government Securities (v) Others (please specify) 2 Unquoted : (i) Shares : (a) Equity (b) Preference (ii) Debentures and Bonds (iii) Units of mutual funds (iv) Government Securities (v) Others (please specify) Long Term investments : 1. Quoted : (i) Shares : (a) Equity (b) Preference (ii) Debentures and Bonds (iii) Units of mutual funds (iv) Government Securities (v) Others (please specify) 2. Unquoted : (i) Shares : (a) Equity (b) Preference (ii) Debentures and Bonds (iii) Units of mutual funds | | |

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| | | | | |
|---|--|--|--------------------------------|-------|
| | (iv) Government Securities (v) Others (please specify) | | | |
| 5 | Borrower group-wise classification of assets financed as in (2) and (3) above : Please see Note 2 below | | | |
| | Category | Amount net of provisions | | |
| | | Secured | Unsecured | Total |
| | 1. Related Parties ** (a) Subsidiaries (b) Companies in the same group (c) Other related parties | | | |
| | 2. Other than related parties | | | |
| | Total | | | |
| 6 | Investor group-wise classification of all investments (current and long term) in shares and securities (both quoted and unquoted): Please see note 3 below | | | |
| | Category | Market Value / Break up or fair value or NAV | Book Value (Net of Provisions) | |
| | 1. Related Parties ** (a) Subsidiaries (b) Companies in the same group (c) Other related parties | | | |
| | 2. Other than related parties | | | |
| | Total | | | |
| | ** As per Accounting Standard of ICAI (Please see Note 3) | | | |
| 7 | Other information | | | |
| | (i) Gross Non-Performing Assets (a) Related parties (b) Other than related parties (ii) Net Non-Performing Assets (a) Related parties (b) Other than related parties (iii) Assets acquired in satisfaction of debt | | | |

Notes :

1. As defined in paragraph 2(1)(xii) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
2. Provisioning norms shall be applicable as prescribed in Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007
3. All Accounting Standards and Guidance Notes issued by ICAI are applicable including for valuation of investments and other assets as also assets acquired in satisfaction of debt. However, market value in respect of quoted investments and break up/fair value/NAV in respect of unquoted investments should be disclosed irrespective of whether they are classified as long term or current in (4) above.

| |
|--|
| <p>6. Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007</p> |
|--|

Master Circular: RBI/2011-12/18 DNBS (PD) CC No.224/ 03.02.001/ 2011-12 dated July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6576

Notification No. DNBS.192/ DG (VL)-2007 dated February 22, 2007

The Reserve Bank of India, having considered it necessary in the public interest, and being satisfied that, for the purpose of enabling the Bank to regulate the credit system to the advantage of the country, it is necessary to issue the Directions relating to the prudential norms as set out below, in exercise of the powers conferred by Section 45JA of the Reserve Bank of India Act, 1934 (2 of 1934) and of all the powers enabling it in this behalf, and in supersession of the Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 contained in Notification No. DFC. 119/DG(SPT)/98 dated January 31, 1998, gives to every non-banking financial company (other than Residuary Non-Banking Company) accepting/ holding public deposits and to every Residuary Non-Banking Company the Directions hereinafter specified.

Short title, commencement and applicability of the Directions:

- 1.(1) These Directions shall be known as the "Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007".

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- (2) These Directions shall come into force with immediate effect.
- (3) (i) The provisions of these Directions, shall apply to:
- a. a non-banking financial company, except a mutual benefit financial company [and a mutual benefit company] as defined in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and accepting/holding public deposit;
 - b. a residuary non-banking company as defined in the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.
- (ii) These Directions shall not apply to a non-banking financial company being a Government company as defined under Section 617 of the Companies Act, 1956 (1 of 1956) and accepting / holding public deposit.

Definitions

2. (1) For the purpose of these Directions, unless the context otherwise requires:

- (i) “break up value” means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company;
- (ii) “carrying cost” means book value of the assets and interest accrued thereon but not received;
- (iii) “current investment” means an investment which is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made;
- (iv) “doubtful asset” means:
 - 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;
- (v) “earning value” means the value of an equity share computed by taking the average of profits after tax as reduced by the

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preference dividend and adjusted for extra-ordinary and non-recurring items, for the immediately preceding three years and further divided by the number of equity shares of the investee company and capitalised at the following rate:

- a) in case of predominantly manufacturing company, eight per cent;
- (b) in case of predominantly trading company, ten per cent; and
- (c) in case of any other company, including non-banking financial company, twelve per cent;

NOTE : If, an investee company is a loss making company, the earning value will be taken at zero;

- (vi) “fair value” means the mean of the earning value and the break up value;
- (vii) “hybrid debt” means capital instrument which possesses certain characteristics of equity as well as of debt;
- (viii) ‘infrastructure loan’ means a credit facility extended by non-banking financial companies to a borrower, by way of term loan, project loan subscription to bonds/debentures/preference shares / equity shares in a project company acquired as a part of the project finance package such that such subscription amount to be “in the nature of advance” or any other form of long term funded facility provided to a borrower company engaged in:

- Developing or
- Operating and maintaining, or
- Developing, operating and maintaining

any infrastructure facility that is a project in any of the following sectors:

- (a) a road, including toll road, a bridge or a rail system;
- (b) a highway project including other activities being an integral part of the highway project;
- (c) a port, airport, inland waterway or inland port;

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- (d) a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;
 - (e) telecommunication services whether basic or cellular, including radio paging, domestic satellite service (i.e., a satellite owned and operated by an Indian company for providing telecommunication service), "Telecom Towers" network of trunking, broadband network and internet services;
 - (f) an industrial park or special economic zone;
 - (g) generation or generation and distribution of power;
 - (h) transmission or distribution of power by laying a network of new transmission or distribution lines;
 - (i) construction relating to projects involving agro-processing and supply of inputs to agriculture;
 - (j) construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality; and
 - (k) [deleted]
 - (l) any other infrastructure facility of similar nature.
- (ix) "loss asset" means:
- (a) an asset which has been identified as loss asset by the non-banking financial company or its internal or external auditor or by the Reserve Bank of India during the inspection of the non-banking financial company, to the extent it is not written off by the non-banking financial company; 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;
- (x) "long term investment" means an investment other than a current investment;

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- (xi) “net asset value” means the latest declared net asset value by the mutual fund concerned in respect of that particular scheme;
- (xii) “net book value” means:
 - (a) in the case of hire purchase asset, the aggregate of overdue and future instalments receivable as reduced by the balance of unmatured finance charges and further reduced by the provisions made as per paragraph 9(2)(i) of these Directions;
 - (b) in the case of leased asset, aggregate of capital portion of overdue lease rentals accounted as receivable and depreciated book value of the lease asset as adjusted by the balance of lease adjustment account.
- (xiii) ‘non-performing asset’ (referred to in these Directions as “NPA”) means:
 - a. an asset, in respect of which, interest has remained overdue for a period of six months or more;
 - b. a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;
 - c. a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;
 - d. a bill which remains overdue for a period of six months or more;
 - 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 six months or more;
 - f. any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;

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- g. the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;
- 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, a non-banking financial company may classify each such account on the basis of its record of recovery;

- (xiv) "owned fund" means paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any;
- (xv) "standard asset" means 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 nor carry more than normal risk attached to the business;
- (xvi) "sub-standard asset" means:
 - a. an asset which has been classified as non-performing asset for a period not exceeding 18 months;
 - 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 23 of these Directions;

- (xvii) "subordinated debt" means an instrument, which is fully paid up, is unsecured and is subordinated to the claims of other

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creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of non-banking financial company. The book value of such instrument shall be subjected to discounting as provided hereunder:

| Remaining Maturity of the instruments | Rate of discount |
|---|-------------------------|
| (a) Upto one year | 100% |
| (b) More than one year but upto two years | 80% |
| (c) More than two years but upto three years | 60% |
| (d) More than three years but upto four years | 40% |
| (e) More than four years but upto five years | 20% |

to the extent such discounted value does not exceed fifty per cent of Tier I capital;

- (xviii) “substantial interest” means holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together in the shares of a company, the amount paid up on which exceeds ten per cent of the paid up capital of the company; or the capital subscribed by all the partners of a partnership firm;
- (xix) “Tier I Capital” means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund;
- (xx) “Tier II capital” includes the following:
 - (a) preference shares other than those which are compulsorily convertible into equity;
 - (b) revaluation reserves at discounted rate of fifty five percent;
 - (c) "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

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in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets;"

- (d) of one and one fourth percent of risk weighted assets;
- (e) hybrid debt capital instruments; and
- (f) subordinated debt

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

(2) Other words or expressions used but not defined herein and defined in the Reserve Bank of India Act, 1934 (2 of 1934) or the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 or the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987 shall have the same meaning as assigned to them under that Act or those Directions. Any other words or expressions not defined in that Act or those Directions shall have the same meaning assigned to them in the Companies Act, 1956 (1 of 1956).

Income recognition

3. (1) The income recognition shall be based on recognised accounting principles.

(2) Income including interest/discount or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

(3) In respect of hire purchase assets, where instalments are overdue for more than 12 months, income shall be recognised only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised, shall be reversed.

(4) In respect of lease assets, where lease rentals are overdue for more than 12 months, the income shall be recognised only when lease rentals are actually received. The net lease rentals taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.

Explanation

For the purpose of this paragraph, 'net lease rentals' mean gross lease rentals as adjusted by the lease adjustment account debited/credited to the

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profit and loss account and as reduced by depreciation at the rate applicable under Schedule XIV of the Companies Act, 1956 (1 of 1956).

Income from investments

4. (1) Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis:

Provided that the income from dividend on shares of corporate bodies may be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the non-banking financial company's right to receive payment is established.

(2) Income from bonds and debentures of corporate bodies and from Government securities/bonds may be taken into account on accrual basis:

Provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.

(3) Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been guaranteed by Central Government or a State Government may be taken into account on accrual basis.

Accounting standards

5. Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these Directions as "ICAI") shall be followed insofar as they are not inconsistent with any of these Directions.

Accounting of investments

6. (1) (a) The Board of Directors of every non-banking financial company shall frame investment policy for the company and implement the same;
- (b) The criteria to classify the investments into current and long term investments shall be spelt out by the Board of the company in the investment policy;
- (c) Investments in securities shall be classified into current and long term, at the time of making each investment;
- (d) (i) There shall be no inter-class transfer on ad-hoc basis;

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- (ii) The inter-class transfer, if warranted, shall be effected only at the beginning of each half year, on April 1 or October 1, with the approval of the Board;
 - (iii) The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
 - (iv) The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored;
 - (v) The depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.
- (2) Quoted current investments shall, for the purposes of valuation, be grouped into the following categories, viz.,
- (a) equity shares,
 - (b) preference shares,
 - (c) debentures and bonds,
 - (d) government securities including treasury bills,
 - (e) units of mutual fund, and
 - (f) others.

Quoted current investments for each category shall be valued at cost or market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.

- (3) Unquoted equity shares in the nature of current investments shall be valued at cost or break up value, whichever is lower. However, non-banking financial companies may substitute fair value for the break up value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one Rupee only.

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- (4) Unquoted preference shares in the nature of current investments shall be valued at cost or face value, whichever is lower.
- (5) Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.
- (6) Unquoted investments in the units of mutual funds in the nature of current investments shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
- (7) Commercial papers shall be valued at carrying cost.
- (8) A long term investment shall be valued in accordance with the Accounting Standard issued by ICAI.

Note: Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

Need for Policy on Demand/Call Loans

7.(1) The Board of Directors of every non-banking financial company granting/intending to grant demand/call loans shall frame a policy for the company and implement the same.

- (2) Such policy shall, inter alia, stipulate the following, -
 - i. A cut off date within which the repayment of demand or call loan shall be demanded or called up;
 - ii. The sanctioning authority shall, record specific reasons in writing at the time of sanctioning demand or call loan, if the cut off date for demanding or calling up such loan is stipulated beyond a period of one year from the date of sanction;
 - iii. The rate of interest which shall be payable on such loans;
 - iv. Interest on such loans, as stipulated shall be payable either at monthly or quarterly rests;
 - v. The sanctioning authority shall, record specific reasons in writing at the time of sanctioning demand or call loan, if no interest is stipulated or a moratorium is granted for any period;

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- vi. A cut off date, for review of performance of the loan, not exceeding six months commencing from the date of sanction;
- vii. Such demand or call loans shall not be renewed unless the periodical review has shown satisfactory compliance with the terms of sanction.

Asset Classification

8. (1) Every non-banking financial company 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.

Provisioning requirements

9. Every non-banking financial company 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:

Loans, advances and other credit facilities including bills purchased and discounted

(1) 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 should be provided for;

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- (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 non-banking financial company 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 | % of provision |
|---|-----------------------|
| Upto one year | 20 |
| One to three years | 30 |
| More than three years | 50 |
- (iii) Sub-standard assets A general provision of 10% of total outstanding shall be made.

Lease and hire purchase assets

- (2) The provisioning requirements in respect of hire purchase and leased assets shall be as under:

Hire purchase assets

- (i) In respect of hire purchase assets, the total dues (overdue and future instalments taken together) as reduced by
- the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges; and
 - the depreciated value of the underlying asset,
- shall be provided for.

Explanation :

For the purpose of this paragraph,

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1. the depreciated value of the asset shall be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of twenty per cent per annum on a straight line method; and
2. in the case of second hand asset, the original cost shall be the actual cost incurred for acquisition of such second hand asset.

Additional provision for hire purchase and leased assets

(ii) In respect of hire purchase and leased assets, additional provision shall be made as under :

- | | | |
|-----|--|-----------------------------------|
| (a) | Where hire charges or lease rentals are overdue upto 12 months | Nil |
| (b) | where hire charges or lease rentals are overdue for more than 12 months but upto 24 months | 10 percent of the net book value |
| (c) | where hire charges or lease rentals are overdue for more than 24 months but upto 36 months | 40 percent of the net book value |
| (d) | where hire charges or lease rentals are overdue for more than 36 months but upto 48 months | 70 percent of the net book value |
| (e) | where hire charges or lease rentals are overdue for more than 48 months | 100 percent of the net book value |
- (iii) On expiry of a period of 12 months after the due date of the last instalment of hire purchase/leased asset, the entire net book value shall be fully provided for.

Notes:

1. The amount of caution money/margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security available in pursuance to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.
2. The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.

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3. It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.
4. An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xvi) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.
5. The balance sheet to be prepared by the non-banking financial company may be in accordance with the provisions contained in sub-paragraph (2) of paragraph 10.
6. All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.

“9A. Every Non Banking Financial Company 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.”

Disclosure in the balance sheet

10. (1) Every non-banking financial company shall separately disclose in its balance sheet the provisions made as per paragraph 9 above without netting them from the income or against the value of assets.

(2) The provisions shall be distinctly indicated under separate heads of account as under:

- (i) provisions for bad and doubtful debts; and
- (ii) provisions for depreciation in investments.

(3) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the non-banking financial company.

(4) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general

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provisions and loss reserves may be written back without making adjustment against them.

Constitution of Audit Committee by non-banking financial companies

11. A non-banking financial company having assets of Rs. 50 crore and above as per its last audited balance sheet shall constitute an Audit Committee, consisting of not less than three members of its Board of Directors.

Explanation I: The Audit Committee constituted by a non-banking financial company as required under Section 292A of the Companies Act, 1956 (1 of 1956) shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 292A of the Companies Act, 1956 (1 of 1956).

Accounting year

12. Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a non-banking financial company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date.

"Every non-banking financial company shall finalise its balance sheet within a period of 3 months from the date to which it pertains".

Schedule to the balance sheet

13. Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 1956, the particulars in the schedule as set out in Annex 1.

Transactions in Government securities

14. Every non-banking financial company may undertake transactions in Government securities through its CSGL account or its demat account: provided that no non-banking financial company shall undertake any transaction in government security in physical form through any broker.

Submission of a certificate from Statutory Auditor to the Bank

15. 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. 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 31 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 one month from the date of finalization of the balance sheet and in any case not later than December 30th of that year".] Such certificate shall also indicate the asset / income pattern of the non-banking financial company for making it eligible for classification as Asset Finance Company, Investment Company or Loan Company.

Requirement as to capital adequacy

16. (1) Every non-banking financial company shall maintain a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than twelve per cent of its aggregate risk weighted assets on balance sheet and of risk adjusted value of off-balance sheet items.

"[Such ratio shall not be less than fifteen percent by March 31, 2012.]"^z

(2) The total of Tier II capital, at any point of time, shall not exceed one hundred per cent of Tier I capital.

