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

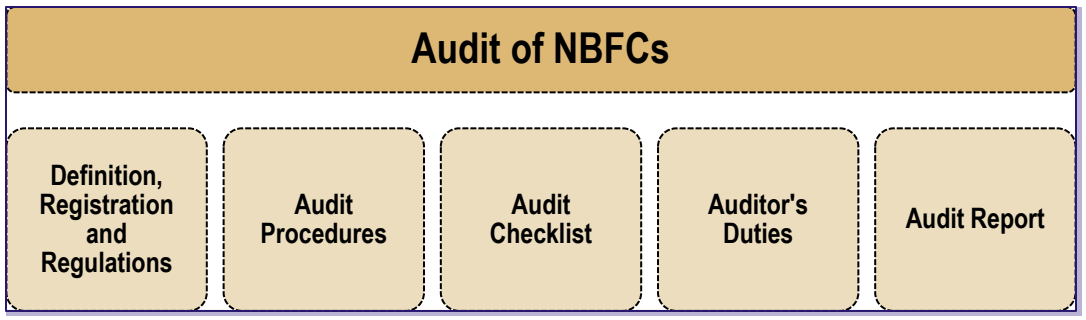
LEARNING OUTCOMES

After studying this chapter, you will be able to:

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

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UNIT OVERVIEW



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

As part of understanding NBFCs, Sachet found such entities to be comprehensively regulated by the Reserve Bank of India. They have to obtain certificate of registration to commence business of non-banking financial institution. RBI has issued various Master Directions, Directions and regulatory frameworks governing acceptance of public deposits, capital adequacy, risk exposure and other measures to monitor financial solvency and reporting.

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

Whereas upper layer comprises of NBFCs specifically identified by RBI for enhanced regulatory requirement, top layer would ideally remain empty unless RBI is of the opinion

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that there is substantial increase in potential systemic risk from specific NBFCs in upper layer. Not in the upper layer published by RBI, he was trying to confirm classification of this very auditee company in accordance with such regulations.

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

1. INTRODUCTION

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



Fig. : NBFCs*



Fig.: Audit of NBFCs*

Definition of NBFC: 45 I(f) of Reserve Bank of India (Amendment) Act, 1997 defines a non-banking financial company as:

(i) A financial institution which is a company;

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

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

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



Fig. : What is NBFC*

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

** Source: Slideshare*

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Registration and Regulation of NBFC:

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

- obtaining a certificate of registration issued by the Reserve Bank of India and
- having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify.
- Provided that the Bank may notify different amount of net owned fund for different categories of non-banking financial companies.

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

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

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

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

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

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

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Types of NBFCs- Compliance and Regulatory Perspective:

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

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

NBFCs mandated to register under RBI

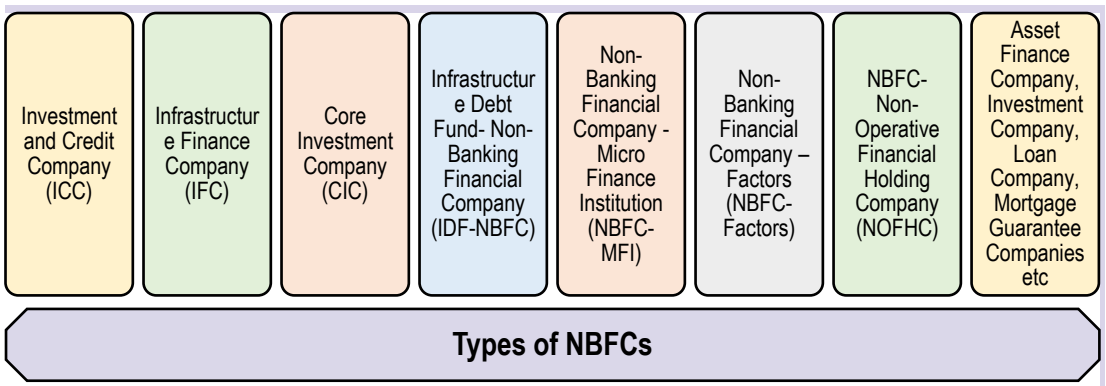
NBFCs registered with RBI are categorized as follows:

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

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

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

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



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

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A. Companies exempted from registration under RBI

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

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

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

RBI has different facets of existing NBFC Classification and regulation like Capital Requirements, Governance Standards, Prudential Regulations, etc. based on four layers that are defined based on their size, activity, and perceived riskiness.

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

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

Details of NBFCs populating the various layers is mentioned below:

Base Layer

The Base Layer shall comprise of (a) non-deposit taking NBFCs below the asset size of ₹1000 crore and (b) NBFCs undertaking the following activities- (i) NBFC-Peer to Peer Lending Platform (NBFC-P2P), (ii) NBFC-Account Aggregator (NBFC-AA), (iii) Non-Operative Financial Holding Company (NOFHC) and (iv) NBFCs not availing public funds and not having any customer interface.

Middle Layer

The Middle Layer shall consist of (a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size, (b) non-deposit taking NBFCs with asset size of ₹1000 crore and above and (c) NBFCs undertaking the following activities (i) Standalone Primary Dealers (SPDs), (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs), (iii) Core Investment Companies (CICs), (iv) Housing Finance Companies (HFCs) and (v) Infrastructure Finance Companies (NBFC-IFCs).

Upper Layer

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

Top Layer

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

Registration Exemption for Certain NBFCs as per Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025

While the Registration Directions 2025 themselves introduced no substantive change from the SBR Directions 2023, a subsequent and significant amendment was introduced vide Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation Amendment Directions, 2026, issued on 29 April 2026, effective from 01 July 2026.The Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation Amendment Directions, 2026 introduced a three-category definitional framework:

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1. *Unregistered (Type I – Exempt): Non-deposit-taking NBFCs with no public funds, no customer interface, and asset size below ₹1,000 crore are exempted from the provisions of Sections 45IA and 45IC of the RBI Act. Such existing NBFCs, including those holding a Certificate of Registration as Type I NBFC, can apply for deregistration by 31 December 2026.*

2. *Type I NBFC (Registered): Non-deposit-taking NBFCs with no public funds and no customer interface, but with an asset size exceeding ₹1,000 crore, continue to require registration.*

3. *Type II NBFC (Registered): NBFCs that avail public funds or have a customer interface, regardless of asset size, continue to require registration.*