Explanations:

On balance sheet assets

(1) In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. 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:

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| 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 |
| | (d) Shares of all companies and debentures/bonds/ commercial papers of all companies and units of all mutual funds | 100 |
| (iii) | Current assets | |
| | (a) Stock on hire (net book value) | 100 |
| | (b) Inter-corporate loans/deposits | 100 |
| | (c) Loans and advances fully secured against deposits held by the company itself | 0 |
| | (d) Loans to staff | 0 |
| | (e) Other secured loans and advances considered good | 100 |
| | (f) Bills purchased/discounted | 100 |
| | (g) Others (To be specified) | 100 |
| (iv) | Fixed Assets (net of depreciation) | |
| | (a) Assets leased out (net book value) | 100 |
| | (b) Premises | 100 |
| | (c) Furniture & Fixtures | 100 |
| (v) | Other assets | |
| | (a) Income tax deducted at source (net of provision) | 0 |
| | (b) Advance tax paid (net of provision) | 0 |
| | (c) Interest due on Government securities | 0 |
| | (d) Others (to be specified) | 100 |

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Notes:

- (1) Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.
- (2) Assets which have been deducted from owned fund to arrive at net owned fund shall have a weightage of 'zero'.
- (3) While calculating the aggregate of funded exposure of a borrower for the purpose of assignment of risk weight, non-banking financial companies may net off the amount of cash margin / caution money/security deposits (against which right to set-off is available) held as collateral against the advances out of the total outstanding exposure of the borrower.
- [(4) The counterparty credit risk, arising out of exposure of NBFCs to CCIL on account of securities financing transactions (CBLOs) will carry a risk weight of zero, as it is presumed that the CCP's exposures to their counterparties are fully collateralised on a daily basis, thereby providing protection for the CCP's credit risk exposures. The deposits / collaterals kept by NBFCs with CCIL will attract a risk weight of 20%"].

Off-balance sheet items

- (2) In these Directions, degrees of credit risk exposure attached to off-balance sheet items have been expressed as percentage of credit conversion factor. Hence, the face value of each item requires to be first multiplied by the relevant conversion factor to arrive at risk adjusted value of off-balance sheet item. The aggregate shall be taken into account for reckoning the minimum capital ratio. This shall have to be again multiplied by the risk weight of 100. The risk adjusted value of the off-balance sheet items shall be calculated as per the credit conversion factors of non-funded items as detailed hereunder : -

| Nature of item | Credit conversion factor – Percentage |
|--|---------------------------------------|
| i) Financial & other guarantees | 100 |
| ii) Share/debenture underwriting obligations | 50 |
| iii) Partly-paid shares/debentures | 100 |
| iv) Bills discounted/rediscouted | 100 |
| v) Lease contracts entered into but yet to be executed | 100 |
| vi) Other contingent liabilities (To be specified) | 50 |

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

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Loans against non-banking financial company's own shares prohibited

17. (1) No non-banking financial company shall lend against its own shares.

(2) Any outstanding loan granted by a non-banking financial company against its own shares on the date of commencement of these Directions shall be recovered by the non-banking financial company as per the repayment schedule.

Non-banking financial company failing to repay public deposit prohibited from making loans and investments

18. A non-banking financial company which has failed to repay any public deposit or part thereof in accordance with the terms and conditions of such deposit, as provided in Section 45QA(1) of the Reserve Bank of India Act, 1934 (2 of 1934) shall not grant any loan or other credit facility by whatever name called or make any investment or create any other asset as long as the default exists.

Restrictions on investments in land and building and Unquoted shares

19. (i) No Asset Finance Company, which is accepting public deposit, shall, invest in -

- (a) land or building, except for its own use, an amount exceeding ten percent of its owned fund;
- (b) unquoted shares of another company, which is not a subsidiary company or a company in the same group of the non-banking financial company, an amount exceeding ten percent of its owned fund.

(ii) No loan company or investment company, which is accepting public deposit, shall, invest in -

- (a) land or building, except for its own use, an amount exceeding ten percent of its owned fund ;
- (b) unquoted shares of another company, which is not a subsidiary company or a company in the same group of the non-banking financial company, an amount exceeding twenty percent of its owned fund:

Provided that the land or building or unquoted shares acquired in satisfaction of its debts shall be disposed off by the non-banking financial company within

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a period of three years or within such period as extended by the Bank, from the date of such acquisition if the investment in these assets together with such assets already held by the non-banking financial company exceeds the above ceiling;

Explanation

While calculating the ceiling on investment in unquoted shares, investments in such shares of all companies shall be aggregated.

Provided further that the ceiling on the investment in unquoted shares shall not be applicable to an Asset Finance Company or a loan company or an investment company in respect of investment in the equity capital of an insurance company upto the extent specifically permitted, in writing, by the Reserve Bank of India.

"NBFCs not to be partners in partnership firms"

19A. (1) No non-banking financial company, which is accepting public deposit shall contribute to the capital of a partnership firm or become a partner of such firm.

(2) A non-banking financial company, which is accepting public deposit and which had already contributed to the capital of a partnership firm or was a partner of a partnership shall seek early retirement from the partnership firm.

Concentration of credit/investment

20. (1) No non-banking financial company shall,

- (i) lend to
 - (a) any single borrower exceeding fifteen per cent of its owned fund; and
 - (b) any single group of borrowers exceeding twenty five per cent of its owned fund;
- (ii) invest in
 - (a) the shares of another company exceeding fifteen per cent of its owned fund; and
 - (b) the shares of a single group of companies exceeding twenty five per cent of its owned fund;
- (iii) lend and invest (loans/investments taken together) exceeding
 - (a) twenty five per cent of its owned fund to a single party; and

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

Provided that the ceiling on credit/investment concentration shall not be applicable to a residuary non-banking company in respect of investments in approved securities, bonds, debentures and other securities issued by a Government company or a public financial institution or a scheduled commercial bank under the provisions of paragraphs 6(1)(a) and 6(1)(b) of the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

Provided further that the ceiling on the investment in shares of another company shall not be applicable to a non-banking financial company in respect of investment in the equity capital of an insurance company upto the extent specifically permitted, in writing, by the Reserve Bank of India.

Provided further that any non-banking financial company, classified as Asset Finance Company by the Reserve Bank of India, may in exceptional circumstances, exceed the above ceilings on credit/investment concentration to a single party or a single group of parties by 5 per cent of its owned fund, with the approval of its Board.

Notes :

- (1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as explained in paragraph 16.
- (2) The investments in debentures for the purposes specified in this paragraph shall be treated as credit and not investment.
- (3) These ceilings shall be applicable to the credit/investment by such a non-banking financial company to companies/firms in its own group as well as to the borrowers/ investee company's group.

Submission of half yearly return

21. Non-banking financial companies including residuary non-banking companies referred to in paragraphs 1(3)(i)(a) and (b) shall submit a half-yearly return within three months of the expiry of the relative half-year as on September and March every year, in the format NBS 2 provided in Annex 2 to the Regional Office of the Department of Non-Banking Supervision of the Reserve Bank of India under whose jurisdiction the registered office of the company is located as per Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Schedule B to Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

Exposure to Capital Market

22. Every non-banking financial company (including residuary non-banking company) with total assets of Rs. 100 crore and above according to the previous audited balance sheet, shall submit a monthly return within a period of 7 days of the expiry of the month to which it pertains in the format NBS 6 provided in Annex 3 to the Regional Office of the Department of Non-Banking Supervision of the Reserve Bank of India as indicated in the Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Schedule B to the Residuary Non-Banking Companies (Reserve Bank) Directions, 1987.

Norms relating to Infrastructure loan

23. (1) Applicability

- (i) These norms shall be applicable to restructuring and/or rescheduling and/or renegotiation of the terms of agreement relating to infrastructure loan, as defined in paragraph 2(1)(viii) of these Directions which is fully or partly secured standard and sub-standard asset and to the loan, which is subjected to restructuring and/or rescheduling and/or renegotiation of terms.
 - (ii) Where the asset is partly secured, a provision to the extent of shortfall in the security available shall be made while restructuring and/or rescheduling and/or renegotiation of the loans, apart from the provision required on present value basis and as per prudential norms.
- (2) Restructuring, reschedulement or renegotiation of terms of infrastructure loan.

The non-banking financial companies may, not more than once, restructure or reschedule or renegotiate the terms of infrastructure loan agreement as per the policy framework laid down by the Board of Directors of the company under the following stages:

- (a) before commencement of commercial production;
- (b) after commencement of commercial production but before the asset has been classified as sub-standard;
- (c) after commencement of commercial production and the asset has been classified as sub-standard:

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Provided that in each of the above three stages, the restructuring and/or rescheduling and/or renegotiation of principal and / or of interest may take place, with or without sacrifice, as part of the restructuring or rescheduling or renegotiating package evolved.

(3) Treatment of restructured standard loan

The rescheduling or restructuring or renegotiation of the instalments of principal alone, at any of the aforesaid first two stages shall not cause a standard asset to be re-classified in the sub-standard category, if the project is re-examined and found to be viable by the Board of Directors of the company or by a functionary at least one step senior to the functionary who sanctioned the initial loan for the project, within the policy framework laid down by the Board:

Provided that rescheduling or renegotiation or restructuring of interest element at any of the foregoing first two stages shall not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100 per cent provision is made thereagainst.

(4) Treatment of restructured sub-standard asset

A sub-standard asset shall continue to remain in the same category in case of restructuring or rescheduling or renegotiation of the instalments of principal until the expiry of one year and the amount of interest foregone, if any, on account of adjustment, including adjustment by way of write off of the past interest dues, in the element of interest as specified later, shall be written off or 100 per cent provision made thereagainst.

(5) Adjustment of interest

Where rescheduling or renegotiation or restructuring involves a reduction in the rate of interest, the interest adjustment shall be computed by taking the difference between the rate of interest as currently applicable to infrastructure loan (as adjusted for the risk rating applicable to the borrower) and the reduced rate and aggregating the present value (discounted at the rate currently applicable to infrastructure loan, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring or rescheduling or renegotiation proposal.

(6) Funded Interest:

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In the case of funding of interest in respect of NPAs, where the interest funded is recognized as income, the interest funded shall be fully provided for.

(7) Income Recognition norms

The income recognition in respect of infrastructure loan shall be governed by the provisions of paragraph 3 of these Directions;

(8) Treatment of Provisions held

The provisions held by the non-banking financial companies against non-performing infrastructure loan, which may be classified as 'standard' in terms of sub-paragraph (3) hereinabove, shall continue to be held until full recovery of the loan is made.

(9) Eligibility for upgradation of restructured sub-standard infrastructure loan

The sub-standard asset subjected to rescheduling and/or renegotiation and/or restructuring, whether in respect of instalments of principal amount, or interest amount, by whatever modality, shall not be upgraded to the standard category until expiry of one year of satisfactory performance under the restructuring and/or rescheduling and/or renegotiation terms.

(10) Conversion of debt into equity

Where the amount due as interest, is converted into equity or any other instrument, and income is recognized in consequence, full provision shall be made for the amount of income so recognized to offset the effect of such income recognition:

Provided that no provision is required to be made, if the conversion of interest is into equity which is quoted;

Provided further that in such cases, interest income may be recognized at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

(11) Conversion of debt into debentures

Where principal amount and/or interest amount in respect of NPAs is converted into debentures, such debentures shall be treated as NPA, ab initio, in the same asset classification as was applicable to the loan just before conversion and provision shall be made as per norms.

(12) Increase in exposure limits for Infrastructure related loan and investment

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The non-banking financial companies may exceed the concentration of credit/investment norms, as provided in paragraph 20 of these Directions, by 5 per cent for any single party and by 10 per cent for a single group of parties, if the additional exposure is on account of infrastructure loan and/ or investment.

(13) Risk weight for investment in AAA rated securitized paper

The investment in “AAA” rated securitized paper pertaining to the infrastructure facility shall attract risk weight of 50 per cent for capital adequacy purposes subject to the fulfilment of the following conditions:

- (i) The infrastructure facility generates income / cash flows, which ensures servicing / repayment of the securitized paper.
- (ii) The rating by one of the approved credit rating agencies is current and valid.

Explanation:

The rating relied upon shall be deemed to be current and valid, if the rating is not more than one month old on the date of opening of the issue, and the rating rationale from the rating agency is not more than one year old on the date of opening of the issue, and the rating letter and the rating rationale form part of the offer document.

- (iii) In the case of secondary market acquisition, the ‘AAA’ rating of the issue is in force and confirmed from the monthly bulletin published by the respective rating agency.
- (iv) The securitized paper is a performing asset.

Exemptions

24. The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any non-banking financial company or class of non-banking financial companies, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

Interpretations

25. For the purpose of giving effect to the provisions of these Directions, the Reserve Bank of India may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of

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any provision of these Directions given by the Reserve Bank of India shall be final and binding on all the parties concerned.

Repeal and saving

26. (1) The Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 shall stand repealed by these Directions.

(2) Notwithstanding such repeal, any circular, instruction, order issued under the Directions in sub-section (1) shall continue to apply to non-banking financial companies in the same manner as they applied to such companies before such repeal.

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|---|
| 7. Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 |
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Master Circular: RBI/2011-12/17 DNBS (PD) CC No 223/03.02.001/2011-12 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6574

The Directions require compliance with certain terms and conditions while accepting deposits from public. The directions give the details of the deposits that would be construed as public deposits.

- NBFC to obtain credit rating for fixed deposits from approved credit rating agencies and inform RBI about any change in the ratings.
- Deposits are to be repayable after a minimum period of one year and not later than 5 years.
- Directions puts a ceiling on the deposit that can be taken by the NBFCs and this would depend upon the type of NBFC and its net owned funds.
- The NBFCs have to adhere to the ceiling on the interest rate that can be offered on their deposits.
- NBFC may, at their discretion, pay interest on overdue deposits which have not been claimed by the depositor on due date.
- NBFC cannot pay brokerage or commission for deposits collected through agents/ brokers.
- NBFC intending to accept public deposits should comply with the provisions of the Non-Banking Financial Companies and Miscellaneous Non-Banking Companies (Advertisement) Rules, 1977 and also give the prescribed particulars in their advertisements.

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- There should be a minimum lock-in period of three months.
- In every report of the Board of Directors laid before the company in a general meeting under sub-section (1) of section 217 of the Companies Act, 1956 (1 of 1956), there shall be included in the case of a non-banking financial company, the following particulars or information, namely :-
 - (i) the total number of accounts of public deposit of the company which have not been claimed by the depositors or not paid by the company after the date on which the deposit became due for repayment; and
 - (ii) the total amounts due under such accounts remaining unclaimed or unpaid beyond the dates referred to in clause (i) as aforesaid.
- Every NBFC is required to open a Constituent Subsidiary General Ledger (CSGL) account with a scheduled Bank or have an account with Stock Holding Corporation of India (SHCIL) for keeping unencumbered approved securities required to be maintained as per Section 45 –IB of RBI Act, 1934.
- NBFC to have a designated banker (Scheduled commercial Bank) and keep the unencumbered deposits with that bank) and the deposits can be withdrawn only for the purpose of repayment of depositors.
- Copies of audited balance sheet, profit and loss account, director's report and auditors report to be submitted to RBI within 15 days of the date of AGM.
- NBFC shall furnish to RBI a copy of the Auditor's report to the Board of Directors and a certificate from its auditor, to the effect that the full amount of liabilities to the depositors of the company, including interest payable thereon, are properly reflected in the balance sheet, and that the company is in a position to meet the amount of such liabilities to the depositors.
- The directions contain the format of the returns that need to be submitted to RBI.
- These directions are not applicable to
 - (a) insurance company

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- (b) a loan company, an investment company, an asset finance company not accepting/holding any public deposit:
- (c) an investment company subject to certain conditions

8. Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 1977

Master Circular : RBI/2011-12/24 DNBS (PD) CC No. 230/ 03. 02.001/2011-12 dated July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6582

These directions are applicable to every miscellaneous NBFCs which do not fall into any specific category of NBFCs. The extent of application is given in the circular.

A miscellaneous NBFC can accept deposits with a minimum maturity period of 6 months and a maximum period of 36 months subject to certain conditions.

Such NBFC are to maintain a register of deposits and the Board's report should furnish information regarding such deposits accepted by them.

Such deposits are subject to ceiling on the amount of deposit and the interest rate on the deposits.

The NBFCs are to furnish the applicable returns/ reports to RBI within the prescribed period.

The returns to be submitted are given as annexure in the circular.

9. Miscellaneous Instructions to All Non-Banking Financial Companies

Master Circular : RBI/2011-12/30 DNBS (PD) CC No.236 /03.02.001/2011-12 dated July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6588

Asset Liability Management (ALM) System for NBFCs - Guidelines

It was decided to introduce an ALM System for the Non-Banking Financial Companies (NBFCs), as part of their overall system for effective risk management in their various portfolios. The abovementioned guidelines would be applicable to all the NBFCs irrespective of whether they are

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accepting / holding public deposits or not. However to begin with, NBFCs (engaged in and classified as equipment leasing, hire purchase finance, loan, investment and residuary non-banking companies) meeting the criteria of asset base of Rs.100 crore (whether accepting / holding public deposits or not) or holding public deposits of Rs. 20 crore or more (irrespective of their asset size) as per their audited balance sheet as of 31 March 2001 would be required to put in place the ALM System.

A system of half yearly reporting was put in place in this regard and the first Asset Liability Management return as on 30 September 2002 was to be submitted to RBI by only those NBFCs which are holding public deposits within a month of close of the relevant half year i.e., before 31 October 2002 and continue thereafter in similar manner. The half yearly returns would comprise of three parts :

- (i) Statement of structural liquidity in format ALM
- (ii) Statement of short term dynamic liquidity in format ALM and
- (iii) Statement of Interest Rate Sensitivity in format ALM.

In the case of companies not holding public deposits, separate supervisory arrangements would be made and advised in due course of time.