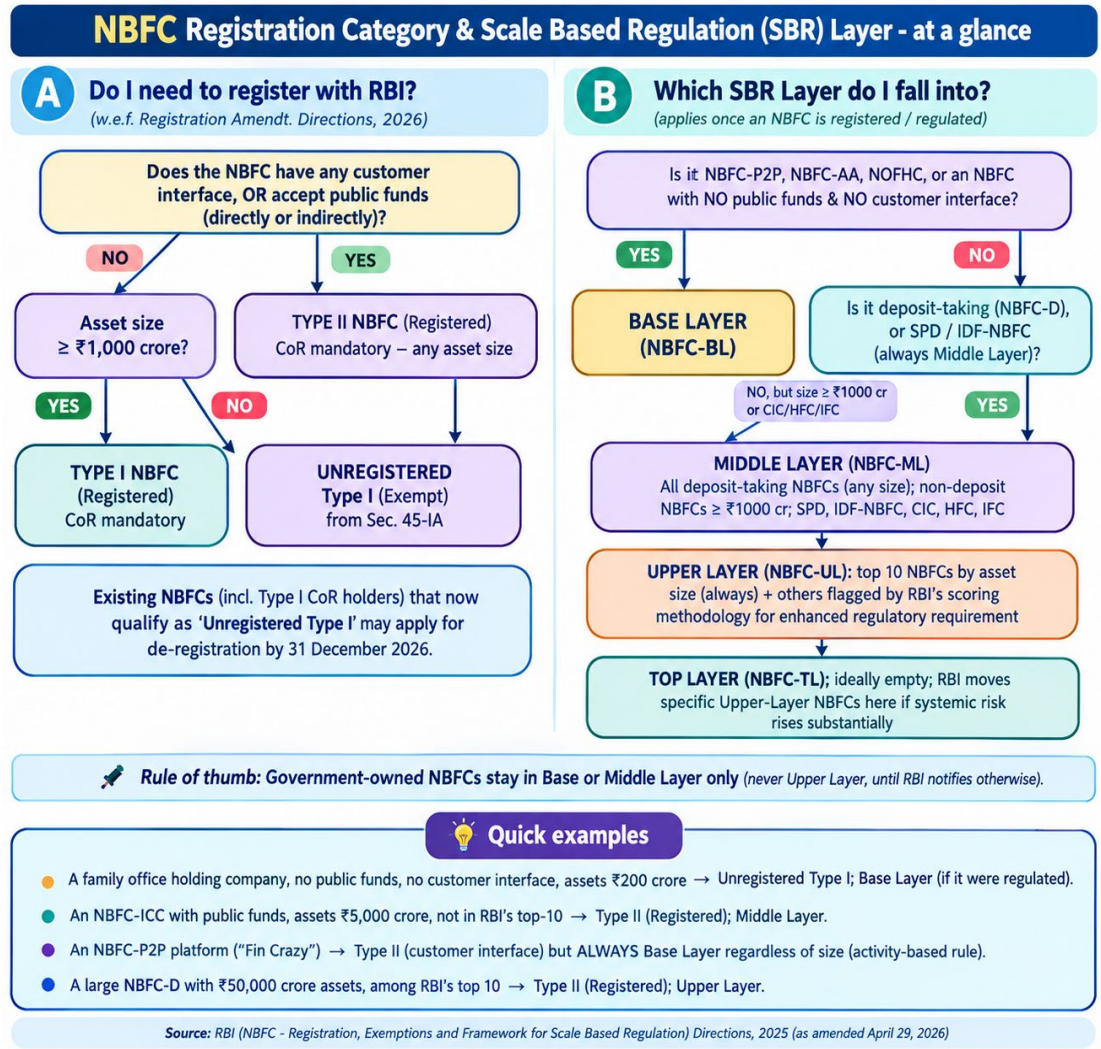
This is a material departure from the position under the SBR Directions 2023, which did not provide for any such statutory exemption from registration for non-public fund, non-customer-facing NBFCs below the ₹1,000 crore threshold.

This deregulation specifically targets micro-NBFCs, private investment vehicles, holding companies, and family offices that previously bore the disproportionate administrative and financial compliance burden of maintaining a CoR simply because their balance sheets mathematically satisfied the 50-50 Test. The new three-tier registration model summary:

Classification Category	Customer Interface Requirement	Acceptance of Public Funds	Asset Size Threshold	RBI Registration Status
Unregistered Type I NBFC	Strictly None	Strictly None (Direct or Indirect)	Less than ₹1,000 crore	Exempt from Section 45-IA
Type I NBFC	Strictly None	Strictly None (Direct or Indirect)	Greater than ₹1,000 crore	Mandatory (CoR Required)
Type II NBFC	Permitted	Permitted	Any Asset Size	Mandatory (CoR Required)

It may be noted that activity-based categorisation operates in conjunction with Scale Based Regulation. Accordingly, the applicable regulatory layer depends upon both the nature of activity and the scale/risk profile prescribed by RBI.

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Categorisation of NBFCs carrying out specific activity

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

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

(b) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.

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(c) The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.

(d) Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice.

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

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

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

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

Student may note that existing NBFCs that have not achieved the prescribed Net Owned Fund requirement should comply with the applicable RBI transition framework, wherever permitted.

2. DIFFERENCE BETWEEN BANKS AND NBFCS

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

i. NBFC cannot accept demand deposits, however some NBFCs can accept Term Deposits;

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;

iii. The deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation (DICGC) is not available to depositors of NBFCs, unlike in case of banks.

iv. No Minimum Exposure to Priority Sector required by NBFCs.

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3. PRUDENTIAL NORMS

Prudential Norms are intended to ensure the financial soundness, transparency, and resilience of NBFCs through requirements relating to income recognition, asset classification, provisioning, capital adequacy and exposure norms.

3.1 Capital Requirements

Every applicable NBFC as defined in the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 shall maintain the minimum capital ratios given below, depending on the layer in which it is placed under the Scale Based Regulation (SBR) framework (see flow chart):

With effect from November 28, 2025 (as updated up to July 01, 2026), the RBI (Non-Banking Financial Companies – Prudential Norms on Capital Adequacy) Directions, 2025 prescribe the capital adequacy requirement on a layer-wise basis under the Scale Based Regulation (SBR) framework, summarised below (see flow chart) –

(a) NBFC primarily engaged in lending against gold jewellery (such loans comprising 50 percent or more of its financial assets), irrespective of layer: minimum Tier 1 capital 12 percent and minimum CRAR 15 percent of aggregate risk weighted assets (Tier 2 capital shall not, at any time, exceed 100 percent of Tier 1 capital);

(b) NBFC – Middle Layer (NBFC-ML) and above (other than gold-jewellery lending NBFCs covered in (a) above): minimum Tier 1 capital 10 percent and minimum CRAR 15 percent of aggregate RWAs (Tier 2 capital ≤ 100 percent of Tier 1 capital);

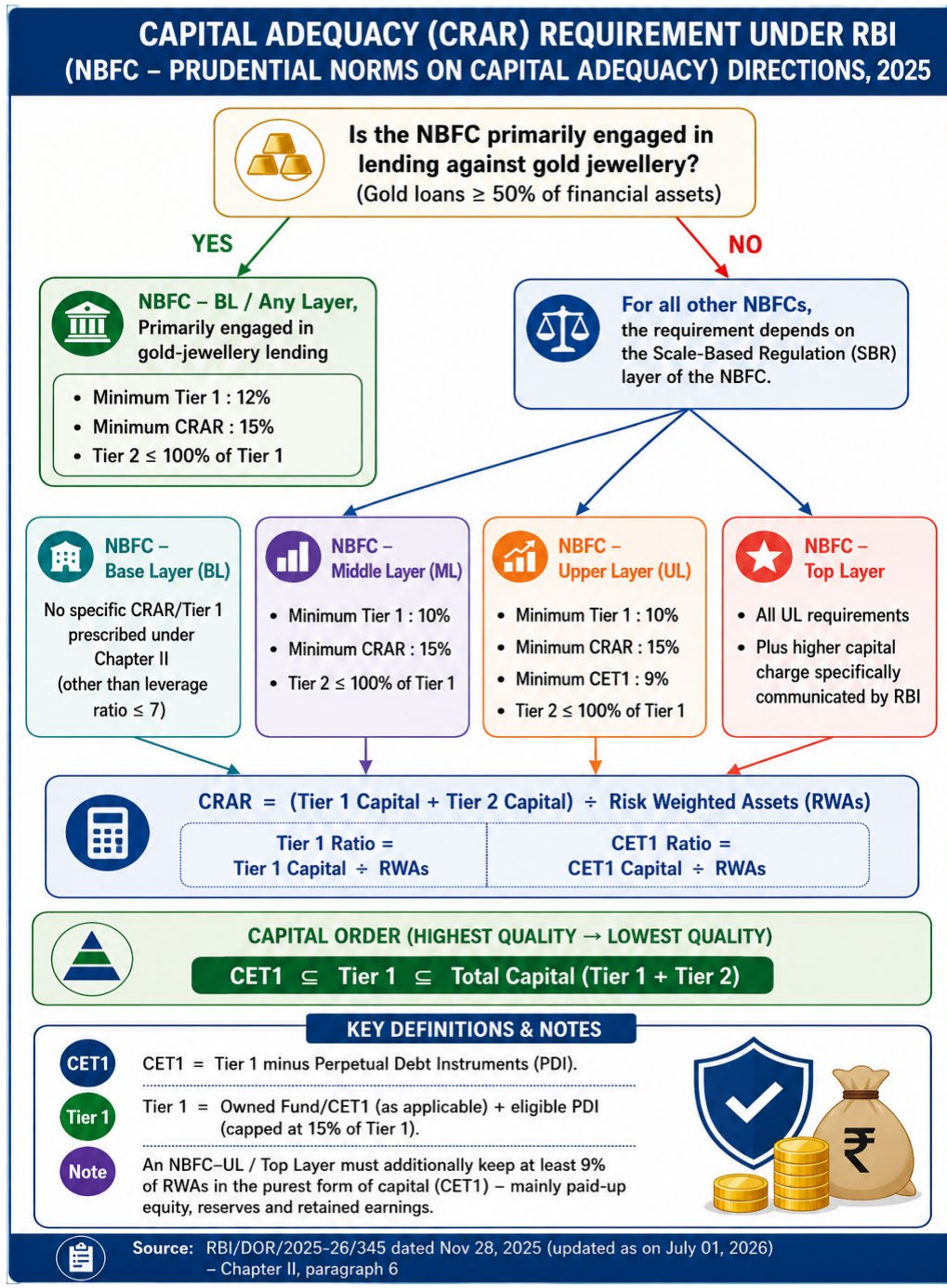
(c) NBFC – Upper Layer (NBFC-UL): all the requirements at (b) above PLUS a minimum Common Equity Tier 1 (CET1) capital of 9 percent of aggregate RWAs. CET1 is the highest-quality slice of Tier 1 capital – broadly, paid-up equity capital, share premium, statutory/capital/other free reserves and retained earnings, less specified regulatory deductions (e.g. goodwill, intangibles, certain DTAs);