[Details in DNBS (PD).CC.No.15 /02.01/2000-2001 dated June 27, 2001]

Besides the above the circular contains following instructions:

- (a) Nomination rules under Section 45QB of RBI Act for NBFC deposits**

[Details in DNBS (PD) C.C.No.27/ 02.05 / 2003-04 dated July 28, 2003]

- (b) Safe custody of liquid assets/ Collection of interest on SLR securities**

[Details in DNBS (PD) C.C. No. 28 / 02.02 / 2002-03 dated July 31 ,2003, DNBS (PD) CC No. 37 / 02.02 / 2003-04 dated May 17, 2004]

- (c) Prudential Norms Directions - Preparation of Balance Sheet as on March 31 of every year**

Details in DNBS (PD) C.C. No. 43 / 05.02 / 2004-05 dated August 10, 2004]

- (d) Certificate of Registration (CoR) issued under Section 45-IA of the RBI Act, 1934 – Continuation of business of NBFI - Submission of Statutory Auditors Certificate - Clarification**

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[Details in DNBS (PD) C.C. No. 79 / 03.05.002/ 2006-07 dated September 21, 2006 DNBS (PD) C.C. No. 81 / 03.05.002/ 2006-07 dated October 19, 2006]

(e) Operative instructions relating to relaxation/modification in Ready Forward Contracts, Settlement of Government Securities Transactions and Sale of securities allotted in Primary Issues

[Details in DNBS (PD) CC No. 38 /02.02/2003-04 dated June 11, 2004, DNBS (PD) CC No.49 /02.02/2004-05 dated June 9, 2005]

(f) FIMMDA Reporting Platform for Corporate Bond Transactions

SEBI has permitted FIMMDA to set up its reporting platform for corporate bonds. It has also been mandated to aggregate the trades reported on its platform as well as those reported on BSE and NSE with appropriate value addition.

All NBFCs would be required to report their secondary market transactions in corporate bonds done in OTC market, on FIMMDA's reporting platform with effect from September 1, 2007.

[Details in DNBS.PD/ C.C. No. 105/ 03.10.001/2007-08 dated July 31, 2007]

(g) Prior Public Notice about change in control / management

Need for public notice before (a) closure of the branch/office by any NBFC
(b) sale/transfer of ownership by an NBFC

(a) NBFC should give at least three months public notice prior to the date of closure of any of its branches/ offices in, at least, one leading national news paper and a leading local (covering the place of branch/ office) vernacular language newspaper indicating therein the purpose and arrangements being made to service the depositors etc.

(b) (i) A public notice of 30 days shall be given before effecting the sale of, or transfer of the ownership by sale of shares, or transfer of control, whether with or without sale of shares. Such public notice shall be given by the NBFC and also by the transferor, or the transferee or jointly by the parties concerned.

For this purpose, the term 'control' shall have the same meaning as defined in Regulation 2(1) (c) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

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- (ii) The public notice should indicate the intention to sell or transfer ownership / control, the particulars of transferee and the reasons for such sale or transfer of ownership / control. The notice should be published in one leading national and another in leading local (covering the place of registered office) vernacular language newspaper.

(h) Change in management and mergers/amalgamation

The following changes are effected in the above instructions in January 2006:

- (i) Merger and amalgamation in terms of the High Court Order.
 - (a) Where merger and amalgamation takes place in terms of the High Court order in pursuance of Sections 391 and 394 of the Companies Act 1956, the company shall inform the Bank about merger or amalgamation along with Court's order approving the same within a period of one month from the date of the order. As the public notice is given by the companies under the Companies Act 1956 and Rules made thereunder, no further public notice is required to be given by the companies in terms of the Bank's Circular as mentioned above.
 - (b) However there will be no change in other instructions contained in paragraph 5(iii) (b) of the Company Circular DNBS (PD) .CC No.12/02.01/99-2000 dated January 13, 2000.

(i) The Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009.

Short title and commencement of the Directions

1. (1) These Directions shall be known as the Non-Banking Financial Companies (Deposit Accepting) (Approval of Acquisition or Transfer of Control) Directions, 2009.
- (2) These Directions shall come into force with immediate effect.

Definitions

2. For the purpose of these Directions, unless the context otherwise requires,-
 - (a) "control" shall have the same meaning as is assigned to it under clause (c) of sub-regulation (1) of regulation 2 of Securities and

Appendices

Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

- (b) "NBFC" means non-banking financial company as defined in clause (xi) of sub-paragraph (1) of Paragraph 2 of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.

Prior approval of RBI in cases of acquisition or transfer of control of deposit taking NBFCs

Any takeover or acquisition of control of a deposit taking NBFC, whether by acquisition of shares or otherwise, or any merger/amalgamation of a deposit taking NBFC with another entity, or any merger/amalgamation of an entity with a deposit taking NBFC, shall require prior written approval of Reserve Bank of India.

Application of other laws not barred

The provisions of these Directions shall be in addition to, and not in derogation of the provisions of any other law, rules, regulations or directions, for the time being in force.

Exemptions

The Reserve Bank of India may, if it considers necessary for avoiding any hardship or for any other just and sufficient reason, exempt any NBFC or class of NBFCs, from all or any of the provisions of these Directions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

(Details are in Notification No. DNBS.(PD) 208/ CGM(ANR)-2009 dated September 17, 2009))

- (ii) Other cases

Where merger and amalgamation or change in the management of the company takes place upon sale / transfer otherwise than as stated in sub-paragraph (i) above, the NBFCs (including RNBCs)(deposit taking and non-deposit taking companies) should give prior public notice of 30 days.

[Details in Company Circular DNBS (PD) CC.No.11/02.01/99-2000 dated November 15, 1999, DNBS (PD) CC No.12/02.01./99-2000 dated January 13, 2000, DNBS (PD) CC No. 63 / 02.02 / 2005-06 dated January 24, 2006 and DNBS (PD) CC No. 82 / 03.02.02 / 2006-07 dated October 27, 2006]

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(j) Cover for public deposits – creation of floating charge on Liquid Assets by deposit taking NBFCs

NBFCs raise funds for their operations from various sources like public deposits, bank borrowings, inter-corporate deposits, secured/unsecured debentures, etc.

In order to ensure protection of depositors interest, NBFCs should ensure that at all times there is full cover available for public deposits accepted by them. While calculating this cover the value of all debentures (secured and unsecured) and outside liabilities other than the aggregate liabilities to depositors may be deducted from the total assets. Further, the assets should be evaluated at their book value or realizable/market value whichever is lower for this purpose. It shall be incumbent upon the NBFC concerned to inform the Regional Office of the Reserve Bank in case the asset cover calculated as above falls short of the liability on account of public deposits.

[Details in DNBS (PD) C.C No. 47/ 02.01/ 2004-05 dated February 07, 2005 and DNBS (PD) C.C No. 87 /03.02.004/2006-07 dated January 4, 2007]

(k) Unsolicited Commercial Communications - National Do Not Call Registry

NBFCs are advised

- (i) not to engage Telemarketers (DSAs/DMA's) who do not have any valid registration certificate from DoT, Govt of India, as telemarketers;
- (ii) to furnish the list of Telemarketers (DSAs/DMA's) engaged by them along with the registered telephone numbers being used by them for making telemarketing calls to TRAI; and
- (iii) to ensure that all agents presently engaged by them register themselves with DoT as telemarketers .

[Details in DNBS.PD/ C.C No. 109/ 03.10.001/2007-08 dated November 26, 2007]

(l) Requirement of minimum NOF of Rs. 200 lakh for all deposit taking NBFCs

[DNBS (PD) C.C. No. 114 /03. 02.059 / 2007-08 dated June 17, 2008]

(m) Reclassification of NBFCs

In terms of Company Circular DNBS.PD. CC No. 85 / 03.02.089 /2006-07 dated December 06, 2006 it was advised that NBFCs financing real / physical assets for productive / economic activity will be classified as Asset Finance

Appendices

Company (AFC) as per the criteria given under paragraph 4 of that circular. Consequent upon re-classification of NBFCs, in the proposed structure the following categories of NBFCs will emerge:

- (i) Asset Finance Company
- (ii) Investment Company
- (iii) Loan Company
- (iv) Infrastructure Finance Company
- (v) Core Investment Companies-ND-SI

[Details in DNBS.PD. CC No. 85 / 03.02.089 /2006-07 dated December 06, 2006 and DNBS.PD. CC No. 128 / 03.02.059 /2008-09 dated September 15, 2008]

(n) Monitoring Framework for non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore

[Details in DNBS.PD/ CC.No. 130 / 03.05.002 /2008-09 dated September 24, 2008 and DNBS.PD/ CC.No. 137 / 03.05.002 /2008-09 dated March 02, 2009]

(o) Accounting for taxes on income- Accounting Standard 22- Treatment of deferred tax assets (DTA) and deferred tax liabilities (DTL) for computation of capital

As creation of DTA or DTL would give rise to certain issues impacting the balance sheet of the company, it is clarified that the regulatory treatment to be given to these issues are as under :-

- The balance in DTL account will not be eligible for inclusion in Tier I or Tier II capital for capital adequacy purpose as it is not an eligible item of capital.
- DTA will be treated as an intangible asset and should be deducted from Tier I Capital.
- NBFCs may keep the above clarifications in mind for all regulatory requirements including computation of CRAR and ensure compliance with effect from the accounting year ending March 31, 2009.

In this connection it is further clarified that

DTL created by debit to opening balance of Revenue Reserves or to Profit and Loss Account for the current year should be included under 'others' of "Other Liabilities and Provisions."

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DTA created by credit to opening balance of Revenue Reserves or to Profit and Loss account for the current year should be included under item 'others' of "Other Assets."

Intangible assets and losses in the current period and those brought forward from previous periods should be deducted from Tier I capital.

DTA computed as under should be deducted from Tier I capital:

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

[Details in DNBS (PD) C.C. No. 124/ 03.05.002/ 2008-09 dated July 31, 2008 and DNBS.PD/ CC. No. 142/ 03.05.002 /2008-09 dated June 9, 2009]

(p) Introduction of Interest Rate Futures- NBFCs

It has been decided that NBFCs may participate in the designated interest rate futures exchanges recognized by SEBI, as clients, subject to RBI / SEBI guidelines in the matter, for the purpose of hedging their underlying exposures.

NBFCs participating in IRF exchanges may submit the data in this regard half yearly, in the format enclosed, to the Regional office of the Department of Non-Banking Supervision in whose jurisdiction their company is registered, within a period of one month from the close of the half year.

(Details are in DNBS.PD.CC.No.161 /3.10.01/ 2009-10 dated September 18, 2009)

(q) Compliance with FDI norms-Half yearly certificate from Statutory Auditors of NBFCs

NBFCs are required to submit a certificate from their Statutory Auditors on half yearly basis (half year ending September and March) certifying compliance with the existing terms and conditions of FDI. Such certificate may be submitted not later than one month from the close of the half year to which the certificate pertains, to the Regional Office in whose jurisdiction the head office of the company is registered.

(Details are in DNBS (PD).CC. No 167 /03.10.01 /2009-10 dated February 04, 2010)

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- (r) **Finance for Housing Projects – Incorporating clause in the terms and conditions to disclose in pamphlets/brochures/ advertisements, information regarding mortgage of property to the NBFC**

(Details are in DNBS (PD) C.C No. 174 /03.10.001/2009-10 dated May 6, 2010)

- (s) **Loan facilities to the physically / visually challenged by NBFCs**

(DNBS.CC.PD.No. 191 /03.10.01/2010-11 dated July 27, 2010)

- (t) **Services to persons with Disability –Training Programme for Employees**

(DNBS.CC.PD.No.208 /03.10.01/2010-11 dated January 27, 2011)

- (u) **Submission of data to Credit Information Companies - Format of data to be submitted by Credit Institutions**

(DNBS.(PD).CC. No. 200 /03.10.001/2010-11 dated September 17, 2010)

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| 10. Master Circular - Miscellaneous Instructions to NBFC- ND-SI |
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Master Circular: RBI/2011-12/29 DNBS (PD) CC No.235/03.10.001/2011-12 dated July 1, 2011

Link : http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6593

1. Financial Regulation of Systemically Important NBFCs and Banks' Relationship with them

The Reserve Bank of India had set up an Internal Group to examine the issues relating to level playing field, regulatory convergence and regulatory arbitrage in the financial sector. Based on the recommendations of the Internal Group and on the basis of the feedback received, final guidelines were issued for implementation on December 12, 2006.

Modifications to the Regulatory Framework

In the light of the concerns that arise out of the divergent regulatory requirements for various aspects of functioning of banks and NBFCs and keeping in view the broad principles for the proposed revision, the following modifications were made in the regulatory framework for NBFCs.

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A. Regulatory Framework for Systemically Important NBFCs – ND (NBFC – ND – SI)

(i) Determination of NBFC – ND – SI

All NBFCs – ND with an asset size of Rs. 100 crore and more as per the last audited balance sheet will be considered as a systemically important NBFC – ND (NBFC-ND-SI).

(ii) Capital Adequacy Ratio for NBFCs – ND – SI

NBFCs – ND – SI shall maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) of 10% which was changed to 12% as on March 31, 2010 and 15% as on March 31, 2011. The present minimum CRAR stipulation at 12 % or 15%, as the case may be, for NBFCs – D shall continue to be applicable.

(iii) Single/Group Exposure norms for NBFCs – ND – SI

Exposure norms were laid down for NBFC-ND-SIs.

Further, the NBFCs – ND – SI were advised to have a policy in respect of exposures to a single entity / group. NBFCs-ND-SI not accessing public funds both directly and indirectly can apply to the Reserve Bank for an appropriate dispensation consistent with the spirit of the exposure limits.

B. Additional Single Exposure norms for Asset Finance Companies

(iv) In terms of circular DNBS.PD.CC.No.85/03.02.089/2006-2007 dated December 6, 2006, companies financing real/physical assets for productive /economic activity will be classified as Asset Finance Companies (AFCs) as per the criteria prescribed therein.

In addition to the single party and single group of parties exposure norms prescribed for NBFCs-D and NBFCs-ND-SI, AFCs are permitted to exceed the exposure to a single party and single group of parties up to a further 5 percent of their owned fund in exceptional circumstances with the approval of their Boards.

C. Expansion of activities of NBFCs through automatic route

(v) NBFCs set up under the automatic route will be permitted to undertake only those 18 activities which are permitted under the automatic route. Diversification into any other activity would require the prior approval of FIPB. Similarly a company which has entered into an area permitted under the FDI policy (such as software) and seeks to diversify into NBFC sector

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subsequently would also have to ensure compliance with the minimum capitalization norms and other regulations as applicable.

Effective date and transition

Taking into account the likelihood that some of the NBFCs may not be in compliance with some of the elements of the revised regulatory framework a transition period up to end March 2007 was provided. Accordingly, NBFCs had to comply with all elements of the revised framework with effect from April 1, 2007. In case any NBFC – ND – SI needed more time for compliance, it had to apply to DNBS before the close of business on January 31, 2007 clearly indicating the reasons for which it is not able to ensure compliance within the above period and the time frame within which it would be able to comply with all the relevant elements.

Scope of application to certain categories

The guidelines contained in this circular are applicable to the NBFCs as specified in the relevant paragraphs except the categories mentioned below:

- (i). The Residuary Non Banking Companies (RNBCs) and Primary Dealers (PDs) as they are subjected to a separate set of regulations.
- (ii). Government owned companies, as defined under Section 617 of the Companies Act, which are registered with the Reserve Bank of India as NBFCs, are exempted from certain provisions of Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998, at present. It is proposed to bring all deposit taking and systemically important government owned companies under the provisions of the said Directions which will be in conformity with the existing guidelines, including those contained in this circular. However, the date from which they are to fully comply with the regulatory framework will be decided later. These companies, were therefore, required to prepare a roadmap for compliance with the various elements of the NBFC regulations, in consultation with the Government, and submit the same to the Reserve Bank (Department of Non Banking Supervision – (DNBS)), by March 31, 2007.

2. Supervisory Framework for Systemically Important non-deposit taking/holding NBFCs (NBFC-ND-SI)

To ensure adherence to compliance with the regulatory framework for Systemically Important NBFCs – ND such companies were advised to put in place a system for submission of an annual statement of capital funds, risk

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asset ratio etc., as at end of March every year in form NBS-7 as per prescribed format. The first such return was to be submitted for the year ending March 31, 2007. The return may be submitted within a period of three months from the close of the financial year, every year.

Such returns are to be submitted electronically and for the purpose, NBFC-ND-SI has to approach the Information Division of Central Office of this Department for assignment of user-id and password for web-enabled submission of the return. A hard copy of the return duly signed by the designated authority may be filed with the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction the company is registered.

3. Guidelines for NBFC-ND-SI as regards capital adequacy, liquidity and disclosure norms

On a review of the experience with the regulatory framework since April 2007, it was felt desirable to enhance the capital adequacy requirement and put in place guidelines for liquidity management and reporting, as also norms for disclosures. Accordingly, the Bank placed on its web-site on June 2, 2008, the draft guidelines for NBFCs-ND-SI as regards the above aspects for receiving the comments of the public. These guidelines were finalized and issued as Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.

(i) Capital adequacy

The Capital adequacy for NBFC-ND-SI was enhanced to 12% as on March 31, 2010 and 15% as on March 31, 2011.