(d) NBFC – Top Layer: all the requirements at (c) above, PLUS a higher capital charge specifically communicated by the RBI to the NBFC at the time of its classification in the Top Layer; and

(e) NBFC – Base Layer (other than gold-jewellery lending NBFCs): no specific CRAR/Tier 1 ratio is prescribed under Chapter II of the Directions; however, its Leverage Ratio (Total Outside Liabilities ÷ Owned Fund) shall not exceed 7 at any point of time.

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CRAR = (Tier 1 Capital + Tier 2 Capital) ÷ Risk Weighted Assets (RWAs); Tier 1 Capital Ratio = Tier 1 Capital ÷ RWAs; CET1 Capital Ratio = CET1 Capital ÷ RWAs.



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

(i) Owned fund as reduced by investment in shares of other NBFCs and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund; and

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

Notes –

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

2. Common Equity Tier 1 (CET1) capital: CET1 is Tier 1 capital as computed above, further reduced by items such as Perpetual Debt Instruments (PDI) included in Tier 1, goodwill and other intangible assets, specified deferred tax assets, and other regulatory deductions. An NBFC-UL and an NBFC in the Top Layer must additionally maintain CET1 of at least 9 percent of aggregate RWAs [see (c) and (d) above]; this requirement does not apply to NBFC-BL and NBFC-ML.

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

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

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

(iii) General provisions (including that for Standard Assets) and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and 1.25% of risk weighted assets;

(iv) Hybrid debt capital instruments;

(v) Subordinated debt; and

Provided that book value of subordinated debt shall be subject to discounting as provided under

Remaining Maturity of the instruments	***Rate of discount***
Up to one year	***100%***
More than one year but up to two years	***80%***

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More than two years but up to three years	*60%*
More than three years but up to four years	*40%*
More than four years but up to five years	*20%*

to the extent such discounted value does not exceed fifty percent of Tier 1 capital; and

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

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

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

Note for Students : For in-depth understanding s***tudent may refer the detailed Directions issued by RBI available on https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12959***

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

S. No.	Weighted risk assets - On-Balance Sheet items	Percentage weight
(i)	Cash and bank balances including fixed deposits and certificates of deposits with banks	0
(ii)	**Investments:**	
	(a) Approved securities [Except at (c) below]	***0***
	(b) Bonds of public sector banks	*20*
	(c) Fixed deposits/certificates of deposits/bonds of public financial institutions	*100*
	(d) Shares of all companies and debentures / bonds/ commercial papers of all companies and units of all mutual funds	*100*
	[(e) (i) Loans to 'High-quality infrastructure projects' as defined in the Reserve Bank of India (Non-Banking Financial Companies - Concentration Risk Management) Directions, 2026 and where the borrower has repaid at least 2 per cent of the sanctioned project debt.	***75***

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	(ii) Loans to 'High-quality infrastructure projects' as defined in the Reserve Bank of India (Non-Banking Financial Companies - Concentration Risk Management) Directions, 2026 and where the borrower has repaid at least 5 per cent of the sanctioned project debt. ***Provided that, for sl no.(e)(i) and (e)(ii) above, in the event the projects that qualify as High-quality infrastructure projects subsequently fail to meet these conditions, they shall be subject to risk weights prescribed under Sr. no.3(e) or (g), as applicable, of this table.*** ***Provided further that for sl no.(e)(i) and (e)(ii) above the repayment threshold should be determined based on the sanctioned project debt. Additional debt, if any, sanctioned as a part of takeover of the loan or otherwise should be clubbed with previous loan(s) sanctioned against the project assets and/or cash flows to determine the repayment threshold.*** ***Provided further that, in case of exposures attracting a lower risk weight under the guidelines applicable up to March 31, 2026, but will be subject to higher risk weights in terms of sl no.(e)(i) and (e)(ii) above, NBFCs can continue to maintain the extant risk weights till the next review / renewal or March 31, 2027, whichever is earlier.***	***50***
(iii)	**Current assets/*Other Financial Assets*:**	
	(a) Stock on hire (net book value)	100
	(b) Intercorporate loans/deposits	100
	(c) Loans and advances fully secured against deposits held	0
	(d) Loans to staff	0
	(e) Other secured loans and advances considered good	100
	(i) Consumer credit exposure (outstanding as well as new) categorised as retail loans, excluding housing loans, educational loans, vehicle loans, loans against gold jewellery and microfinance/SHG loans	***125***

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	(ii) Credit Card Receivables	***125***
	[Except at (vi) below]	
	(f) Bills purchased/discounted	100
	(g) Others (To be specified)	100
(iv)	**Fixed Assets (net of depreciation):**	
	(a) Assets leased out (net book value)	100
	(b) Premises	100
	(c) Furniture & Fixture	100
(v)	**Other assets:**	
	(a) Income tax deducted at source (net of provision)	0
	(b) Advance tax paid (net of provision)	0
	(c) Interest due on Government securities	0
	(d) Others (to be specified) ***(including ROU Assets)***	100
(vi)	**Domestic Sovereign:**	
	(a) Fund based claims on the Central Government	0
	(b) Direct loan / credit / overdraft exposure and investment in State Government securities	0
	(c) Central Government guaranteed claims	0
	(d) State Government guaranteed claims, which have not remained in default / which are in default for a period not more than 90 days	20
	(e) State Government guaranteed claims, which have remained in default for a period of more than 90 days	100

3.2 Income Recognition

The income recognition shall be based on recognised accounting principles. Income including interest/ discount/ hire charges/ lease rentals or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.

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

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

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(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets.

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

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

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

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

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

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

(iii) Doubtful Asset shall mean:

(a) a term loan, or

(b) a lease asset, or

(c) a hire purchase asset, or

(d) any other asset,

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

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(iv) Loss Asset shall mean:

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

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

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

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

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

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

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

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

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

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

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

(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.

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

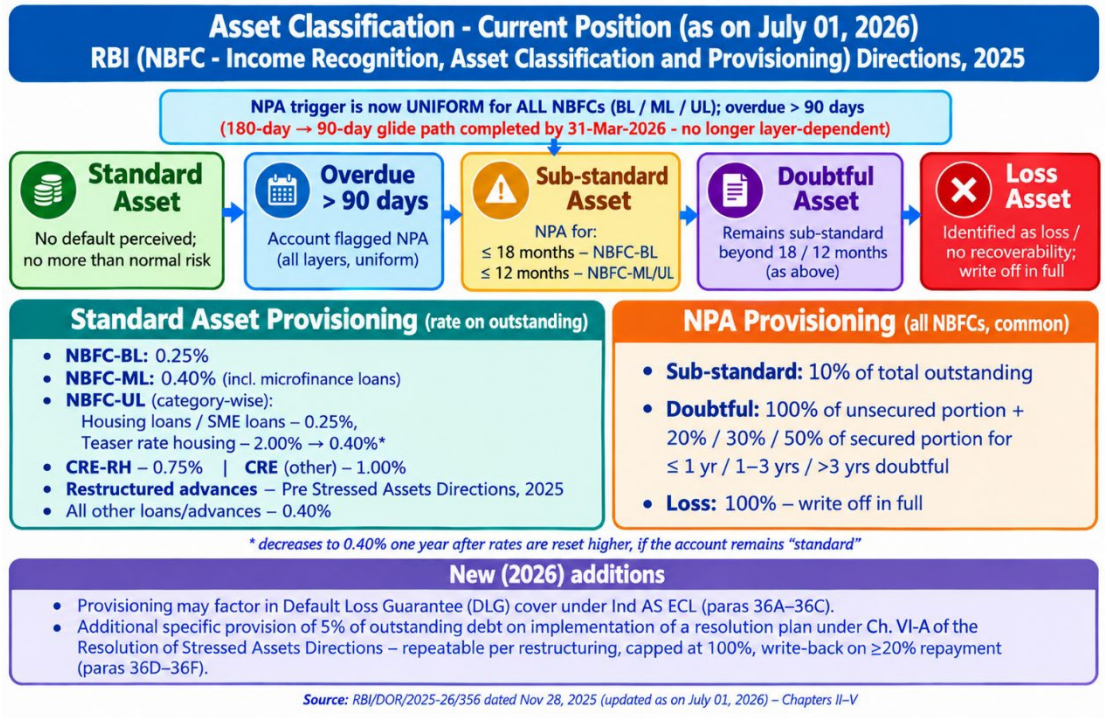
Non-Performing Asset (referred as "NPA") Glide Path:

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

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

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

Students may note that the glide path above is now complete – with effect from March 31, 2026, the 90-day overdue norm for NPA classification applies UNIFORMLY to every NBFC, including NBFC-BL (which earlier used 180 days). The only item that still differs by layer is how long an account stays 'sub-standard' before becoming 'doubtful': up to 18 months for NBFC-BL, and up to 12 months for NBFC-ML and NBFC-UL (see flow chart below).



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3.3 Provisioning Requirements

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

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

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

(ii) **Doubtful Assets:**

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

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

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

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

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

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Standard asset provisioning – NBFC-ML: NBFC-ML shall make provisions for standard assets at 0.40 percent of the outstanding (including microfinance loans), which shall not be reckoned for arriving at net NPAs.

Standard asset provisioning – NBFC-UL (category-wise): Individual housing loans / loans to SMEs – 0.25%; housing loans at teaser rates – 2.00% (decreasing to 0.40% one year after reset, if still 'standard'); advances to CRE-RH – 0.75%; advances to CRE (other than CRE-RH) – 1.00%; restructured advances – as per the Resolution of Stressed Assets Directions, 2025; all other loans/advances (incl. Medium Enterprises) – 0.40%.

Illustration: *An NBFC-UL has the following 'standard' assets outstanding: individual housing loans ₹200 crore; CRE (other than CRE-RH) advances ₹50 crore; and other loans ₹100 crore. Standard asset provision = (200 × 0.25%) + (50 × 1.00%) + (100 × 0.40%) = ₹0.50 crore + ₹0.50 crore + ₹0.40 crore = ₹1.40 crore.*

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

Students may note that (a) an NBFC may factor in Default Loss Guarantee (DLG) cover while computing Ind AS Expected Credit Loss provisions, subject to conditions; and (b) on implementation of a resolution plan under Chapter VI-A of the Resolution of Stressed Assets Directions, 2025, an additional specific provision of 5% of the outstanding debt is required per instance of restructuring (capped at 100%), written back once the borrower repays at least 20% without slipping back into NPA.

[Students may refer Master Direction – Reserve Bank of India (Non-Banking Financial Companies – Income Recognition, Asset Classification and Provisioning) Directions, 2025 for detailed guidelines on prudential norms relating to Non-Banking Financial Companies covered in these Directions.]

4. AUDIT PROCEDURES

The following are the necessary steps involved -

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

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

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

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

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

(3) **Verify Registration with the RBI -** Section 45-IA inserted in the RBI Act, 1934, w.e.f. 9th January, 1997, has made it incumbent on the part of all NBFCs to comply with registration requirements and have minimum net owned funds (NOF) of ₹ 10 crore for strengthening the financial sector and technology adoption, and in view of the



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increasing complexities of services offered by NBFCs, it shall be mandatory for all NBFCs to raise minimum NOF to ₹ 10 crore) for commencing/ carrying on its business. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI and maintenance of minimum net owned funds have been duly complied with by the concerned NBFC.

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

(4) Check Public Deposit Compliance [NBFC Acceptance of Public Deposit Directions Non-Banking Financial Companies – Acceptance of Public Deposits) Directions, 2025] - The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association and its financial results. Thereafter, it must be ascertained whether the company has complied with the following aspects in relation to the activity of mobilisation of public deposits:

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

In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with

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the revised credit rating assigned to it within a specified time frame and should ensure that the NBFC has informed about the same to the RBI in writing.

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

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

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

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

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

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

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

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

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

(v) Check whether the investments made in approved liquid assets by NBFC holding public deposits have been lodged in safe custody with a designated scheduled

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commercial bank as required by the NBFC Acceptance of Public Deposits Directions and also whether. certificate was obtained from the RBI to that effect.

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

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

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

(5) Test NBFC Prudential Norms Compliance as under-

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

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

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

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

(v) Check whether all accounts which have been classified as NPAs in the previous year also continue to be shown as such in the current year also. If the same is not treated

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as an NPA in the current year, the auditor should specifically examine such accounts to ascertain whether the account has become regular and the same can be treated as performing as per the Directions.

TEST YOUR UNDERSTANDING 1

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

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

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

5. CLASSIFICATION OF FRAUDS BY NBFC

In order to have uniformity in reporting, frauds have been classified as under under Chapter VI of the Non-Banking Financial Companies - Fraud Risk Management Directions, 2026 [RBI/DoS/2026-27/463 dated 31st July 2026]:

(a) Misappropriation of funds and criminal breach of trust.

(b) Fraudulent encashment through forged instruments.

(c) Manipulation of books of accounts or through fictitious accounts, and conversion of property.

(d) Cheating by concealment of facts with the intention to deceive any person and cheating by impersonation.

(e) Forgery with the intention to commit fraud by making any false documents/electronic records.

(f) Wilful falsification, destruction, alteration, mutilations of any book, electronic record, paper, writing, valuable security or account with intent to defraud.

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(g) Fraudulent credit facilities extended for illegal gratification.

(h) Cash shortages on account of frauds.

(i) Fraudulent transactions involving foreign exchange.

(j) Fraudulent electronic banking/digital payment related transactions committed on NBFCs.

(k) Other type of fraudulent activity not covered under any of the above.

NBFCs, covered in the Reserve Bank of India (Non-Banking Financial Companies - Fraud Risk Management) Directions, 2026 [RBI/DoS/2026-27/463 dated 31st July 2026], which superseded the Master Directions on Fraud Risk Management in NBFCs (including Housing Finance Companies) dated 15th July 2024 and the erstwhile Master Direction - Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016, having overseas branches/offices should report all frauds perpetrated at such branches/offices also to the concerned overseas Law Enforcement Agencies in accordance with the relevant laws/regulations of the host countries.

Applicability and Auditor's Role under the Non-Banking Financial Companies – Fraud Risk Management Directions, 2026: These Directions apply to all NBFCs (including HFCs) in the Upper Layer and Middle Layer, and to NBFCs in the Base Layer with an asset size of ₹500 crore and above, as per the audited balance sheet as at 31st March of the immediately preceding financial year ("Applicable NBFCs").