(ii) Disclosure in the Balance Sheet

The disclosure norms in respect of NBFCs-ND-SI have been reviewed and it has been decided that such Systemically Important NBFCs-ND shall make additional disclosures in their Balance Sheet from the year ending March 31, 2009 relating to:

Capital to Risk Assets Ratio (CRAR)

Exposure to real estate sector, both direct and indirect; and

Maturity pattern of assets and liabilities

The format of disclosure of this additional information is furnished in Company Circular DNBS (PD). CC. No.125/03.05.002 / 2008-2009 dated August 1, 2008.

4. Asset Liability Management (ALM) – Reporting

NBFC-ND-Sis are required to submit three ALM returns i.e. ALM 1,ALM-2 and ALM-The periodicity of the Statement of short term dynamic liquidity [NBS-ALM1] shall be monthly and that of Statement of structural liquidity [NBS-ALM2] half-yearly. The frequency of Statement of Interest Rate Sensitivity [NBS-ALM3] would be half yearly, The Bank has since hosted the format of the ALM Returns (I, II and III) on the Bank's following website (<https://cosmos.rbi.org.in>).

(Details are given in DNBS (PD).CC.No.125/03.05.002/2008-2009 dated August 1,2008 and in DNBS.PD.CC.No.169 /22.05.02/2009-10 dated April 22, 2010)

5. Enhancement of NBFCs' capital raising option for capital adequacy purposes

Taking into consideration, the need for enhanced funds for increasing business and meeting regulatory requirements, it has been decided that Systemically Important Non-Deposit taking Non-Banking Financial Companies (NBFCs-ND-SI) may augment their capital funds by issue of Perpetual Debt Instruments (PDI) in accordance with the guidelines contained in the circular. Such PDI shall be eligible for inclusion as Tier I Capital to the extent of 15% of total Tier I capital as on March 31 of the previous accounting year.

(Details are given in DNBS (PD) CC.No.131 /03.05.002 /2008-2009 dated October 29,2008)

6. Ratings of NBFCs

NBFCs also issue financial products like Commercial Paper, Debentures etc. to which rating is assigned by rating agencies. The ratings assigned to such products may undergo changes for various reasons ascribed to by the rating agencies. It has therefore been decided that all NBFCs (both deposit taking and non-deposit taking) with asset size of Rs 100 crore and above shall furnish the information about downgrading / upgrading of assigned rating of any financial product issued by them, within fifteen days of such a change in rating, to the Regional Office of the Bank under whose jurisdiction their registered office is functioning.

[DNBS (PD) CC.No.134/03.10.001 /2008-2009 dated February 04, 2009]

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7. Criteria for deciding NBFC-ND-SI status

A non-deposit taking NBFC with an asset size of less than Rs. 100 crore as on balance sheet date might subsequently add on assets before the next balance sheet date due to several reasons including business expansion plan. It is clarified that once an NBFC reaches an asset size of Rs. 100 crore or above, it shall come under the regulatory requirement for NBFCs-ND-SI as stated above, despite not having such assets as on the date of last balance sheet. Therefore, it is advised that all such non-deposit taking NBFCs may comply with RBI regulations issued to NBFC-ND-SI from time to time, as and when they attain an asset size of Rs. 100 crore, irrespective of the date on which such size is attained.

It is further observed that in a dynamic environment, the asset size of a company can fall below Rs 100 crore in a given month, which may be due to temporary fluctuations and not due to actual downsizing. It is clarified that in such a case the company may continue to submit the Monthly return on Important Financial Parameters to Reserve Bank of India and to comply with the extant directions as applicable to NBFC-ND-SI, till the submission of their next audited balance sheet to Reserve Bank of India and a specific dispensation is received from the Bank in this regard.

(Details are given in DNBS (PD) CC.No.141/03.10.001/2008-09 dated June 4, 2009)

Ready Forward Contracts in Corporate Debt Securities

In terms of 'Repo in Corporate Debt Securities (Reserve Bank) Directions, 2010' dated January 08, 2010 issued by Internal Debt Management Department (IDMD) of RBI, NBFCs registered with RBI (other than Govt companies as defined in Section 617 of the Companies Act, 1956) are eligible to participate in repo transactions in corporate debt securities. IDMD has also issued revised guidelines on uniform accounting for repo / reverse repo transactions on March 23, 2010.

2. NBFCs participating in such repo transactions shall comply with the Directions and accounting guidelines issued by IDMD. Certain clarifications are being made in this regard as given below.

Eligible participants

- (i) NBFCs-ND with asset size of Rs. 100 crore and above (i.e. NBFCs-ND-SI).

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Capital Adequacy

- (ii) Risk weights for credit risk for assets that are the collateral for such transactions as well as risk weights for the counterparty credit risk shall be as applicable to the issuer / counterparty in the NBFC (non-deposit accepting or holding) Prudential Norms Directions, 2007 as amended from time to time.

Classification of balances in the accounts

- (iv) Classification of balances in the various accounts viz; repo account, reverse repo account etc. shall be done in the relevant schedules similar to that of banks.

3. In all other matters related to such repo transactions, NBFCs-ND-SI shall follow the Directions and accounting guidelines issued by IDMD viz; Repo in Corporate Debt Securities (Reserve Bank) Directions, 2010 dated January 08, 2010 and Revised Guidelines on Uniform Accounting for Repo / Reverse repo transactions on March 23, 2010 respectively.

(DNBS.PD/ CC.No.196/ 03.05.002 /2010-11 dated August 11, 2010)

Participation in Currency Options

Reserve Bank had issued guidelines to banks on trading in currency options in recognised stock/new exchanges on July 30, 2010.

2. Accordingly, it has been decided that NBFCs may participate in the designated currency options exchanges recognized by SEBI as clients, subject to RBI (Foreign Exchange Department) guidelines in the matter, only for the purpose of hedging their underlying forex exposures. Appropriate disclosures may be made regarding transactions undertaken in the Balance sheet.

(DNBS (PD) CC No.199 / 03.10.001/ 2010-11 dated September 16, 2010)

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| 11. Introduction of New Category of NBFCs - 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) – Directions |
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RBI/2011-12/290 DNBS.CC.PD.No. 250/03.10.01/2011-12 dated December 02, 2011

Link: http://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=6857

Creation of a Separate Category of NBFC-MFI

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It has been decided to create a separate category of NBFCs viz; Non Banking Financial Company-Micro Finance Institution (NBFC-MFI). Consequently there would be following categories of NBFCs:

- i. Asset Finance Company (AFC)
- ii. Investment Company (IC)
- iii. Loan Company (LC)
- iv. Infrastructure Finance Company (IFC)
- v. Core Investment Company (CIC)
- vi. Infrastructure Debt Fund- Non- Banking Financial Company (IDF-NBFC)
- vii. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI).

Notification DNBS. PD.No.234 / CGM(US)-2011 dated December 02, 2011

These Directions shall be known as the Non-Banking Financial Company - Micro Finance Institutions (Reserve Bank) Directions, 2011.

- ii. These Directions shall come into force with immediate effect.

2. Extent of the Directions

These Directions shall apply to every Non Banking Financial Company-Micro Finance Institution (NBFC-MFI) as defined in these Directions.

3. Definition of NBFC-MFI

An NBFC-MFI is defined as a non-deposit taking NBFC(other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils the following conditions:

- i. Minimum Net Owned Funds of Rs.5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore).
- ii. Not less than 85% of its net assets are in the nature of “qualifying assets.”

For the purpose of ii. above,

“Net assets” are defined as total assets other than cash and bank balances and money market instruments.

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“Qualifying asset” shall mean a loan which satisfies the following criteria:-

- a. *loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000;*
 - b. *loan amount does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in subsequent cycles;*
 - c. *total indebtedness of the borrower does not exceed Rs. 50,000;*
 - d. *tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;*
 - e. *loan to be extended without collateral;*
 - f. *aggregate amount of loans, given for income generation, is not less than 75 per cent of the total loans given by the MFIs;*
 - g. *loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower*
- iii. Further the income an NBFC-MFI derives from the remaining 15 percent of assets shall be in accordance with the regulations specified in that behalf.
 - iv. An NBFC which does not qualify as an NBFC-MFI shall not extend loans to micro finance sector, which in aggregate exceed 10% of its total assets.

4. Regulatory Framework for NBFC-MFIs

A. Entry Point Norm

As stated above, all new NBFC-MFIs except those in the North Eastern Region of the country should have a minimum Net Owned Funds(NoF) of Rs 5 crore; those located in the North eastern region should have a minimum NoF of Rs. 2 crore for purposes of registration. The existing NBFCs to be classified as NBFC-MFIs will be required to comply with this norm w.e.f April 01, 2012.

B. Prudential Norms

- a. Capital Requirement

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All new NBFC-MFIs shall maintain a capital adequacy ratio consisting of Tier I and Tier II Capital which shall not be less than 15 percent of its aggregate risk weighted assets. The total of Tier II Capital at any point of time, shall not exceed 100 percent of Tier I Capital. The risk weights for on-balance sheet assets and the credit conversion factor for off-balance sheet items will be as provided in para 16 of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve bank) Directions 2007.

Note:

- i. *Among the existing NBFCs to be classified as NBFC-MFIs, those with asset size less than Rs. 100 crore will be required to comply with this norm w.e.f April 01, 2012. Those with asset size of Rs. 100 crore and above are already required to maintain minimum CRAR of 15%.*
- ii. *The CRAR for NBFC-MFIs which have more than 25% loan portfolio in the state of Andhra Pradesh will be at 12% for the year 2011-2012 only. Thereafter they have to maintain CRAR at 15%.*

b. Asset Classification and Provisioning Norms:

With effect from April 01, 2012 all NBFC-MFIs shall adopt the following norms(till then they shall follow the asset classification and provisioning norms as given in the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007).

Asset Classification Norms:

- i. Standard asset means 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 nor carry more than normal risk attached to the business;
- ii. Nonperforming asset means an asset for which, interest/principal payment has remained overdue for a period of 90 days or more.

Provisioning Norms:

The aggregate loan provision to be maintained by NBFC-MFIs at any point of time shall not be less than the higher of a) 1% of the outstanding loan portfolio or b) 50% of the aggregate loan instalments which are overdue for more than 90 days and less than 180 days and 100% of the aggregate loan instalments which are overdue for 180 days or more.

- c. All other provisions of the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 will be applicable to NBFC-MFIs except as indicated therein.

C. Other Regulations

a. Pricing of Credit

- i. All NBFC-MFIs shall maintain an aggregate margin cap of not more than 12%. The interest cost will be calculated on average fortnightly balances of outstanding borrowings and interest income is to be calculated on average fortnightly balances of outstanding loan portfolio of qualifying assets.
- ii. Interest on individual loans will not exceed 26% per annum and calculated on a reducing balance basis.
- iii. Processing charges shall not be more than 1 % of gross loan amount. Processing charges need not be included in the margin cap or the interest cap.
- iv. NBFC-MFIs shall recover only the actual cost of insurance for group, or livestock, life, health for borrower and spouse. Administrative charges where recovered, shall be as per IRDA guidelines.

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| 12. Non Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) - Provisioning Norms-Extension of time |
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RBI/2011-12/463 DNBS.PD/ CC.No.263 / 03.10.038 /2011-12 dated March 20, 2012

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7081>

A new category of NBFCs namely 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) was introduced vide DNBS.CC.PD.No.250/03.10.01/2011-12 dated December 02, 2011, which also contained guidelines on asset classification and provisioning norms to be adhered to by the MFIs with effect from April 01, 2012. Taking into account the difficulties faced by MFI sector and the representation received by the Bank from them, it has been decided to defer the implementation of asset classification and provisioning norms for NBFC-MFIs to April 01, 2013.

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| 13. Mortgage Guarantee Companies Investment (Reserve Bank) Directions, 2008 |
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Technical Guide on Audit of NBFCs

Master Circular: RBI/2011-12/34 DNBS (PD-MGC) C.C.
No.10/23.11.01/2011-12 dated **July 1, 2011**

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6566

This Master circular contains the directions relating to the prudential norms relating to investment policy, pattern of investments, income recognition and accounting for investments.

The mortgage companies are required to make investments only in specified securities with a minimum of 25% investment in government securities. The remaining investments may be in corporate bonds, debentures and debt oriented mutual funds with a ceiling of 25% in each category. Further sub limits may be fixed by the Board of the company. The Investments in securities other than the government securities should have a minimum credit rating as assigned by SEBI registered rating agencies. However, a mortgage guarantee company may hold investments in equity shares of any company which may be quoted or unquoted or other unquoted investments acquired in satisfaction of its debts which shall be disposed of by the mortgage guarantee company within a period of three years or within such period as extended by the Bank, from the date of such acquisition.

Accounting:

- (i) Mortgage Guarantee Companies may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.
- (ii) Mortgage Guarantee Companies may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payments is established.
- (iii) Mortgage Guarantee Companies may book income from Government securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are pre-determined and provided interest is serviced regularly and as such is not in arrears.
- (iv) Mortgage Guarantee Companies should book income from units of mutual funds on cash basis.

Accounting of investments

(1) All investments shall be marked to market;

Quoted investments shall, for the purposes of valuation, be grouped into the following categories, viz.,

- (a) Government securities including treasury bills,
- (b) Government guaranteed bonds/securities;
- (c) Bonds of banks/ PFIs;
- (d) Debentures/bonds of corporates; and
- (e) Units of mutual fund.

Quoted investments for each category shall be valued at cost or market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.

(2) Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.

(3) Unquoted investments acquired in satisfaction of its debts shall be valued as under:

- (a) Unquoted investments in the units of mutual funds shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme;
- (b) Unquoted equity shares shall be valued at cost or break up value, whichever is lower. However, mortgage guarantee companies may substitute fair value for the break up value of the shares, if considered necessary. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at Rupee one per company;
- (c) Unquoted preference shares shall be valued at cost or face value, whichever is lower.

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Note: Unquoted debentures shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

The investment policy of the Mortgage guarantee company should be in tune with these directions and approval of the Board.

14. Notification as amended up to June 30, 2011 – “Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008”

Master Circular: RBI/2011-12/32 DNBS (PD-MGC) C.C. No. 8/23.11.01/2011-12 dated July 1, 2011

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The guidelines include guidelines on Registration and Operations of Mortgage Guarantee Company under Section 45L(1)(b) of the Reserve Bank of India Act, 1934 for the formation, registration of mortgage companies, capital structure, Board composition etc.

A mortgage company shall have a capital adequacy ratio of 10% of the risk weighted assets.

A mortgage guarantee company shall maintain at least six percent (6%) of its aggregate risk weighted assets of on balance sheet and of risk adjusted value of off-balance sheet items as Tier I capital.

The mortgage guarantee company shall also comply with all the relevant Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India from time to time.

No single guarantee shall exceed 10% of the company's Tier I and Tier II capital.

Mortgage guarantee companies shall not accept public deposits.

Mortgage guarantee companies shall not avail External Commercial Borrowings.

Creation and maintenance of Reserves

Contingency Reserves

A mortgage guarantee company shall create and maintain a “Contingency Reserve” on an ongoing basis. The mortgage guarantee company:

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- (a) Shall appropriate each year **at least** forty percent (40%) of the premium or fee earned during that accounting year or twenty five percent (25%) of the profit (after provisions and tax), whichever is higher, to the Contingency Reserve;
- (b) In case of inadequate profits, such appropriation shall either result in or increase the amount of carry forward loss;
- (c) May appropriate a lower percentage of the premium or fee earned during any accounting year when the provisions made each year towards losses on account of settlement of mortgage guarantee claims exceeds thirty-five percent (35%) of the premium or fee earned during that accounting year;
- (d) Shall ensure that the Contingency Reserve is built up to **at least five percent** (5%) of the total outstanding mortgage guarantee commitments;
- (e) Shall retain the amounts appropriated each year to the Contingency Reserve for a minimum period of seven (7) subsequent years which shall be eligible for reversal only in the eighth year subject to the condition in (d) above;
- (f) Shall utilize the Contingency Reserve only with the prior approval of the Reserve Bank of India;
- (g) Shall show the amount of 'Contingency Reserve' as a separate line item on the liability side of the balance sheet; however, Contingency Reserve may be treated as 'free reserve' for the purpose of net owned fund.

Accounting of Unearned Premium

A mortgage guarantee company shall account the premium or fee on the mortgage guarantee contracts as an income in the profit and loss account in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India. The amount of unearned premium shall be shown as a separate line on the liability side of the balance sheet.

Provision for losses on invoked guarantees

A mortgage guarantee company is exposed to a potential loss when its guarantee is invoked. Mortgage guarantee companies shall hold provisions for losses in respect of such invoked guarantees pending recovery of assets. The amount of provisions required to be held shall be equal to the contract-wise aggregate of 'amount of invocation' after adjusting the realisable value

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of the assets held by the company in respect of each housing loan where the guarantee has been invoked. In case the realisable value of the assets held in respect of any invoked guarantee is more than the amount of invocation, the excess shall not be adjusted against the shortfall in other invoked guarantees. In case the amount of provisions already held is in excess of the amount as computed above, the excess shall not be reversed. The amount of provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of provision held for losses on settlement of invoked guarantees shall be shown as a separate line item on the liability side of the balance sheet.