Role of Auditors: During the course of the audit, if the auditor comes across instances where the transactions in the account or the underlying documents point to the possibility of fraudulent transactions, the auditor should immediately bring the matter to the notice of the senior management and, if necessary, to the Audit Committee of the Board (ACB) of the Applicable NBFC for appropriate action.

Internal Audit of the Applicable NBFC is required to cover the controls and processes involved in prevention, detection, classification, monitoring, reporting, closure and withdrawal of fraud cases, as well as weaknesses observed in the fraud risk management framework, including delay in reporting, non-reporting, conduct of staff accountability examination and prudential provisioning.

Disclosure: The Applicable NBFC is required to disclose the amount related to fraud reported during the year in its Financial Statements – Notes to Accounts; the auditor should verify that this disclosure has been made.

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Reporting timeline: A Fraud Monitoring Return (FMR) is required to be furnished by the Applicable NBFC in individual fraud cases, irrespective of the amount involved, immediately but not later than 14 days from the date of classification of an incident/account as fraud.

Legal audit: Title deeds and other title documents in respect of credit facilities of ₹ 1 crore and above are required to be subjected to periodic legal audit and re-verification, till the loan is fully repaid, in accordance with the Board-approved policy.

6. AUDIT CHECK-LIST

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

(e.g., NBFC - Investment and Credit Company (NBFC-ICC)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

xvi. Obtain balance confirmations from the concerned parties.

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

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

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

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

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



7. AUDITOR'S DUTY

The following are the important duties of an auditor -

7.1 Compliance with NBFC Auditor's Report - RBI Directions

The RBI Directions have considerably increased the responsibility of auditors of NBFCs. A very onerous task of reporting to the Board of Directors on certain specified matters and to the RBI on an exception basis has been imposed upon him. This reporting requirement is in addition to the normal reporting requirements to the shareholders under section 143 of the Companies Act, 2013. Auditors will, thus, have to be very careful whilst carrying out audits of NBFCs to ensure that all matters which they are required to take into consideration for the purposes of reporting to the RBI have been taken due care of.

Section 45MA of the Reserve Bank of India Act, 1934 was introduced with effect from 13.12.1974. Under this provision the auditor of a non-banking financial company or a non-banking

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

Report to Board of Directors under the Non-Banking Financial Companies - Auditor's Report Directions, 2026 [RBI/DoS/2026-27/468 dated 31st July 2026]

(1) The Reserve Bank of India (RBI) had issued the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 to the auditor of every non-banking financial company. As per these directios, the auditor's reporting obligations set out below reflect the requirements of the said 2026 Directions, which now also expressly exclude Housing Finance Companies (HFCs) from their scope; auditors of HFCs continue to be governed by the Reserve Bank of India (Housing Finance Companies) Directions, 2025.

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

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

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

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

I. Conducting Non-Banking Financial Activity without a valid Certificate of Registration (CoR) granted by the RBI is an offence under chapter V of the RBI Act, 1934. Therefore, if the company is engaged in the business of non-banking financial institution as defined in section 45-I (a) of the RBI Act and meeting the Principal Business Criteria (Financial asset/income pattern) as laid down vide

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the RBI's press release dated April 08, 1999, and directions issued by the ***Reserve Bank of India (Non-Banking Financial Companies - Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025 and the directions on Non-Reckoning of Fixed Deposits with banks as Financial Assets [Paragraph 21 of the Reserve Bank of India (Non-Banking Financial Companies - Miscellaneous) Directions, 2025], auditor shall examine whether the company has obtained a Certificate of Registration (CoR) from the RBI.***

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

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in ***Master Direction – Reserve Bank of India (Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025.***

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

The format of Statutory Auditor's Certificate (SAC) is now to be submitted by NBFCs as 'DNBS10 – Statutory Auditor's Certificate (SAC) Return', through the Centralised Information Management System (CIMS) portal of RBI, in terms of the Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026.

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

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

(i) Whether the public deposits accepted by the company together with other borrowings indicated below viz.

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(a) from public by issue of unsecured non-convertible debentures/bonds;

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

(c) from entities which are not excluded from the definition of 'public deposit' in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016, are within the limits admissible to the company as per the provisions of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(ii) Whether the public deposits held by the company in excess of the quantum of such deposits permissible to it under the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 are regularised in the manner provided in the said Directions;

(iii) Whether the non-banking financial company is accepting "public deposit" without minimum investment grade credit rating from an approved credit rating agency as per the provisions of Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016;

(iv) Whether the capital adequacy ratio as disclosed in the return submitted to the Bank in terms of the ***Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026*** has been correctly determined and whether such ratio is in compliance with the minimum CRAR prescribed in ***Reserve Bank of India (Non-Banking Financial Companies – Prudential Norms on Capital Adequacy) Directions, 2025***;

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

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

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

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

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

(viii) Whether the company has complied with the prudential norms on income recognition, accounting standards, asset classification, provisioning for bad and doubtful debts, and concentration of credit/investments as specified in the Directions issued by the Bank in terms of the ***Master Directions – Reserve Bank of India (Non-Banking Financial Companies – Income Recognition, Asset Classification and Provisioning) Directions, 2025, (Non-Banking Financial Companies – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025 and (Non-Banking Financial Companies – Concentration Risk Management) Directions, 2025;***

(ix) Whether the company has complied with the liquid assets requirement as prescribed by the Bank in exercise of powers under section 45-IB of the RBI Act and whether the details of the designated bank in which the approved securities are held is communicated to the office concerned of the RBI in the return DNBS03 – Important Prudential Parameters – Quarterly, as laid down in the Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026;

(x) Whether the company has furnished to the RBI within the stipulated period the return on deposits as specified in the ***DNBS 01*** to ***Important Financial Parameters – Quarterly, as specified in the Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026***;

(xi) Whether the company has furnished to the RBI within the stipulated period the quarterly return on prudential norms as specified in the ***DNBS03 – Important Prudential Parameters – Quarterly return, as specified in the Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026;***

(xii) Whether, in the case of opening of new branches or offices to collect deposits or in the case of closure of existing branches/offices or in the case of appointment of agent, the company has complied with the requirements contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

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

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

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

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

(iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of ***Master Direction – Reserve Bank of India (Non-Banking Financial Companies – Income Recognition, Asset Classification and Provisioning) Directions, 2025, and (Non-Banking Financial Companies – Classification, Valuation and Operation of Investment Portfolio) Directions, 2025;***

(iv) (a) Whether the capital adequacy ratio as disclosed in the return submitted to the RBI in ***form DNBS03, has been correctly arrived at and whether such ratio is in compliance with the minimum CRAR prescribed by the RBI in terms of the Reserve Bank of India (Non-Banking Financial Companies – Prudential Norms on Capital Adequacy) Directions, 2025 [applicable to NBFCs in the Middle Layer and above, as defined in the Reserve Bank of India (Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025];***

(b) Whether the company has furnished to the RBI the ***quarterly statement of capital funds, risk assets/exposures and risk asset ratio (DNBS03), as prescribed under the Reserve Bank of India (Non-Banking Financial Companies - Supervisory Returns) Directions, 2026, within the stipulated period.***

(v) whether the non-banking financial company has been correctly classified as NBFC Micro Finance Institutions (MFI) as defined in the ***Reserve Bank of India (Non-Banking Financial Companies – Microfinance Institution) Directions, 2025.***

(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

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

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

(5) **Obligation of auditor to submit an exception report to the RBI** — Such report shall be made to the concerned Senior Supervisory Manager (SSM) of RBI / concerned Regional Office of the Department of Supervision (DoS), RBI, under whose jurisdiction the registered office of the NBFC is located.

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

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

(b) ***the applicable extant directions issued by RBI, in terms of the Reserve Bank of India (Non-Banking Financial Companies - Auditor's Report) Directions, 2026 [RBI/DoS/2026-27/468 dated 31st July 2026].***

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

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

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7.2 Compliance with CARO 2020

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

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

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

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

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

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

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

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

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

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

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

7.3 Appointment of Statutory Auditors – RBI (NBFC – Statutory Audit) Directions, 2026

With effect from 31st July 2026, appointment/re-appointment of Statutory Central Auditors (SCAs)/Statutory Auditors (SAs) of NBFCs (including HFCs) is governed by the Reserve Bank of India (Non-Banking Financial Companies – Statutory Audit) Directions, 2026 [RBI/DoS/2026-27/465 dated 31st July 2026], which supersede all earlier RBI instructions on the subject. Non-deposit taking NBFCs with asset size below ₹1,000 crore have the option to continue with their extant procedure for appointment of auditors.

(a) Joint audit: NBFCs with asset size of ₹15,000 crore and above (as at the end of the previous year) shall have their statutory audit conducted under joint audit by a minimum of two audit firms, which shall not have any common partners and shall not be under the same network of audit firms.

(b) Maximum number of SCAs/SAs (subject to the Board deciding the actual number, having regard to the size, spread and complexity of operations): up to ₹5,00,000 crore asset size – 4 auditors; above ₹5,00,000 crore and up to ₹10,00,000 crore – 6 auditors; above ₹10,00,000 crore and up to ₹20,00,000 crore – 8 auditors; above ₹20,00,000 crore – 12 auditors.

(c) Branch coverage: The SCAs/SAs (other than for Core Investment Companies) shall visit and audit at least the top 20 branches, or the top 20% of branches for NBFCs with fewer than 100 branches, selected by level of outstanding advances, so as to cover a minimum of 15% of the total gross advances of the NBFC.

(d) Eligibility criteria: The audit firm must satisfy minimum norms (scaled to the NBFC's asset size, in three bands – up to ₹1,000 crore; above ₹1,000 crore and up to ₹15,000 crore; and above ₹15,000 crore) as regards the number of full-time partners, FCA partners, partners/paid CAs with CISA/ISA qualification, years of audit experience of the firm, and professional staff strength, in addition to being duly qualified under

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Section 141 of the Companies Act, 2013 and not being under debarment by ICAI, NFRA, RBI or any other financial regulator.

(e) Independence: The ACB (or Board, where no ACB exists) shall monitor and assess the independence of the auditors, with any concerns flagged to the concerned Senior Supervisory Manager (SSM), Department of Supervision, RBI. Concurrent auditors of the NBFC cannot be appointed as its SCAs/SAs, and a cooling-off period of at least one year is required between the SCA/SA assignment and specified non-audit work for the NBFC or its group entities.

(f) Tenure and rotation: SCAs/SAs are to be appointed for a continuous tenure of three years, subject to meeting the eligibility norms annually. An audit firm is not eligible for re-appointment to the same NBFC for six years (two tenures) after completion of a full or part tenure. One audit firm can concurrently take up statutory audit of a maximum of eight NBFCs (along with prescribed limits for banks/AIFIs/UCBs/co-operative banks), subject to compliance with eligibility norms.

(g) Appointment procedure: No prior RBI approval is required for appointment of SCAs/SAs. NBFCs under the Mumbai region intimate the Central Office (DoS), while other NBFCs intimate the concerned Regional Office (DoS) of RBI having jurisdiction over their Head Office, by way of a certificate (Form A) within one month of appointment, along with an eligibility certificate (Form B) obtained from the audit firm.

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RBI DIRECTIONS, 2026 – APPOINTMENT / RE-APPOINTMENT OF SCAs / SAs OF NBFCs (Including HFCs)

Sr. No.	Area	Requirement
1	Applicable Directions	Effective **31 July 2026**, appointment/re-appointment of Statutory Central Auditors (SCAs) / Statutory Auditors (SAs) of NBFCs, including HFCs, is governed by the Reserve Bank of India (Non-Banking Financial Companies – Statutory Audit) Directions, 2026 [**RBI/DoS/2026-27/465** dated **31 July 2026**], which supersede all earlier RBI instructions on the subject.
2	Small NBFCs	Non-deposit taking NBFCs with asset size below **₹1,000 crore** have the option to continue with their extant procedure for appointment of auditors.
3	Joint Audit	NBFCs with asset size of **₹15,000 crore and above** (as at the end of the previous year) shall have their statutory audit conducted under joint audit by a minimum of two audit firms, which shall not have any common partners and shall not be under the same network of audit firms.
4	Maximum Number of SCAs / SAs	Subject to the Board deciding the actual number, having regard to the size, spread and complexity of operations: • Up to ₹5,00,000 crore asset size – **4 auditors** • Above ₹5,00,000 crore and up to ₹10,00,000 crore – **6 auditors** • Above ₹10,00,000 crore and up to ₹20,00,000 crore – **8 auditors** • Above ₹20,00,000 crore – **12 auditors**
5	Branch Coverage	The SCAs / SAs (other than for Core Investment Companies) shall visit and audit at least the **top 20 branches**, or the **top 20%** of **branches** for NBFCs with fewer than 100 branches, selected by level of outstanding advances, so as to cover a minimum of **15%** of the total gross advances of the NBFC.
6	Eligibility Criteria	The audit firm must satisfy minimum norms (scaled to the NBFC's asset size, in three bands – up to ₹1,000 crore; above ₹1,000 crore and up to ₹15,000 crore; and above ₹15,000 crore) as regards the number of full-time partners, FCA partners, partners/paid CAs with CISA/ISA qualification, years of audit experience of the firm, and professional staff strength, in addition to being duly qualified under **Section 141** of the Companies Act, 2013 and not being under debarment by ICAI, NFRA, RBI or any other financial regulator.
7	Independence	The **ACB** (or Board, where no ACB exists) shall monitor and assess the independence of the auditors, with any concerns flagged to the concerned Senior Supervisory Manager (**SSM**), Department of Supervision, **RBI**. Concurrent auditors of the NBFC cannot be appointed as its SCAs / SAs, and a cooling-off period of at least **one year** is required between the SCA / SA assignment and specified non-audit work for the NBFC or its group entities.
8	Tenure	SCAs / SAs are to be appointed for a continuous tenure of **three years**, subject to meeting the eligibility norms annually.
9	Rotation	An audit firm is not eligible for re-appointment to the same NBFC for **six years (two tenures)** after completion of a full or part tenure.
10	Maximum NBFC Assignments	One audit firm can concurrently take up statutory audit of a maximum of **eight NBFCs** (along with prescribed limits for banks / AIFIs / UCBs / co-operative banks), subject to compliance with eligibility norms.
11	RBI Approval	**No prior RBI approval** is required for appointment of SCAs / SAs.
12	Intimation – Mumbai Region	NBFCs under the Mumbai region intimate the **Central Office (DoS), RBI**.
13	Intimation – Other Regions	Other NBFCs intimate the concerned **Regional Office (DoS)** of RBI having jurisdiction over their Head Office.
14	Time Limit & Forms	Intimation by way of a certificate **(Form A)** within **one month** of appointment, along with an eligibility certificate **(Form B)** obtained from the audit firm.

Key Takeaway: The Directions, 2026 lay down a risk and size based framework for auditor appointment, emphasizing joint audit for large NBFCs, branch coverage, eligibility, independence, rotation and timely intimation to RBI.

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7.4 Filing of Supervisory Returns – RBI (NBFC – Supervisory Returns) Directions, 2026

With effect from 31st July 2026, all periodic/ad-hoc regulatory returns of NBFCs (excluding HFCs, which continue to be governed separately) are consolidated under the Reserve Bank of India (Non-Banking Financial Companies – Supervisory Returns) Directions, 2026 [RBI/DoS/2026-27/466 dated 31st July 2026], and are to be filed electronically through RBI's Centralised Information Management System (CIMS) or other designated online portals; hard-copy or e-mail submissions are not accepted except as a contingency measure. As part of the audit, the auditor should verify that the NBFC has filed the applicable returns completely, accurately and within the prescribed timelines, and that adequate data governance, IT infrastructure and reconciliation controls are in place as required under Chapter II of these Directions.