Provision for 'Incurred But-Not-Reported (IBNR) losses'

A mortgage guarantee company is exposed to a potential loss when there is a default in a housing loan guaranteed by it. Mortgage guarantee companies shall hold provisions in respect of such defaulted housing loans where the trigger event is yet to occur or the guarantee is yet to be invoked. The potential loss to which the guarantee company is exposed to is referred to as 'Incurred-But-Not-Reported (IBNR) losses'. The amount of provisions required to be held shall be arrived at on an actuarial basis depending upon the estimates of loss frequency

and loss severity for incurred but not reported losses which are derived from historic data, trends, economic factors and other statistical data in relation to paid claims, the provisions held for claims settled, risk statistics, etc. In case the amount of provisions already held is in excess of the amount as computed above, the excess shall not be reversed. The amount of provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of provision held for Incurred But-Not-Reported (IBNR) losses shall be shown as a separate line item on the liability side of the balance sheet.

A mortgage guarantee company is required to maintain Register of guarantees containing details of borrower

A mortgage guarantee company shall not pay commissions, rebates, or other inducements for referral of mortgage guarantee business to any person.

A mortgage guarantee company shall constitute an Audit Committee consisting of not less than three non-executive Directors of the Board of the company, at least one of whom will be a Chartered Accountant.

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| 15. Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008 |
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Master Circular: RBI/2011-12/33 DNBS (PD-MGC) C.C. No. 9/23.11.01/2011-12 dated July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5844

Short title, commencement and applicability of the directions

1. (i) These directions shall be known as the "Mortgage Guarantee Companies Prudential Norms (Reserve Bank) Directions, 2008".

(ii) These directions shall come into force with immediate effect and shall apply to every Mortgage Guarantee Company which has been granted Certificate of Registration under the scheme of Registration of Mortgage Guarantee Companies by the Reserve Bank of India.

Definitions

2. (1) For the purpose of these directions, unless the context otherwise requires:

- (i) "doubtful asset" means an asset which remains a sub-standard asset for a period exceeding 12 months;
- (ii) "hybrid debt capital instrument" means capital instrument which possesses certain characteristics of equity as well as of debt;
- (iii) "loss asset" means:
 - (a) an asset which has been identified as loss asset by the mortgage guarantee company or its internal or external auditor or by the Reserve Bank of India, to the extent it is not written off by the mortgage guarantee company; and
 - (b) an asset which is adversely affected by a potential threat of non-recoverability for reasons like 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, etc.;
- (iv) Mortgage Guarantee Company" means as defined in paragraph 2(1)(I) of the Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008;
- (v) (I) For the purpose of these directions 'net owned fund' means:

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- (a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the company after deducting therefrom-
 - (i) accumulated balance of loss;
 - (ii) deferred revenue expenditure; and
 - (iii) other intangible assets; and
- (b) further reduced by the amounts representing-
 - (1) investments of such company in shares of-
 - (i) its subsidiaries;
 - (ii) companies in the same group;
 - (iii) all other non-banking financial companies; and (2) the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with-
 - (i) subsidiaries of such company; and
 - (ii) companies in the same group, to the extent such amount exceeds ten per cent, of (a) above.
 - (II) "subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act, 1956 (1 of 1956).]
- (vi) 'non-performing asset' (NPA) in respect of mortgage guarantee asset means, an asset acquired from the credit institution on the happening of trigger event which is straight away classified as non-performing asset and shall thereafter be classified according to the age of NPA;
- (vii) "owned fund" means paid up equity capital, free reserves including contingency reserves maintained as per paragraph 18 of the Guidelines on Registration and Operations of Mortgage Guarantee Company, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any;
- (viii) "standard asset" means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which

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does not disclose any problem nor carry more than normal risk attached to the business;

- (ix) "sub-standard asset in respect of mortgage guarantee asset" means an asset which has been classified as non-performing asset for a period not exceeding 12 months;
- (x) "subordinated debt" means an instrument, which is fully paid up, is unsecured and is subordinated to the claims of other creditors and is free from restrictive clauses and is not redeemable at the instance of the holder or without the consent of the supervisory authority of the mortgage guarantee company. The book value of such instrument shall be subjected to discounting as provided hereunder:

Remaining Maturity of the instruments Rate of discount

- (a) Upto one year 100%
- (b) More than one year but upto two years 80%
- (c) More than two years but upto three years 60%
- (d) More than three years but upto four years 40%
- (e) More than four years but upto five years 20%

to the extent such discounted value does not exceed fifty per cent of Tier I capital;

- (xi) "substantial interest" means holding of a beneficial interest by an individual or his spouse or minor child, whether singly or taken together in the shares of a company, the amount paid up on which exceeds ten per cent of the paid up capital of the company; or the capital subscribed by all the partners of a partnership firm;
- (xii) "Tier I Capital" means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund;

Note;- Investment in shares of subsidiaries, companies in the same group and other NBFCs refers to that which has been acquired by the mortgage guarantee company in satisfaction of debt;

- (xiii) "Tier II Capital" includes the following:-

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- (a) preference shares;
 - (b) revaluation reserves at discounted rate of fifty five percent;
 - (c) general provisions 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 and provisions made on standard assets, to the extent of one and one fourth percent of risk weighted assets;
 - (d) hybrid debt capital instruments; and
 - (e) subordinated debt,
- to the extent the aggregate does not exceed Tier I capital;
- (xiv) ‘ Turnover or business turnover’ means the total mortgage guarantee contracts entered during the year together with the volume of business arising out of other activities undertaken during the year;
- (2) Other words or expressions used but not defined herein and defined in the Reserve Bank of India Act, 1934 (2 of 1934) or Mortgage Guarantee Company (Reserve Bank) Guidelines, 2008 contained in Notification DNBS(PD)MGC)No.3 /CGM (PK) - 2008 dated February 15, 2008 shall have the same meaning as assigned to them under that Act or that Directions. Any other words or expressions not defined in that Act or that Directions, shall have the same meaning assigned to them in the Companies Act, 1956 (1 of 1956).

Income recognition

3. (i) Income including interest/discount or any other charges on an asset which is NPA or on an asset which is NPA and is taken over from creditor institution on happening of trigger event shall be recognised only on cash basis.
- (ii) A mortgage guarantee company shall account the premium or fee on the mortgage guarantee contracts as an income in the profit and loss account in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India. The amount of unearned premium shall be shown as a separate line on the liability side of the balance sheet.
- (iii) In respect of any other business undertaken by the mortgage guarantee company as specified in Section 45 I (c) of the RBI Act, 1934 within the permitted limit, income shall be recognised as per income recognition norms

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prescribed for such assets as contained in the "Non-Banking Financial (Non - Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007".

Accounting standards

4. Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these directions as "ICAI") shall be followed insofar as they are not inconsistent with any of the provisions of these directions.

Asset Classification

5. (1) Every mortgage guarantee company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify its 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.

* Assets acquired under guarantee obligations will not be classified as standard assets.

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

Provisioning requirements

6. (1) **Provision for losses on invoked guarantees:** A mortgage guarantee company is exposed to a potential loss when its guarantee is invoked. Mortgage guarantee companies shall hold provisions for losses in respect of such invoked guarantees pending recovery of assets. The amount of provisions required to be held shall be equal to the contract-wise aggregate of 'amount of invocation' after adjusting the realisable value of the assets held by the company in respect of each housing loan where the guarantee has been invoked. In case the realisable value of the assets held in respect of any invoked guarantee is more than the amount of invocation, the excess shall not be adjusted against the shortfall in other invoked guarantees. In case the amount of provisions already held is in excess of the amount as computed above, the excess shall not be reversed. The amount of

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provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of provision held for losses on settlement of invoked guarantees shall be shown as a separate line item on the liability side of the balance sheet.

(2) **Provision for 'Incurred But-Not-Reported (IBNR) losses':** A mortgage guarantee company is exposed to a potential loss when there is a default in a housing loan guaranteed by it. Mortgage guarantee companies shall hold provisions in respect of such defaulted housing loans where the trigger event is yet to occur or the guarantee is yet to be invoked. The potential loss to which the guarantee company is exposed to is referred to as 'Incurred-But-Not-Reported (IBNR) losses'. The amount of provisions required to be held shall be arrived at on an actuarial basis depending upon the estimates of loss frequency and loss severity for incurred but not reported losses which are derived from historic data, trends, economic factors and other statistical data in relation to paid claims, the provisions held for claims settled, risk statistics, etc. In case the amount of provisions already held is in excess of the amount as computed above, the excess shall not be reversed. The amount of provisions made each year shall be shown as a separate line item in the Profit and Loss Account. The amount of provision held for Incurred But-Not-Reported (IBNR) losses shall be shown as a separate line item on the liability side of the balance sheet.

(3) Subject to what has been mentioned above, every mortgage guarantee company 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 each class as provided hereunder :-

(4) **Mortgage guarantee assets**

The provisioning requirement in respect of mortgage guarantee assets shall be as under:

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| (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 should 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 |

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| | <p>which the mortgage guarantee company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis;</p> <p>(b) In regard to the secured portion, provision is to be made on the following basis to the extent of 20% to 100% of the secured portion depending upon the period for which the asset has remained doubtful:</p> <p>Period for which the asset has remained in doubtful category</p> <p>% of provision</p> <p>Up to one year 20 %</p> <p>One to three years 30%</p> <p>More than three years 100 %</p> |
| (iii) Sub-standard assets | A general provision of 10% of total outstanding shall be made. |
| For Standard Assets Standard asset | <p>Mortgage guarantee companies should make general provisions for standard asset on the following basis;</p> <p>(a) Guarantee cover for residential housing loans beyond Rs. 20 lakhs at 1%;</p> <p>(b) All other guarantee cover at 0.40%</p> |

Notes:

- (1) The provisions on standard asset should not be reckoned for arriving at net NPAs.
- (2) The provisions towards standard assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others' in the balance sheet.
- (3) It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding

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balances. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.

Other Activities

7. A mortgage guarantee company can take up any activity up to 10% of its total assets. If a mortgage guarantee company undertakes any other business as specified in 45I(c) of the RBI Act 1934 within the permitted limit, for which Prudential Norms are already prescribed and the same is contained in Notification No. DNBS. 193 DG(VL)-2007 dated February 22, 2007, as amended from time to time, the said norms for valuation of investments, asset classification and provisioning should be followed.

Accounting year

8. Every mortgage guarantee company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a mortgage guarantee company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.

Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the mortgage guarantee company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date.

Disclosure in the balance sheet

9. (1) Every mortgage guarantee company shall separately disclose in its balance sheet the provisions made as per paragraph 6 above without netting them from the income or against the value of assets.

(2) The provisions shall be distinctly indicated under separate heads of account separately for mortgage guarantee business and others and individually for each type of assets as under :-

- (i) provisions for bad and doubtful debts; and
- (ii) provisions for depreciation in investments.

(3) Such provisions for each year shall be made from the profit and loss account.

Constitution of Audit Committee by mortgage guarantee company

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10. Every mortgage guarantee company shall constitute an Audit Committee, consisting of not less than three non-executive Directors of the Board of its company, at least one of whom will be Chartered Accountant.

Explanation I: The Audit Committee constituted by a mortgage guarantee company as required under Section 292A of the Companies Act, 1956 (1 of 1956) shall be the Audit Committee for the purposes of this paragraph.

Explanation II: The Audit Committee constituted under this paragraph shall have the same powers, functions and duties as laid down in Section 292A of the Companies Act, 1956 (1 of 1956).

Transactions in Government securities

11. Every mortgage guarantee company may undertake transactions in Government securities through its CSDL account or its demat account:

Provided that no mortgage guarantee company shall undertake any transaction in government security in physical form through any broker.

Requirement as to capital adequacy

12. (1) Every mortgage guarantee company subject to the condition that the net owned fund shall be a minimum of 100 crore rupees or such other amount that Reserve Bank of India may specify from time to time, shall maintain, a minimum capital ratio consisting of Tier I and Tier II capital which shall not be less than ten per cent of its aggregate risk weighted assets of its on balance sheet and of risk adjusted value of off-balance sheet items. Of the required capital ratio, it shall maintain at least 6% of its aggregate risk weighted assets as Tier I.

(2) The total of Tier II capital, at any point of time, shall not exceed one hundred per cent of Tier I capital.

Explanations:

On balance sheet assets

(1) In these Directions, degrees of credit risk expressed as percentage weightages have been assigned to balance sheet assets. 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:

| Items of assets – On-Balance Sheet items | Risk weight %age |
|---|-----------------------------|
|---|-----------------------------|

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| (i) Cash | 0 |
| (ii) Bank balances and claims on banks including fixed deposits and certificates of deposits. | 20 |
| (iii) Investments | |
| (a) Central Government and State Government Securities | 0 |
| (b) Bonds of banks | 20 |
| (c) Fixed deposits/certificates of deposits/bonds of public financial institutions | 100 |
| (d) Shares of all companies | 100 |
| *and debentures/bonds/commercial papers of all companies and units of debt oriented/money market mutual funds | |

(*As per paragraph 3(ii) of Mortgage Guarantee Companies Investment (Reserve Bank) Directions, 2008 shares of corporates can be acquired only in satisfaction of debt)

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| (iv) Current assets | |
| (a) Loans and advances | 100 |
| (b) Loans to staff, if fully covered by superannuities, benefits & mortgage of flats/houses | 20 |
| (c) Other loans to staff | 100 |
| (d) Other secured loans and advances | 100 |
| (e) Others (including net stock on hire, bills purchased and discounted, etc.) | 100 |
| (v) Fixed Assets (net of depreciation) | |
| (a) Assets leased out (net book value) | 100 |
| (b) Premises | 100 |
| (c) Furniture & Fixtures | 100 |
| (d) Other fixed assets | 100 |
| (vi) 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 | 100 |

Notes:

- (1) Netting may be done only in respect of assets where provisions for depreciation or for bad and doubtful debts have been made.

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- (2) Assets which have been deducted from owned fund to arrive at net owned fund shall have a weightage of 'zero'.
- (3) While calculating the aggregate of funded exposure of a borrower for the purpose of assignment of risk weight, mortgage guarantee companies may net off the amount of cash margin/caution money/security deposits (against which right to set-off is available) held as collateral against the advances out of the total outstanding exposure of the borrower.

Off-balance sheet items

(2) In these Directions, degrees of credit risk exposure attached to off-balance sheet items have been expressed as percentage of credit conversion factor. Hence, the face value of each item requires to be first multiplied by the relevant conversion factor to arrive at credit equivalent value of off-balance sheet item. The credit equivalent value of each item shall have to be again multiplied by the risk weight as applicable to the respective counterparties. The aggregate risk weighted value shall be taken into account for reckoning the minimum capital ratio. The credit equivalent value of the off-balance sheet items shall be calculated as per the credit conversion factors for non-funded items as detailed hereunder:

| Nature of item | Credit conversion factor – Percentage |
|--|--|
| i) Financial & other guarantees | 100 |
| ii) Underwriting obligations in r/o capital investment such as shares/ debentures, etc | 50 |
| iii) Partly-paid shares/debentures | 100 |
| iv) Lease contracts entered into but yet to be executed | 100 |
| v) Other contingent liabilities | 50 |

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

Loans against Mortgage Guarantee Company's own shares prohibited

13. (1) No mortgage guarantee company shall lend against its own shares.

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(2) Any outstanding loan against its own shares shall be recovered by the mortgage guarantee company as per the repayment schedule before grant of Certificate of Registration to it.

Concentration of credit/investment

14. (1) No mortgage guarantee company shall lend to

- (a) any single borrower exceeding fifteen per cent of its owned fund; and
- (b) any single group of borrowers exceeding twenty five per cent of its owned fund.

(2) Every mortgage guarantee company shall formulate a policy in respect of exposures to a single party / a single group of parties.

Notes :

- (1) For determining the limits, off-balance sheet exposures shall be converted into credit risk by applying the conversion factors as explained above.
- (2) The investments in debentures for the purposes specified in this paragraph shall be treated as credit and not investment.
- (3) These ceilings shall be applicable to credit exposure by such a mortgage guarantee company to companies/firms in its own group as well as to the borrower company's group.

Information in regard to change of address, directors, auditors, etc. to be submitted

15. Every mortgage guarantee company shall communicate to Reserve Bank of India, not later than one month from the occurrence of any change in:

- (a) the complete postal address, telephone number/s and fax number/s of the registered/corporate office;
- (b) the names and residential addresses of the directors of the company;
- (c) the names and the official designations of its principal officers;
- (d) the names and office address of the auditors of the company; and
- (e) the specimen signatures of the officers authorised to sign on behalf of the company.

Exemptions

16. The Reserve Bank of India may, if it considers it necessary for avoiding any hardship or for any other just and sufficient reason, grant extension of time to comply with or exempt any mortgage guarantee company or class of mortgage guarantee companies, from all or any of the provisions of these instructions either generally or for any specified period, subject to such conditions as the Reserve Bank of India may impose.

Interpretations

17. For the purpose of giving effect to the provisions of these directions, the Reserve Bank of India may, if it considers necessary, issue necessary clarifications in respect of any matter covered herein and the interpretation of any provision of these directions given by the Reserve Bank of India shall be final and binding on all the parties concerned.