(a) ***Key returns relevant to the audit include: DNBS01 – Important Financial Parameters (quarterly, for NBFC-UL/ML); DNBS02 – Important Financial Parameters (quarterly, for NBFC-BL); DNBS03 – Important Prudential Parameters, e.g. capital adequacy and provisioning (quarterly, for NBFC-UL/ML); DNBS10 – Statutory Auditor's Certificate (SAC) (yearly, all NBFCs, filed by the Statutory Auditor); Form A Certificate on appointment of SCA/SA (yearly, all NBFCs); and the Fraud Monitoring Return (FMR)/FMR Update Application (FUA)/FMR4 (RBR), as applicable.***

(b) ***Prescribed timelines (unless specified otherwise): weekly returns – by the following Wednesday; monthly returns – within 15 days of month-end; quarterly returns – within 21 days of quarter-end; yearly returns – within 21 days of year-end. All audited returns are to be filed within 5 working days of the date of signing of the Auditor's report under Section 134 of the Companies Act, 2013. The DNBS10 (SAC) return is subject to a specific timeline of 5 working days from signing of the Auditor's report, but not later than 31st December of the same year; the Form A Certificate is to be filed within one month of appointment of the SCA/SA; and the FMR is to be filed within 14 days of fraud classification.***

(c) ***Non-compliance, including furnishing inaccurate or incomplete information in returns, may attract penalty/action by RBI under the extant provisions of the RBI Act, 1934.***

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TEST YOUR UNDERSTANDING 2

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

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

8. INDIAN ACCOUNTING STANDARDS (IND AS)

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

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

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

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

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

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

Particulars	Note No.	Figures as at the end of current reporting period (₹)	Figures as at the end of previous reporting period (₹)
ASSETS			
(1) Financial Assets (a) Cash and cash equivalents			

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

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

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Particulars	Note No.	Figures as at the end of current reporting period (₹)	Figures as at the end of previous reporting period (₹)
(3) Non-financial Capital (a) Equity share capital (b) Other equity			
Total Liabilities and Equity			

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

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

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

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

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

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

8.3 Related Party Exposure Disclosures

Pursuant to the Financial Statements Directions 2025, the RBI issued the Reserve Bank of India (Non-Banking Financial Companies – Financial Statements: Presentation and Disclosures) Amendment Directions, 2026 on 05 January 2026, effective from 01 April 2026 (hereinafter referred to as the "FS Amendment Directions 2026"), bearing reference number RBI/2025-26/187 DOR.CRE.REC.388/21.04.018/2025-26.

The FS Amendment Directions 2026 insert a new sub-paragraph (9A) after sub-paragraph 21(9) in Chapter III (Disclosure in Financial Statements – Notes to Accounts), requiring NBFCs to disclose the following details in respect of exposures to related parties (as defined under the Reserve Bank of India (Non-Banking Financial Companies – Credit Risk Management) Directions, 2025):

1. ***Aggregate value of loans sanctioned to related parties during the year;***
2. ***Aggregate value of outstanding loans to related parties as on 31 March;***
3. ***Aggregate value of outstanding loans to related parties as a proportion of total credit exposure;***
4. ***Aggregate value of outstanding loans to related parties categorised as SMA and NPA;***
5. ***Amount of provisions held in respect of loans to related parties;***
6. ***Aggregate value of contracts and arrangements awarded to related parties during the year; and***

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7. Aggregate value of outstanding contracts and arrangements involving related parties as on 31 March.

This represents a materially enhanced disclosure requirement for related party transactions and exposures that was not explicitly prescribed in the SBR Directions 2023 with this level of granularity.

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

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

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

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

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

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

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

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

TEST YOUR UNDERSTANDING 3

You are auditor of a deposit taking NBFC (NBFC-D). The NBFC is identified by RBI in its upper layer and its financial statements are required to be prepared in accordance with requirements of Ind AS. The following is extract of statement of profit and loss for year ending 31St March, 2026 in accordance with Division III of Schedule III of the Companies Act, 2013. Previous year figures are ignored.

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Particulars			Note No.	Figures for year ended 31st March, 2026 (in ₹ Crores)
Revenue from Operations				
(i)	Interest income		15	9500
(ii)	Dividend income			-
(iii)	Rental Income			150
(iv)	Fees and commission income		16	100
(v)	Net gain on fair value changes		17	150
(vi)	Net gain on derecognition of financial instruments under amortised category			
	(I)	Total revenue from operations		9900
	(II)	Other Income	18	100
	(III)	Total Income		10000

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

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

Key Takeaways

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

  (i) A financial institution which is a company;

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

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

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

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

- RBI has issued directions to non-banking financial companies on acceptance of public deposits, prudential norms like capital adequacy, income recognition, asset classification, provision for bad and doubtful debts, risk exposure norms and other measures to monitor the financial solvency and reporting by NBFCs.
- RBI has introduced scale based regulations for NBFCs based on four layers that are defined based on their size, activity, and perceived riskiness. The four layers are- Base layer, middle layer, upper layer and top layer.
- NBFCs lend like banks. However, such entities cannot accept demand deposits although some can accept term deposits. These also do not form part of payment and settlement system. DICGC cover is not available to depositors of NBFCs. No minimum exposure to priority sector is required by NBFCs.
- Every applicable NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets in accordance with prescribed norms.
- Audit procedures for NBFCs have to be tailored in accordance of nature of business of NBFC and regulatory directions.
- Besides issuing a report in accordance with requirements of section 143(3) of the Companies Act, 2013 and covering matters specified under CARO, 2020, statutory auditor of NBFC is also required to submit an additional report to Board of Directors of the company.
- ***The Reserve Bank of India (RBI) had issued the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (the "Directions") to the auditor of every non-banking financial company in this regard. These Directions were repealed with effect from 28th November 2025 pursuant to RBI's consolidation of its Master Directions, and the requirements below now stand consolidated within RBI's Master Directions on Statutory Audit for Non-Banking Financial Companies. Under these directions, the auditor of an NBFC has to submit an additional report to the Board of Directors of the company covering matters specified in these directions.***

For a concise revision of the key concepts covered in this chapter, students may refer to the Saransh Booklet for Paper 3: Advanced Auditing, Assurance and Professional Ethics, which serves as a useful last-mile revision resource for examination preparation. Saransh Booklet can be accessed at https://boslive.icai.org/AAAPE_SARANSH.pdf

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TEST YOUR KNOWLEDGE

Theoretical Questions

1. *Define NBFC. Also give a brief description about types of NBFCs covering any five NBFCs.*

2. *Shubham & Associates are going to start the audit of NBFCs. They have not performed much work for the NBFCs in the past years. You are required to explain the requirements related to registration and regulation of NBFCs which an auditor needs to keep in his mind while planning the audit of NBFC which would help this firm.*

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

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

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

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

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

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

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

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

10. *Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company had net owned funds of ₹1,50,00,000/-(one crore fifty lakhs) and was not having registration certificate from RBI and applied for it on 30th March 2026. The company appointed Mr. Kabra as its statutory auditor for the year 2025-26. Advise the auditor with reference to auditor procedures to be taken and reporting requirements on the same in view of CARO 2020?*

11. *Yo-Yo Finance Limited is NBFC-ML as per the revised categorisation of NBFC done by RBI. YAK & Associates, a firm of chartered accountants, are appointed as Statutory Auditors of the Company for the year 2025-26.*

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

12. *Singh Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures/securities issued by government or local authorities. For the year ended 31st March 2026, the following are some extracts from the financial statements:*

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

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

13. ***CA M is appointed as the Statutory auditor of Fincorp Limited for the financial year 2025-26. This company is an NBFC covered under Non-Banking Financial Company - Systemically Important Non-Deposit-taking company. To comply with the RBI Prudential Norms for asset classification, Fincorp Limited has made the following provisioning in respect of loans, advances and other credit facilities as on 31st March, 2026:***

Particulars	***Balance outstanding as on 31st March, 2026***	***Provision for the Financial year 2025-26***
Standard Assets	***₹ 200 crores***	***NIL***
Sub-standard Assets	***₹ 15 crores (Fully secured)***	***₹ 1.50 crores***
Doubtful Assets (one to three years)	***₹ 8 crores (Fully secured)***	***₹ 2.00 crores***
Loss Assets	***₹ 2 crores***	***₹ 2.00 crores***
Total Provision for NPA		***₹ 5.50 crores***

CA M is of the opinion that the company has not done the provisioning correctly. Is the opinion of CA M correct? In this context, explain the provisioning requirements applicable to this NBFC and comment on the provision for NPA made by the company.