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| <p>16. Directions/instructions issued to the Securitisation Companies/ Reconstruction Companies</p> |
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Master Circular: RBI/2011-2012/16 DNBS (PD) CC. No. 27/SCRC/26.03.001/ 2011-2012 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6564

This Master circular contains the gist of all the circulars issued by RBI to Securitisation/ Reconstruction Companies. It includes

- (1) Submission of application for a Certificate of Registration to commence/carry on the business of a Securitisation Company or Reconstruction Company
- (2) Maintenance of minimum owned fund for carrying out the business of securitisation or asset reconstruction
- (3) Commencement of business by Securitisation Companies/Reconstruction Companies within 6 months of registration.
- (4) Submission of quarterly statements by Securitisation Companies/ Reconstruction Companies
- (5) Regulation of SCs/RCs-submission of returns and audited balance sheet by SCs/RCs within one month from the date of annual general meeting. in which the audited results are adopted.

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- (6) Investment in Security Receipts issued by the trusts floated by Securitisation Companies/Reconstruction Companies
- (7) Guidelines on Declaration of Net Asset Value of Security Receipts issued by Securitisation Company/Reconstruction Company
- (8) Regulation of SCs/RCs-disclosure while issuing Security Receipts (SRs)
- (9). Quarterly Statement to be submitted by Securitisation Companies/Reconstruction Companies registered with the Reserve Bank of India under Section 3(4) of the SARFAESI Act
- (10). 'Restructuring of loans by SC/RC' is one of the measures allowed to be undertaken by SC/RCs for realisation of their dues.
- (11) Resolution of acquired assets - Extension in time frame for redemption of security receipts (SRs) issued
- (12). Guidelines on Change in or Take Over of the Management of the Business of the Borrower by Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines, 2010
- (13) The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003
- (14) Securitisation Company or Reconstruction Company shall continue to hold a minimum of 5% of the Security Receipts of each class issued by the SC/RC under each scheme on an ongoing basis till the redemption of all the Security Receipts issued under such scheme.
- (15) All SC/RCs being 'credit institutions' are required to become a member of at least one credit information company as per the statute.
- (16) Setting up of Central Electronic Registry under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002

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| 17. The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 |
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Master Circular : RBI/2011-2012/35 DNBS (PD) CC. No. 25/SCRC / 26.03.001/ 2011-2012 dated July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6592

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The provisions of these guidelines and directions shall apply to Securitisation companies or Reconstruction Companies registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

- Every Securitisation Company or Reconstruction Company shall apply for registration in the form of application specified vide Notification No.DNBS.1/CGM(CSM)-2003, dated March 7, 2003 and obtain a certificate of registration from the Bank
- A Securitisation Company or Reconstruction Company shall commence business within six months from the date of grant of Certificate of Registration by the Bank;
Provided that on the application by the Securitisation Company or Reconstruction Company, the Bank may grant extension for such further period, not exceeding one year in aggregate from the date of grant of Certificate of Registration.
- Provisions of section 45 -IA, 45-IB and 45-IC of RBI Act,1934 shall not apply to non banking financial company, which is a securitisation company or reconstruction company registered with the Bank under section 3 of the SARFAESI Act,2002].
- A Securitisation Company or Reconstruction Company shall not raise monies by way of deposit.
- Every such company shall have a 'Financial Asset Acquisition Policy' and 'rescheduling of Debts' approved by its Board.
- Every Securitisation Company or Reconstruction Company shall maintain, on an ongoing basis, a capital adequacy ratio, which shall not be less than fifteen percent of its total risk weighted assets

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| 18. Regulatory Framework for Core Investment Company (CICs) |
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RBI/2011-12/31 DNBS (PD) CC No.237/03.02.001/2011-12 dated July 1, 2011

Link : http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6589

Core Investment companies are companies which have their assets predominantly as investments in shares for holding stake in group companies but not for trading, and also do not carry on any other financial activity

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The regulatory framework for the Core Investment Companies can be accessed at the above link or at

http://www.rbi.org.in/scripts/BS_NBFCNotificationView.aspx?Id=5944

In the case of Non Deposit taking Systematically Important Core Investment Companies, the above referred Regulatory framework requires an annual certificate from their statutory auditors regarding compliance with the above guidelines within one month from the date of finalisation of the balance sheet.

19. Infrastructure Finance Companies

RBI/2009-10/316 DNBS.PD. CC No.168/03.02.089 /2009-10 dt February 12 , 2010

Link: <http://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=5503&Mode=0>

Reserve Bank has classified NBFCs under three categories, viz., Asset Finance Companies, Loan companies and Investment Companies and have recently introduced a fourth category of NBFCs as "Infrastructure Finance Companies"(IFCs). An IFC is defined as non deposit taking NBFC that fulfils the criteria mentioned below:

- (i) a minimum of 75 per cent of its total assets should be deployed in infrastructure loans as defined in Para 2(viii) of the Non Banking Financial (Non Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;
- (ii) Net owned funds of Rs. 300 crore or above;
- (iii) minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA or equivalent rating by any other accrediting rating agencies
- (iv) CRAR of 15 percent (with a minimum Tier I capital of 10 percent)

20. 'Know Your Customer' (KYC) Guidelines – Anti Money Laundering Standards (AML) -'Prevention of Money Laundering Act, 2002 - Obligations of NBFCs in terms of Rules notified there under'

Master Circular : RBI/2011-12/25 DNBS (PD) CC No.231/03.10.42/2011-12 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6575

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NBFCs are required to put in place a KYC policy with the approval of the Board. The information collected from the client should be kept confidential.

The guidelines are to be adhered by the brokers / agents etc. of the NBFC.

As an extension of the KYC Guidelines, NBFCs should put in place a process of due diligence in respect of persons authorised by NBFCs including brokers/agents etc. collecting deposits on behalf of the company through a uniform policy for appointment and detailed verification.

All deposit receipts should bear the name and Registered Office address of the NBFC and must invariably indicate the name and other details of the persons authorised by NBFCs including brokers/agents etc.

There may be relaxation in the KYC procedures for a depositor if the total balance in all their accounts does not exceed Rs 50000 and the total credit in all the accounts would not exceed Rs 100000 in a year.

It may be appreciated that KYC norms/AML standards/CFT measures have been prescribed to ensure that criminals are not allowed to misuse the banking/financial channels. It would, therefore, be necessary that adequate screening mechanism is put in place by NBFCs as an integral part of their recruitment/hiring process of personnel.

21. Corporate Governance

Master circular - RBI/2011-12/28 - DNBS (PD) CC No. 234 / 03.10.001 / 2011-12 July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6584

(a) Rotation of partners of the statutory auditors audit firm - with public deposits/ deposits of Rs 50 crore and above

The partner/s of the Chartered Accountant firm conducting the audit could be rotated every three years so that same partner does not conduct audit of the company continuously for more than a period of three years. However, the partner so rotated will be eligible for conducting the audit of the NBFC after an interval of three years, if the NBFC, so decides. Companies may incorporate appropriate terms in the letter of appointment of the firm of auditors and ensure its compliance.

Circular reference RBI/2005-06/ 232 DNBS (PD).CC. No. 61 / 02.82 / 2005-06 dt December 12, 2005

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=2661&Mode=0>

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(b) Guidelines on Corporate Governance

NBFCs are essentially corporate entities. Listed NBFCs which are required to adhere to listing agreement and rules framed by SEBI on Corporate Governance are already required to comply with SEBI prescriptions on Corporate Governance. . In order to enable NBFCs to adopt best practices and greater transparency in their operations following guidelines are proposed for consideration of the Board of Directors of all Deposit taking NBFCs with deposit size of Rs 20 crore and above and all non-deposit taking NBFCs with asset size of Rs 100 crore and above (NBFC-ND-SI).

Constitution of Audit Committee

- (i) In terms of extant instructions, an NBFC having assets of Rs. 50 crore and above as per its last audited balance sheet is already required to constitute an Audit Committee, consisting of not less than three members of its Board of Directors, the instructions shall remain valid.
- (ii) In addition, NBFC-D with deposit size of Rs 20 crore may also consider constituting an Audit Committee on similar lines.

Constitution of Nomination Committee

The importance of appointment of directors with 'fit and proper' credentials is well recognised in the financial sector. In terms of Section 45-IA (4) (c) of the RBI Act, 1934, while considering the application for grant of Certificate of Registration to undertake the business of non-banking financial institution it is necessary to ensure that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the interest of its present and future depositors. In view of the interest evinced by various entities in this segment, it would be desirable that NBFC-D with deposit size of Rs 20 crore and above and NBFC-ND-SI may form a Nomination Committee to ensure 'fit and proper' status of proposed/existing Directors.

Constitution of Risk Management Committee

The market risk for NBFCs with Public Deposit of Rs.20 crore and above or having an asset size of Rs.100 crore or above as on the date of last audited balance sheet is addressed by the Asset Liability Management Committee (ALCO) constituted to monitor the asset liability gap and strategize action to mitigate the risk associated. To manage the integrated risk, a risk management committee may be formed, in addition to the ALCO in case of the above category of NBFCs.

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Disclosure and transparency

The following information should be put up by the NBFC to the Board of Directors at regular intervals as may be prescribed by the Board in this regard:

- progress made in putting in place a progressive risk management system, and risk management policy and strategy followed
- conformity with corporate governance standards viz. in composition of various committees, their role and functions, periodicity of the meetings and compliance with coverage and review functions, etc.

Connected Lending

RBI has received suggestions in the matter with reference to paragraph 2(vi) of the circular dated May 28, 2007 containing instructions on connected lending. The suggestions are being studied and the instructions contained in paragraph 2 (vi) of the said circular will become operational after final evaluation of the suggestions and modifications, if any considered necessary.

NBFCs shall frame their internal guidelines on corporate governance, enhancing the scope of the guidelines without sacrificing the spirit underlying the above guidelines and it shall be published on the company's web-site, if any, for the information of various stakeholders.

Details in DNBS.PD/ CC 94 / 03.10.042 /2006-07 dated May 8, 2007 read with

(Link : <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=3499&Mode=0>)

DNBS.PD/ CC 104 / 03.10.042 /2007-08 dated July 11, 2007

Link : <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=3706&Mode=0>

22. Fair Practice Code

Master Circular : RBI/2011-12/26 DNBS (PD) CC No. 232/03.10.042/2011-12 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6583

The Reserve Bank of India, being satisfied that for the purpose of enabling it to regulate the credit system of the country to its advantage, it is necessary to do, hereby, in exercise of powers conferred under Section 45 L of the Reserve Bank of India Act, 1934 (Act 2 of 1934) and of all the powers enabling it in this behalf, hereby prescribes the broad guidelines on fair

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practices that are to be framed and approved by the Board of Directors of all Non- Banking Financial Companies (including RNBCs). The fair practices code so framed and approved by the Board of Directors should be published and disseminated on the web-site of the company, if any, for the information of the public. The Fair Practices Code based on guidelines given below were to be put in place by all NBFCs with the approval of their Boards within one month from the date of issue of the circular dated September 28, 2006.

The guidelines include the following

- (i) Requirements in the applications for loans and their processing
- (ii) Loan appraisal and terms/conditions- The NBFCs should convey in writing to the borrower by means of sanction letter or otherwise, the amount of loan sanctioned along with the terms and conditions including annualised rate of interest and method of application thereof and keep the acceptance of these terms and conditions by the borrower on its record.
- (iii) Disbursement of loans including changes in terms and conditions
- (iv) General guidelines like- NBFC to refrain from interference in the affairs of the borrower
- (v) Creating a grievance redressal mechanism to resolve disputes
- (vi) Keep a track on interest charged and to refrain from charging excessive interest rate
- (vii) Boards of NBFCs are advised to lay out appropriate internal principles and procedures in determining interest rates and processing and other charges.

The Board of each NBFC shall adopt an interest rate model taking into account relevant factors such as, cost of funds, margin and risk premium, etc and determine the rate of interest to be charged for loans and advances

The rate of interest should be annualised rates so that the borrower is aware of the exact rates that would be charged to the account.

- (viii) Clarification regarding repossession of vehicles financed by the NBFCs- repossession clause should be built in the loan/ borrowing agreement.

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| 23. Frauds – Future approach towards monitoring of frauds in NBFCs |
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Master Circular: RBI/2011-12/23 DNBS.PD.CC. No.229/03.10.042/2011-12
July 1, 2011

Link: http://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6586

Applicable to All Deposit taking NBFCs (including RNBCs)

1. Introduction

1.1 Incidence of frauds in NBFCs is a matter of concern. While the primary responsibility for preventing frauds lies with NBFCs themselves, a reporting system for frauds is prescribed in the following paragraphs, which may be adopted by NBFCs.

1.2 It is possible that frauds are, at times, detected in NBFCs long after their perpetration. NBFCs should, therefore, ensure that a reporting system is in place so that frauds are reported without any delay. NBFCs should fix staff accountability in respect of delays in reporting of fraud cases to the Reserve Bank.

1.3 Delay in reporting of frauds and the consequent delay in alerting other NBFCs about the modus operandi and issue of caution advices against unscrupulous borrowers could result in similar frauds being perpetrated elsewhere. NBFCs may, therefore, strictly adhere to the timeframe fixed in this circular for reporting fraud cases to the Reserve Bank failing which NBFCs would be liable for penal action as prescribed under the provisions of Chapter V of the RBI Act, 1934.

1.4 NBFCs should specifically nominate an official of the rank of General Manager or equivalent who will be responsible for submitting all the returns referred to in this circular.

1.5 It may be noted that NBFCs are not required to submit 'Nil' reports to Frauds Monitoring Cell/Regional Offices of Department of Non-Banking Supervision. At the same time enough precautions may be taken by deposit-taking NBFCs to ensure that the cases reported by them are duly received by Frauds Monitoring Cell/Regional Offices of Department of Non-Banking Supervision as the case may be.

2. Classification of Frauds

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2.1 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.

2.2 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 Rs.10,000/- and
- (b) cases of cash shortages more than Rs. 5000/- if detected by management /auditor / inspecting officer and not reported on the occurrence by the persons handling cash.

2.3 NBFCs having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the Reserve Bank as per the format and procedure detailed under Paragraph 3 below.

3. Reporting of Frauds to Reserve Bank of India

3.1 Frauds involving Rs. 1 lakh and above

3.1.1 Fraud reports should be submitted in all cases of fraud of Rs. 1 lakh and above perpetrated through misrepresentation, breach of trust, manipulation of books of account, fraudulent encashment of FDRs unauthorised handling of securities charged to the NBFC, misfeasance, embezzlement, misappropriation of funds, conversion of property, cheating, shortages, irregularities, etc.

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3.1.2 Fraud reports should also be submitted in cases where central investigating agencies have initiated criminal proceedings suo moto and/or where the Reserve Bank has directed that they be reported as frauds.

3.1.3 NBFCs may also report frauds perpetrated in their subsidiaries and affiliates/joint ventures. Such frauds should, however, not be included in the report on outstanding frauds and the quarterly progress reports referred to in paragraph 4 below. (DNBS PD CC No 127/03.10.42/2008-09 dated August 14, 2008)

3.1.4 The fraud reports in the prescribed format should be sent to the Central Office (CO) of the Reserve Bank of India, Department of Banking Supervision, Frauds Monitoring Cell where the amount involved in fraud is Rs 25 lakhs and above and to Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls where the fraud amount involved in fraud is less than Rs 25 lakh, in the format given in FMR – 1, within three weeks from the date of detection.

A copy of FMR-1 where the amount involved in the Fraud is Rs 25 lakhs and above should also be submitted to the Regional Office of the Department of Non-Banking Supervision of Reserve Bank of India under whose jurisdiction the Registered Office of the NBFC falls.

3.2 Frauds committed by unscrupulous borrowers

3.2.1 It is observed that a large number of frauds are committed by unscrupulous borrowers including companies, partnership firms/proprietary concerns and/or their directors/partners by various methods including the following :

- (i) Fraudulent discount of instruments.
- (ii) Fraudulent removal of pledged stocks/disposing of hypothecated stocks without the NBFC's knowledge/inflating the value of stocks in the stock statement and drawing excess finance.
- (iii) Diversion of funds outside the borrowing units, lack of interest or criminal neglect on the part of borrowers, their partners, etc. and also due to managerial failure leading to the unit becoming sick and due to laxity in effective supervision over the operations in borrowal accounts on the part of the NBFC functionaries rendering the advance difficult of recovery.

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3.2.2 In respect of frauds in borrowal accounts, additional information as prescribed under Part B of FMR-1 should also be furnished. (DNBS.PD.CC. No 127 /03.10.42/2008-09 dated August 14, 2008)

3.3 Frauds involving Rs. 25 lakh and above

In respect of frauds involving Rs. 25 lakh and above, in addition to the requirements given at paragraphs 3.1 and 3.2 and above, NBFCs may report the fraud by means of a D.O. letter addressed to the Chief General Manager-in-charge of the Department of Banking Supervision, Reserve Bank of India, Frauds Monitoring Cell, Central Office and a copy endorsed to the Chief General Manager-in-charge of the Department of Non-Banking Supervision, Reserve Bank of India, Central Office within a week of such frauds coming to the notice of the NBFC. The letter may contain brief particulars of the fraud such as amount involved, nature of fraud, modus operandi in brief, name of the branch/office, names of parties involved (if they are proprietorship/partnership concerns or private limited companies, the names of proprietors, partners and directors), names of officials involved, and whether the complaint has been lodged with the Police. A copy of the D.O. letter should also be endorsed to the Regional Office of Reserve Bank, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC is functioning.

3.4 Cases of attempted fraud

Cases of attempted fraud, where the likely loss would have been Rs. 25 lakh or more, had the fraud taken place, should be reported to the Central Office of the Reserve Bank, Department of Banking Supervision, Frauds Monitoring Cell and a copy endorsed to Central Office of the Reserve Bank, Department of Non-Banking Supervision indicating the modus operandi and how the fraud was detected. Such cases should not be included in the other returns to be submitted to the Reserve Bank.

4. Quarterly Returns

4.1 Report on Frauds Outstanding

4.1.1 NBFCs should submit a copy of the Quarterly Report on Frauds Outstanding in the format given in FMR – 2 to the Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls irrespective of amount within 15 days of the end of the quarter to which it relates.

4.1.2 Part A of the report covers details of frauds outstanding as at the end of the quarter. Parts B and C of the report give category-wise and

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perpetrator-wise details of frauds reported during the quarter respectively. The total number and amount of fraud cases reported during the quarter as shown in Parts B and C should tally with the totals of columns 4 and 5 in Part – A of the report.

4.1.3 NBFCs should furnish a certificate, as part of the above report, to the effect that all individual fraud cases of Rs. 1 lakh and above reported to the Reserve Bank in FMR – 1 during the quarter have also been put up to the NBFC's Board and have been incorporated in Part – A (columns 4 and 5) and Parts B and C of FMR – 2.

4.2 Progress Report on Frauds

4.2.1 NBFCs should furnish case-wise quarterly progress reports on frauds involving Rs. 1 lakh and above in the format given in FMR – 3 to the Central Office (CO) of the Reserve Bank of India, Department of Banking Supervision, Frauds Monitoring Cell where the amount involved in fraud is Rs 25 lakhs and above and to Regional Office of the Reserve Bank of India, Department of Non-Banking Supervision under whose jurisdiction the Registered Office of the NBFC falls where the fraud amount involved in fraud is less than Rs 25 lakh within 15 days of the end of the quarter to which it relates.

4.2.2 In the case of frauds where there are no developments during a quarter, a list of such cases with a brief description including name of branch and date of reporting may be furnished as per FMR – 3.

5. Reports to the Board

5.1 Reporting of Frauds

5.1.1 NBFCs should ensure that all frauds of Rs. 1 lakh and above are reported to their Boards promptly on their detection.

5.1.2 Such reports should, among other things, take note of the failure on the part of the concerned officials, and consider initiation of appropriate action against the officials responsible for the fraud.

5.2 Quarterly Review of Frauds

5.2.1 Information relating to frauds for the quarters ending March, June and September may be placed before the Board of Directors during the month following the quarter to which it pertains.

5.2.2 These should be accompanied by supplementary material analysing statistical information and details of each fraud so that the Board would have

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adequate material to contribute effectively in regard to the punitive or preventive aspects of frauds.

5.2.3 All the frauds involving an amount of Rs 25 lakh and above should be monitored and reviewed by the Audit Committee of the Board (ACB) or if ACB is not there, other Committee of the Board of NBFCs. The periodicity of the meetings of the Committee may be decided according to the number of cases involved. However, the Committee should meet and review as and when a fraud involving an amount of Rs 25 lakh and above comes to light.

5.3 Annual Review of Frauds

5.3.1 NBFCs should conduct an annual review of the frauds and place a note before the Board of Directors for information. The reviews for the year-ended December may be put up to the Board before the end of March the following year. Such reviews need not be sent to RBI. These may be preserved for verification by the Reserve Bank's inspecting officers.

5.3.2 The main aspects which may be taken into account while making such a review may include the following :

- (a) Whether the systems in the NBFC are adequate to detect frauds, once they have taken place, within the shortest possible time.
- (b) Whether frauds are examined from staff angle.
- (c) Whether deterrent punishment is meted out, wherever warranted, to the persons found responsible.
- (d) Whether frauds have taken place because of laxity in following the systems and procedures and, if so, whether effective action has been taken to ensure that the systems and procedures are scrupulously followed by the staff concerned.
- (e) Whether frauds are reported to local Police, as the case may be, for investigation.

5.3.3 The annual reviews should also, among other things, include the following details:

- (a) Total number of frauds detected during the year and the amount involved as compared to the previous two years.
- (b) Analysis of frauds according to different categories detailed in Paragraph 2.1 and also the different business areas indicated in the Quarterly Report on Frauds Outstanding (vide FMR – 2).

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- (c) Modus operandi of major frauds reported during the year along with their present position.
- (d) Detailed analyses of frauds of Rs. 1 lakh and above.
- (e) Estimated loss to the NBFC during the year on account of frauds, amount recovered and provisions made.
- (f) Number of cases (with amounts) where staff are involved and the action taken against staff.
- (g) Time taken to detect frauds (number of cases detected within three months, six months and one year of their taking place).
- (h) Position with regard to frauds reported to Police.
- (i) Number of frauds where final action has been taken by the NBFC and cases disposed of.
- (j) Preventive/punitive steps taken by the NBFC during the year to reduce/minimise the incidence of frauds.

6. Guidelines for Reporting Frauds to Police

NBFCs should follow the following guidelines for reporting of frauds such as unauthorised credit facilities extended by the NBFC for illegal gratification, negligence and cash shortages, cheating, forgery, etc. to the State Police authorities :

- (a) In dealing with cases of fraud/embezzlement, NBFCs should not merely be actuated by the necessity of recovering expeditiously the amount involved, but should also be motivated by public interest and the need for ensuring that the guilty persons do not go unpunished.
- (b) Therefore, as a general rule, the following cases should invariably be referred to the State Police :
 - (i) Cases of fraud involving an amount of Rs. 1 lakh and above, committed by outsiders on their own and/or with the connivance of NBFC staff/officers.
 - (ii) Cases of fraud committed by NBFC employees, when it involves NBFC funds exceeding Rs. 10,000/-.

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| 24. Exemptions from RBI Act, 1934 |
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Master Circular : RBI/2011-12/22 DNBS.PD. CC.No.228 /03. 02.004 / 2011-12 dated July 1, 2011

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Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6573

1. Introduction

The Bank has issued notifications from time to time exempting some entities from the requirements of Chapter III B of the RBI Act, 1934 or part thereof. While the Master Circular has been prepared to enable the users to have the benefit of a consolidated circular for the purpose of operations, they should refer to the instructions / directions contained in the relevant notifications. The Master Circular is based on notifications listed in the Annex.

2 (i) Exemption from provisions of Chapter III B of the RBI Act, 1934 – Housing Finance Institutions.

The Bank has exempted a non-banking financial company which is a housing finance institution as defined in Section 2(d) of the National Housing Bank Act, 1987 from the provisions of Chapter III B of the RBI Act, 1934.

(Notification DFC(COC) No 112 ED(SG)/97 read with circular DFC(COC) No. 4438/02.04/96-97 dated June 18, 1997)

2(ii) Merchant Banking Company

(Notification No. DFC 123/ED(G)-98, dated February 3, 1998,

Notification DFC(COC) No 118 DG(SPT)-98 dated January 31, 1998

Notification DFC(COC) No 119 DG(SPT)-98 dated January 31, 1998)

A merchant banking company has been exempted from the provisions of Section 45-IA [Requirement of registration and net owned fund], Section 45-IB [Maintenance of liquid assets] and 45-IC [Creation of Reserve Fund] of the RBI Act, 1934, Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 subject to compliance with the following conditions:

- (a) It is registered with the Securities and Exchange Board of India as a Merchant Banker under Section 12 of the Securities and Exchange Board of India Act, 1992 and is carrying on the business of merchant Banker in accordance with the Securities and Exchange Board of India Merchant Banking (Rules) 1992 and Securities and Exchange Board of India Merchant Banking (Regulations) 1992;
- (b) acquires securities only as a part of its merchant banking business;
- (c) does not carry on any other financial activity referred to in Section 45I(c) of the RBI Act, 1934; and

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- (d) does not accept or hold public deposits as defined in paragraph 2(1)(xii) of the Notification No. DFC 118/DG(SPT)-98 dated January 31, 1998.

2 (iii) Micro Finance Companies

Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 (2 of 1934) shall not apply to any non-banking financial company, which is

- (a) engaged in micro financing activities, providing credit not exceeding Rs. 50,000 for a business enterprise and Rs. 1,25,000 for meeting the cost of a dwelling unit to any poor person for enabling him to raise his level of income and standard of living; and
- (b) licensed under Section 25 of the Companies Act, 1956; and
- (c) not accepting public deposits as defined in paragraph 2(1)(xii) of Notification No. 118 /DG(SPT)-98 dated January 31, 1998.

{Microfinancing activities - Notification No.DNBS.138/CGM(VSNM)-2000 read with DNBS.(PD).CC.No. 12 /02.01/99-2000dated January 13, 2000}

Mutual Benefit Companies

Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 (2 of 1934) shall not apply to any non-banking financial company which

• being a mutual benefit company as defined in paragraph 2(1) (ixa) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 contained in Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998). A “mutual benefit company” means a company not notified under section 620A of the Companies Act, 1956 (1 of 1956) and carrying on the business of a non-banking financial institution, -

- (a) on 9th January 1997; and
- (b) having the aggregate of net owned funds and preferential share capital of not less than ten lakhs of rupees; and
- (c) has applied for issue of certificate of registration to the Bank on or before 9th July 1997; and
- (d) is complying with the requirements contained in the relevant provisions of the Directions issued under Section 637A of the Companies Act, 1956 to Nidhi Companies by the Central Government.

2(iv) Government Companies

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Sections 45-IB and 45-IC of the Reserve Bank of India Act, 1934 (2 of 1934), paragraphs 4 to 7 of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998 (since repealed by Prudential Norms Directions Notification No 192 dated February 22, 2007), except paragraph 13 A of the said directions relating to submission of information to Reserve Bank in regard to change of address, directors, auditors, etc. shall not apply to any non-banking financial company as defined in section 45-I(f) of the Reserve Bank of India Act, 1934 (2 of 1934) being a Government company as defined in section 617 of the Companies Act, 1956. A Government Company is a company in which not less than 51% of the paid up capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments and includes a company which is subsidiary of a Government Company as thus defined.

(Notification No.DNBS.134, 135, 138/CGM(VSNM)-2000 read with DNBS.(PD).CC.No. 12 /02.01/99-2000dated January 13, 2000)

2(v) Venture Capital Fund Companies

(Notification No.DNBS.163/CGM(CSM)-2002 read with DNBS(PD)CC No.22 /02.59/ 2002-03 dated November 28, 2002)

Section 45-IA and Section 45-IC of the Reserve Bank of India Act, 1934 (2 of 1934); Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998; and Notification No. DFC.119 / DG(SPT)-98 dated January 31, 1998 shall not apply to a non-banking financial company, which is a venture capital fund company holding a certificate of registration obtained under Section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) and not holding or accepting public deposit as defined in paragraph 2(1)(xii) of the Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998.

2(vi) Insurance/Stock Exchange/Stock Broker/Sub-Broker

The provisions of Section 45-IA, 45-IB, 45-IC, 45MB and 45MC of the Reserve Bank of India Act, 1934 (2 of 1934) and provisions of Non-Banking Financial Companies Acceptance of Public Deposit (Reserve Bank) Directions contained in Notification No. DFC.118 / DG(SPT)-98 dated January 31, 1998, "Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007" shall not apply to any non-banking financial company not holding or accepting public

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deposit as defined in paragraph 2(1)(xii) of the Notification No. DFC.118/DG(SPT)-98 dated January 31, 1998, and -

- (a) doing the business of insurance, holding a valid certificate of registration issued under Section 3 of the Insurance Act, 1938 (IV of 1938);
- (b) being a stock exchange, recognised under Section 4 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) ; and
- (c) doing the business of a stock-broker or sub-broker holding a valid certificate of registration obtained under Section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

(Insurance - Notification No.DNBS.164/CGM(CSM)-2003 read with DNBS (PD) CC No. 23 / 01.18 / 2002-03 dated January 8, 2003)

2(vii) Nidhi Companies

(Notification No.DNBS.164/CGM(CSM)-2003 read with DNBS (PD) CC No. 23 / 01.18 / 2002-03 dated January 8, 2003)

The provisions of Sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 (2 of 1934) shall not apply to any non-banking financial company

- (a) Notified under Section 620A of the Companies Act, 1956 (1 of 1956), known as Nidhi Companies;

And

[“The provisions contained in Non-Banking Financial Companies Acceptance of Company; Public Deposits (Reserve Bank) Directions, 1998 shall not apply to a Mutual Benefit Financial Company or a Mutual Benefit company

Provided that the application of Mutual Benefit Company is not rejected by Government of India under the provisions of the Companies Act, 1956(Act 1 of 1956).”]

Chit Companies

- (b) doing the business of chits, as defined in clause (b) of Section 2 of the Chit Funds Act, 1982 (No. 40 of 1982).

Securitisation and Reconstruction Companies

(Notification No.DNBS. 3/CGM(OPA)-2003 dated August 28, 2003)

- (c) Securitisation company or Reconstruction company registered with the Reserve Bank of India under Section 3 of the Securitisation and

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Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Mortgage Guarantee Companies

(Notification No. DNBS.(MGC) 2/CGM(PK)-2008 read with DNBS (PD)(MGC) CC No. 111 / 03.11.001 / 2007-08 dated January 15, 2008)

(d) Mortgage Guarantee Companies notified as non-banking financial company in terms of Section 45 I (f)(iii) of the Reserve Bank of India Act, 1934 (2 of 1934) with the prior approval of the Central Government, and a company registered with the Bank under the scheme for registration of Mortgage Guarantee Companies.

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| 25. Notification of change in or take over of management of the business of the borrower by securitisation and reconstruction companies (Reserve Bank) Guidelines, 2010 |
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Master Circular : RBI/2011-2012/36 DNBS (PD) CC. No. 26/SCRC /26.03.001/ 2011-2012 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6587

RBI has notified the above said guidelines, framed under Section 9(a) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) to provide for the proper management of the business of the borrower to enable the Securitisation Company or Reconstruction Company (SC/RC) to realise their dues from the borrowers, by effecting change in or take over of the management of the business of the borrower and related matters.

SC/RCs shall report to the Bank all cases where they have taken action to cause change in or take over the management of the business of the borrower for realization of its dues from the borrower in terms of circular DNBS (PD) CC. No.12 / SCRC / 10.30.000/ 2008-2009 dated September 26, 2008.

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| 26. Allied activities- entry into insurance business, issue of credit card and marketing and distribution of certain products |
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Master Circular : RBI/2011-12/27 DNBS (PD) CC No. 233/03.10.001/2011-12 dated July 1, 2011

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Link : http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6577

- (a) NBFCs registered with Reserve Bank of India may take up insurance agency business on fee basis and without risk participation, without the approval of Reserve Bank of India subject to the certain conditions; Statutory auditor certificate is required while filing the application with RBI.

[Details in DNBS.(PD).CC. No. 13 /02.01/99-2000 dated June 30, 2000, DNBS(PD).CC.No.18/02.01/2001-02 dated January 1, 2002 read with DNBS (PD) C.C. No. 35 / 10.24 / 2003-04 dated February 10, 2004]

- (b) NBFCs are allowed to take up credit card business with RBI approval subject to compliance with terms and conditions. However NBFCs are not permitted to issue debit cards, smart cards, stored value cards, charge cards, etc.

[Details in DNBS (PD) C.C. No. 41/10.27/2004-05 dated July 7, 2004, DBOD.FSD.BC. 49/ 24.01.011/ 2005-06 dated November 21, 2005]

[Details in DNBS (PD) CC No. 83/03.10.27/ 2006-07 dated December 04, 2006]

- (b) NBFCs are allowed to market mutual fund products.

[Details in DNBS (PD) CC No. 84/ 03.10.27/2006-07 dated December 04, 2006]

27. NBFCs-ND-SI issuing guarantees - Applicability of exemption from Concentration norms

RBI/2010-11/110 DNBS.PD/ CC.No.190 /03.02.002/2010-11 dated July 9, 2010

Link : http://www.rbi.org.in/scripts/BS_NBFCNotificationView.aspx?Id=5867

Non deposit taking, systematically important NBFCs can make an application to RBI for modifications in the prescribed ceilings with regard to Concentration of credit / investment norms.

28. Opening of Branch-Subsidiary-Joint Venture-Representative office or Undertaking Investment Abroad by NBFCs

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Master Circular : RBI/2011-12/101 DNBS (PD) CC No. 238/03.02.001/2011-12 dated July 1, 2011

Link: http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=6563

1. No NBFC shall open subsidiaries/joint ventures/representative office abroad or shall make investment in any foreign entities without obtaining prior approval in writing from the Reserve Bank of India. The application from the NBFC seeking No Objection would be considered subject to these directions.

2. These directions are in addition to those prescribed by Foreign Exchange Department for opening of branches abroad or for investments in Joint Venture/Wholly Owned Subsidiary.