14. ***FinBridge Digital Lending Ltd., a non-deposit taking financial intermediary registered with the financial sector regulator, operates an online platform that enables individual lenders to fund retail borrowers after performing onboarding, credit scoring, documentation, and recovery support functions. During the audit, CA Mehta, the***

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engagement partner, observed that certain borrower accounts with overdue instalments were internally tagged as "watchlist" instead of being migrated to non-performing categories pending expected recovery from collection agents.

Further, income relating to such stressed accounts continued to be recognised based on contractual schedules. The Board has approved broad risk policies, however, detailed operational guidance and periodic monitoring reports were not consistently documented.

Mr. Mehta wants to assess whether FinBridge Digital Lending Ltd., is complying with the Prudential Norms. Guide Mr. Mehta in this regard.

15. ***ABC Finance Ltd., an NBFC having an asset size of ₹18,500 crore as at the end of the previous financial year, appointed only one statutory auditor for FY 2026-27. The auditor was also acting as the concurrent auditor of the company. The Audit Committee approved the appointment for three years without evaluating the auditor's independence. The audit firm had completed its previous three-year tenure in the same NBFC two years ago and was again appointed. Further, the NBFC did not submit Form A to RBI after appointment.***

Examine the validity of the above actions with reference to the Reserve Bank of India (Non-Banking Financial Companies – Statutory Audit) Directions, 2026.

Answers to Test Your Understanding.

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

- Gaining an understanding of business conducted by NBFC-P2P. It should be verified that the company undertakes only permissible activities applicable to such type of NBFCs like providing online market place to participants for lending and borrowing. It should not be engaged in the business of lending funds on its own.
- Verifying certificate of registration obtained from RBI for carrying business of P2P platform.
- Verifying Board approved policy setting out eligibility criteria for participants i.e lenders and borrowers.
- Verifying board approved policy for pricing of services provided by P2P platform

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- Verification of adherence to lending and borrowing guidelines prescribed by RBI
- Verifying appropriate arrangements have been entered into among participants and NBFC-P2P.
- Compliance with reporting requirements of RBI
- Verifying board approved policy for grievance redressal and complaints

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

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

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

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

Answers to Theoretical Questions

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

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

- obtaining a certificate of registration issued by the RBI; and
- having a net owned fund (NOF) of ₹ 25 lakhs (₹ 2 crore since April 1999) not exceeding hundred crore rupees, as the RBI may, by notification in the Official Gazette, specify.

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

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

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

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

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

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

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

4. Refer Para 6.

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

6. Refer Para 7.1(5).

7. Ref Para 7.1.

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

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

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

III. Whether the non-banking financial company is meeting the required net owned fund requirement as laid down in ***Master Direction – Reserve Bank of India (Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation) Directions, 2025.***

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

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

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

(iii) Whether the company has complied with the prudential norms relating to income recognition, accounting standards, asset classification and provisioning for bad and doubtful debts as applicable to it in terms of ***Master Direction – Reserve Bank of India (Non-Banking Financial Companies – Income Recognition, Asset Classification and Provisioning) Directions, 2025;***

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

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8. Ref Para 7.1.

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

(I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 of the Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016 (repealed w.e.f. 28th November 2025 and now consolidated within RBI's Master Directions on Statutory Audit for Non-Banking Financial Companies, under which the corresponding exception-reporting obligation continues), is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:

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

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

(c) the applicable Master Directions issued by the Reserve Bank of India for Non-Banking Financial Companies in 2025 (including the Directions on Registration, Exemptions and Framework for Scale Based Regulation; Prudential Norms on Capital Adequacy; Income Recognition, Asset Classification and Provisioning; and Concentration Risk Management), as amended from time to time.

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

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

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9. Refer Para 8.3.

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

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

Audit Procedures and Reporting:

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

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

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

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

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

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

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

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

In the instant case Abhimanyu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2015. The company was having net owned funds of ₹ 1,50,00,000/-(one crore fifty lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 30th March 2026). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO, 2020.

11. Refer Para 4.5.

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

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

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

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

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

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

Income from financial assets = ₹ 68 Crore

Gross Income = ₹ 118.75 Crore

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

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

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

Categories of Non-Performing Assets:	***Provision required (%)***
Standard Assets: Every NBFC (covered under Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016) shall make provisions for standard assets at 0.40 per cent by the end of March 2018 and thereafter, of the outstanding, which shall not be reckoned for arriving at net NPAs.	***0.40%***
Substandard Assets	***10%***
Doubtful Assets (up to 1 to 3 years)	***30%***
Loss Assets	***100%***

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In the given situation, CA M is appointed as Statutory Auditor of Fincorp Limited, an NBFC covered under NBFC (covered under Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016) for the financial year 2025-26. The Fincorp Limited has made the following provisioning in respect of loans, advances and other credit facilities as under:

Categories of Non-Performing Assets:	Balance outstanding as on 31st March, 2026	Provision required (%)	Provision required (in `)	Provision made by the Co.
Standard Assets	₹ 200 crores	0.40%	₹ 80 lakhs	NIL
Substandard Assets	₹ 15 crores	10%	₹ 1.5 crores	₹ 1.5 crores
Doubtful Assets (up to 1 to 3 years)	₹ 8 crores	30%	₹ 2.4 crores	₹ 2 crores
Loss Assets	₹ 2 crores	100%	₹ 2 crores	₹ 2 crores
		Total Provision for NPA	₹ 6.7 crores	₹ 5.5 crores

From the above, it can be concluded that provisioning for Substandard Assets and Loss Assets is in accordance with the prescribed RBI Prudential Norms whereas in case of Standard Assets and Doubtful Assets it is not as per provisioning norms. Thus, CA M is correct in his opinion that the company has not done the provisioning correctly.

14 *Refer Point 5 under Para 4*

Considering the facts of the case, Mr. Mehta should critically examine whether overdue borrower accounts were deliberately retained in "watchlist" categories to avoid NPA classification and provisioning requirements. He should also verify whether income from such stressed accounts has been incorrectly recognised on accrual basis contrary to Prudential Norms. If material non-compliance is identified, appropriate adjustments, additional disclosures and reporting implications should be considered in the audit report.

15. *Refer Para 7.3*

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In the given case, several actions of ABC Finance Ltd. are not in conformity with the Reserve Bank of India (Non-Banking Financial Companies – Statutory Audit) Directions, 2026:

- ***The appointment of only one statutory auditor is not valid, as an NBFC with an asset size of ₹18,500 crore is required to have its statutory audit conducted under joint audit by a minimum of two audit firms.***
- ***The appointment of a concurrent auditor as the statutory auditor is not permissible and violates the independence requirements.***
- ***The Audit Committee has failed to discharge its responsibility by approving the appointment without assessing the independence of the auditor.***
- ***The re-appointment of the audit firm after only two years is not permissible, since the prescribed cooling-off period after completion of a tenure has not been complied with.***
- ***The failure of the NBFC to submit Form A to the RBI within the prescribed time after appointment constitutes non-compliance with the prescribed appointment procedure.***

In the given case, ABC Finance Ltd. has not complied with several requirements of the RBI (Non-Banking Financial Companies – Statutory Audit) Directions, 2026. The appointment of only one statutory auditor, appointment of the concurrent auditor as the statutory auditor, re-appointment of the audit firm before completion of the prescribed cooling-off period, failure of the Audit Committee to evaluate the auditor's independence, and non-submission of Form A to RBI are all inconsistent with the prescribed regulatory requirements. Accordingly, the NBFC should take appropriate corrective measures to ensure compliance with the Directions.

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