29. Implementation of Green Initiative of the Government

RBI/2011-12/237 DNBS(PD).CC. No 248/03.10.01 /2011-12 dated October 28 , 2011

Link : http://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=6783

For better utilisation of resources and better delivery of services, NBFCs are requested to take proactive steps to increase the use of electronic payment systems, elimination of post-dated cheques and gradual phase-out of cheques in their day to day business transactions. These will result in more cost-effective transactions and faster and accurate settlements.

30. NBFCs - Infrastructure Debt Funds (IDFs)

RBI/2011-12/268 DNBS.PD.CC.No.249/03.02.089/2011-12 dated November 21, 2011

Link: http://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?Id=6830

The Finance Minister had in his budget speech for the year 2011-2012 announced the setting up of The Reserve Bank had vide its Press Release dated September 23, 2011, issued broad parameters for banks and NBFCs to set up IDFs. Detailed guidelines are set out in the following paragraphs prescribing the regulatory framework for Non Banking Financial Companies (NBFCs) to sponsor IDFs which are to be set up as Mutual Funds (MFs) and NBFCs. Such entities would be designated as “Infrastructure Debt Fund – Mutual Funds (IDF-MF) and “Infrastructure Debt Fund – Non-Banking Financial Company (IDF-NBFC)”. All NBFCs, including Infrastructure Finance Companies (IFCs) registered with the Bank may sponsor IDFs to be set up as Mutual Funds. However, only IFCs can sponsor IDF-NBFCs.

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Eligibility Parameters for NBFCs as Sponsors of IDF-MFs

3. All NBFCs would be eligible to sponsor (sponsorship as defined by SEBI Regulations for Mutual Funds) IDFs as Mutual Funds with prior approval of RBI subject to the following conditions, in addition to those prescribed by SEBI, in the newly inserted Chapter VI B to the MF Regulations :

- i. The NBFC should have a minimum Net Owned Funds (NOF) of Rs. 300 crore and Capital to Risk Weighted Assets (CRAR) of 15%;
- ii. Its net NPAs should be less than 3% of net advances;
- iii. It should have been in existence for at least 5 years.
- iv. It should be earning profits for the last three years and its performance should be satisfactory;
- v. The CRAR of the NBFC post investment in the IDF-MF should not be less than the regulatory minimum prescribed for it;
- vi. The NBFC should continue to maintain the required level of NOF after accounting for investment in the proposed IDF and
- vii. There should be no supervisory concerns with respect to the NBFC.

Eligibility Parameters for IFCs setting up IDF-NBFCs

4. Only NBFC-IFCs can sponsor IDF-NBFC with prior approval of the Reserve Bank and subject to the following conditions.

- i. Sponsor IFCs would be allowed to contribute a maximum of 49 percent to the equity of the IDF-NBFCs with a minimum equity holding of 30 percent of the equity of IDF-NBFCs,;
- ii. Post investment in the IDF-NBFC, the sponsor NBFC-IFC must maintain minimum CRAR and NOF prescribed for IFCs
- iii. There are no supervisory concerns with respect to the IFC.

Tripartite Agreement

5. IDF-NBFCs will enter into Tripartite Agreements to which, the Concessionaire, the Project Authority and IDF-NBFC shall be parties. Tripartite Agreement binds all the parties thereto to the terms and conditions of the other Agreements referred to therein also and which collectively provide, inter alia, for the following:-

- i. take over a portion of the debt of the Concessionaire availed from Senior Lenders,

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- ii. a default by the Concessionaire, shall trigger the process for termination of the agreement between Project Authority and Concessionaire,
 - iii. the Project Authority shall redeem the bonds issued by the Concessionaire which have been purchased by IDF-NBFC, from out of the termination payment as per the Tripartite Agreement and other Agreements referred to therein (compulsory buyout),
 - iv. the fee payable by IDF-NBFC to the Project Authority as mutually agreed upon between the two.
6. NBFC and IFCs that fulfill the eligibility criteria as above may approach the Central Office of the Department of Non-Banking Supervision, Reserve Bank of India, Centre I, World Trade Centre, Cuffe Parade, Mumbai – 400 005 for sponsoring IDFs as MFs and NBFCs, as applicable.

Investment by NBFCs and IFCs in IDFs

7. The exposure of sponsor NBFCs / IFCs and non-sponsor NBFCs / IFCs to the equity and debt of the IDFs would be governed by the extant credit concentration norms as given in para 18 of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
8. Notification containing the detailed guidelines issued with regard to regulation of IDF-NBFCs viz; DNBS.PD.No.233/CGM (US)-2011, dated November 21, 2011 are enclosed for meticulous compliance. As regards foreign exchange related aspects of the functioning of IDF-NBFCs, a separate circular is being issued.

b. Fair Practices in Lending

I. Transparency in Interest Rates

- a. There shall be only three components in the pricing of the loan viz., the interest charge, the processing charge and the insurance premium (which includes the administrative charges in respect there of).
- b. There will be no penalty charged on delayed payment.
- c. NBFC-MFIs shall not collect any Security Deposit/ Margin from the borrower.
- d. There should be a standard form of loan agreement.
- e. Every NBFC-MFI should provide to the borrower a loan card reflecting
 - (i) the effective rate of interest charged
 - (ii) all other terms and conditions attached to the loan
 - (iii) information which adequately identifies the borrower and
 - (iv) acknowledgements by the NBFC-MFI of all repayments including instalments received and the final discharge.
 - (v) all entries in the Loan Card should be in the vernacular language.
- f. The effective rate of interest charged by the NBFC-MFI should be prominently displayed in all its offices and in the literature issued by it and on its website.

II. Multiple-lending, Over-borrowing and Ghost-borrowers

- a. NBFC-MFIs can lend to individual borrowers who are not member of Joint Liability Group(JLG)/Self Help Group(SHG) or to borrowers that are members of JLG/SHG.
- b. a borrower cannot be a member of more than one SHG/JLG.
- c. not more than two NBFC-MFIs should lend to the same borrower.
- d. there must be a minimum period of moratorium between the grant of the loan and the due date of the repayment of the first instalment. The moratorium shall not be less than the

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frequency of repayment. For eg: in the case of weekly repayment, the moratorium shall not be less than one week.

- e. recovery of loan given in violation of the regulations should be deferred till all prior existing loans are fully repaid.
- f. All sanctioning and disbursement of loans should be done only at a central location and more than one individual should be involved in this function. In addition, there should be close supervision of the disbursement function.

III. Non- Coercive Methods of Recovery

- NBFC-MFIs shall ensure that a Code of Conduct and systems are in place for recruitment, training and supervision of field staff. The Code of Conduct should also incorporate the Guidelines on Fair Practices Code issued for NBFCs vide circular CC No.80 dated September 28, 2006 as amended from time to time.
- Recovery should normally be made only at a central designated place. Field staff shall be allowed to make recovery at the place of residence or work of the borrower only if borrower fails to appear at central designated place on 2 or more successive occasions.
- All other elements of the Fair Practices Code issued for NBFCs vide CC No 80 dated September 28, 2006 as amended from time to time shall be adhered to.

c. Corporate Governance

The Master Circular issued for NBFCs on Corporate Governance vide CC No. 187 dated July 01, 2011 shall be applicable to NBFC-MFIs also.

d. Improvement of Efficiency

NBFC-MFIs shall review their back office operations and make the necessary investments in Information Technology and systems to achieve better control, simplify procedures and reduce costs.

e. Others

All NBFCs may refer to the circular RPCD.CO.Plan BC. 66 /04.09.01/2010-11 dated May 3, 2011 issued by the Rural Planning and Credit Department of RBI titled "Bank loans to Micro Finance Institutions (MFIs) – Priority Sector status" issued to banks with regard to guidelines on priority sector.

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5. Existing NBFCs that satisfy the above conditions may approach the Regional Office in the jurisdiction of which their Registered Office is located, along with the original Certificate of Registration (CoR) issued by the Bank for change in their classification as NBFC-MFIs. Their request must be supported by their Statutory Auditor's certificate indicating the asset (loan) pattern as on March 31, 2011. The onus of including only eligible assets for the purpose of classification as NBFC-MFI shall be that of the company concerned. The change in classification would be incorporated in the Certificate of Registration issued by the Bank as NBFC-MFI.

6. In terms of paragraph 15 of the Non-Banking Financial (Non-Deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 all NBFCs are required to submit Statutory Auditors Certificate with reference to the position of the company as at end of the financial year ended March 31 every year. For an NBFC-MFI, such Certificate will also indicate that the company fulfils all conditions stipulated to be classified as an NBFC-MFI in this circular.

7. Non-compliance with these Directions shall invite penal provisions under the RBI Act, 1934.

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| 31. Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs |
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RBI/2011-12/316 DNBS.CC.PD.No.252/03.10.01/2011-12 dated December 26, 2011

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=6892>

To introduce greater granularity in the risk weights and credit conversion factors for different types of off balance sheet items, NBFCs will need to calculate the total risk weighted off-balance sheet credit exposure as the sum of the risk-weighted amount of the market related and non-market related off-balance sheet items. The risk-weighted amount of an off-balance sheet item that gives rise to credit exposure will be calculated by means of a two-step process :

- a. the notional amount of the transaction is converted into a credit equivalent amount, by multiplying the amount by the specified credit conversion factor or by applying the current exposure method; and
- b. the resulting credit equivalent amount is multiplied by the applicable risk weight.

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For the off-balance sheet items already contracted by NBFCs, the risk weights shall be applicable with effect from the Financial Year beginning April 01, 2012. For all new contracts undertaken including CDS, the new risk weights shall be applicable from the date of the circular.

The amending Notifications DNBS.PD.No.237/ CGM (US) 2011 and DNBS.PD.No. 238/CGM (US) 2011 both dated December 26, 2011 amending the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) directions, 2007 and the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 respectively are enclosed with the circular.

32. Revised Capital Adequacy Framework for Off-Balance Sheet Items for NBFCs-Clarification

RBI/2011-12/333 DNBS.CC.PD.No.254/03.10.01/2011-12 dated December 30, 2011

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=6914>

Paragraph 16(2) of Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007(hereinafter referred to as the said Directions), contained in Notification No. DNBS. 192/DG(VL)-2007 dated February 22, 2007 has been replaced with the following:

“E. Credit conversion factors for Credit Default Swaps (CDS):

NBFCs are only permitted to buy credit protection to hedge their credit risk on corporate bonds they hold. The bonds may be held in current category or permanent category. The capital charge for these exposures will be as under:

- (i) For corporate bonds held in current category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, the credit protection will be permitted to be recognised to a maximum of 80% of the exposure hedged. Therefore, the NBFC will continue to maintain capital charge for the corporate bond to the extent of 20% of the applicable capital charge. This can be achieved by taking the exposure value at 20% of the market value of the bond and then multiplying that with the risk weight of the issuing entity. In addition to this, the bought CDS position will attract a capital charge for counterparty risk which will be calculated by applying a credit conversion factor of 100 percent and a risk weight as applicable to

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the protection seller i.e. 20 per cent for banks and 100 per cent for others.

- (ii) For corporate bonds held in permanent category and hedged by CDS where there is no mismatch between the CDS and the hedged bond, NBFCs can recognise full credit protection for the underlying asset and no capital will be required to be maintained thereon. The exposure will stand fully substituted by the exposure to the protection seller and attract risk weight as applicable to the protection seller i.e. 20 per cent for banks and 100 per cent for others.

The Notifications DNBS.PD.No.239/ CGM (US) 2011 and DNBS.PD.No. 240/CGM (US) 2011 both dated December 30, 2011 amending the Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, (as amended vide Notifications.No.237 and No. 238 both dated December 26, 2011) are enclosed with this circular.

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| 33. Monitoring of frauds- All Non-Deposit taking NBFCs with asset size of Rs.100 crore and above and Deposit taking NBFCs |
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RBI/2011-12/424 DNBS.PD.CC. No. 256 /03.10.042 / 2011-12 dated March 02, 2012

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7037>

All NBFCs-ND-SI are advised to follow the Guidelines which inter alia, stipulate that individual cases of frauds involving amount less than Rs. 25 lakhs shall be reported to the respective Regional Offices(ROs) of DNBS in whose jurisdiction registered office of the company is located whereas individual cases of frauds involving amount of Rs. 25 lakhs and above may be reported to RBI.

Additionally, all non-deposit taking NBFCs with asset size of Rs.100 crore and above and deposit taking NBFCs shall disclose the amount related to fraud, reported in the company for the year in their balance sheets. As envisaged in the CC dated October 26, 2005, it is reiterated that NBFCs failing to report fraud cases to the Reserve Bank would be liable for penal action prescribed under the provisions of Chapter V of the RBI Act, 1934.

34. Non- Reckoning Fixed Deposits with Banks as Financial Assets

RBI/2011-12/446 DNBS (PD)CC.No.259 /03.02.59/2011-12 dated March 15, 2012

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7063>

1. In terms of Section 45IA (1) of the RBI Act 1934, no non-banking financial company shall commence business or carry on the business of a non-banking financial institution without (a) obtaining a certificate of registration (CoR) from the Reserve Bank and (b) having a net owned fund of twenty five lakh rupees, which was increased to Rs. 200 lakh with effect from April 21, 1999.

2. It has, however, come to the notice of the Reserve Bank that some NBFCs obtain registration from the Bank, park their funds in fixed deposits with commercial banks but do not commence NBFI activities for several years thereafter. The Auditors of the companies have in these cases also certified that the companies are conducting NBFI activities, justifying the continued holding of the CoR issued by the Bank.

3. It is clarified, that the Reserve Bank issues a Certificate of Registration for the specific purpose of conducting NBFI activities. Investments in fixed deposits cannot be treated as financial assets and receipt of interest income on fixed deposits with banks cannot be treated as income from financial assets as these are not covered under the activities mentioned in the definition of “financial Institution” in Section 45I(c) of the RBI Act 1934. Besides, bank deposits constitute near money and can be used only for temporary parking of idle funds, and/or in the above cases, till commencement of NBFI business.

4. In addition, the NBFC which is in receipt of a CoR from the Bank must necessarily commence NBFC business within six months of obtaining CoR. If the business of NBFC is not commenced by the company within the period of six months from the date of issue of CoR, the CoR will stand withdrawn automatically. Further, there can be no change in ownership of the NBFC prior to commencement of business and regularization of its CoR.

35. Lending Against Security of Single Product – Gold Jewellery

RBI/ 2011-12/467 DNBS.CC.PD.No.265/03.10.01/2011-12 dated March 21, 2012

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Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Mode=0&Id=7086>

All NBFCs shall maintain a Loan-to-Value(LTV) ratio not exceeding 60 percent for loans granted against the collateral of gold jewellery and disclose in their balance sheet the percentage of such loans to their total assets.

NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of their financial assets) shall maintain a minimum Tier I capital of 12 percent by April 01, 2014.

NBFCs should not grant any advance against bullion / primary gold and gold coins.

36. Foreign investment in NBFC Sector under the FDI Scheme – Clarification

RBI/2011-12/562 A.P. (DIR Series) Circular No. 127 dated May 15, 2012

Link: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=7216&Mode=0>

RBI has clarified that the activity 'leasing and finance', which is one among the eighteen NBFC activities wherein FDI up to 100 per cent is permitted under the automatic route, subject to minimum capitalisation norms, covers only 'financial leases' and not 'operating leases', in so far as the NBFC sector is concerned.

ICAI Announcement dated September 18, 2007

http://www.icai.org/resource_file/7945announ1158.pdf

ANNOUNCEMENT

For the Immediate Attention of the Members Audits of NBFCs

Non Banking Finance Companies (NBFCs) are playing a vital role as the financial resource mobilised in India given the country's geographical and population spread. However, having regard to the locations at which they generally operate, the type of clientele they serve and the some of instances of fraudulent/ mismanaged NBFCs, the Reserve Bank of India (RBI) established a strict regulatory framework for operation of NBFCs. Annual statutory audit of the NBFCs, including the NBFC Auditor's Report

(Reserve Bank) Directions, 1998 constitutes important pillar of that framework. The aforesaid Directions include a number of reporting responsibilities, including making of exception reports, for the statutory auditors of NBFCs.

The Institute of Chartered Accountants of India has recently received a communication from the Department of Non Banking Supervision of the RBI

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in respect of audit of NBFCs. In its said communication the Reserve Bank of India has given an illustrative inclusive list of irregularities in NBFCs, required to be reported by the statutory auditors of NBFCs in terms of the requirements of the aforesaid Directions, but one or more of which have not been reported by some of the statutory auditors.

The abovementioned list is as follows:

- Net Owned Funds below the minimum required level not reported
- Item not eligible for inclusion in 'Free Reserve' for the purpose of calculation of Net Owned Fund not excluded nor reported e.g. Share Premium included in Free Reserve in case where the shares are redeemable at premium and the NBFC has not created any redemption reserve.
- Company engaged in the business of Non-Banking Financial Institution without obtaining Certificate of Registration from the Reserve Bank of India.
- Failure to comply with the prudential in terms of the Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007 and Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007.
- Non-reporting of downgrading of credit rating of deposit-taking NBFCs having bearing on the quantum of deposits permissible under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- Failure to report passing of Board Resolution by NBFCs (Non Deposit Taking) that they shall not accept public deposits.
- Failure to report acceptance of deposit by the NBFCs in excess of the quantum of deposits permitted in terms of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998.
- Failure to report adherence to conditions subject to which a company is classified as Core Investment Company.

Members are requested to take note of the above.