

Chapter 14B

SPECIAL FEATURES OF AUDIT OF NON-BANKING FINANCIAL COMPANIES (NBFC)

Auditors Duty: Reporting

1. Auditor's duty to report
2. Matters to be included in the auditor's report to the BOD
 - A. In Case of NBFC'S
 - B. In case the NBFC accepting / holding public deposits Additionally include
 - C. In case of NBFC not accepting PD
 - D. In case of a Co. engaged in the business of non-banking financial Institution not required to hold certificate of registration subject
3. Exception Reporting to RBI

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FINISH

Schedule-III (Division-III)

1. Applicability of Ind AS on NBFC
2. Differences between Division II & III

Provision in CARO 2020 for NBFC Auditors

Amendment 2026



Amendment Notes N26

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Check List (Additional Points to be Covered in Audit of NBFC)

- I. Investment Credit Company (ICC)
 - Concept of ICC
- II. Audit Checklist - ICC

Classification of Frauds by NBFC

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1. Ascertaining the business of the Co.
2. Evaluation of IC system
3. Registration with RBI & NOF
 - Investments in Liquid Assets
4. NBFC Public Deposit Directions
5. NBFC Prudential Norms Directions (NBFC - PD, 2016)

- 3.A Capital Requirements
- 3.B Income Recognition
- 3.C Asset classification and provisioning requirements (except NBFC-MFI'S)
 - (i) NPA
 - (ii) Standard Asset
 - (iii) Sub-standard Asset
 - (iv) Doubtful Asset
 - (v) Loss Asset

Prudential Norms

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Difference Between Bank & NBFC

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Audit Procedures

- A. Definition
 - B. Registration and Regulation of NBFC
 - I. NOF
 - II. How to apply?
 - III. RBI Directions
 - IV. NBFC RBI : Section 45I
 - C. Types of NBFCs
 1. Classification of NBFC'S registered with RBI
 2. NBFC'S exempted from registration with RBI
 3. Classification of NBFC as per Scale Based Regulation (SBR)
 1. Base Layer (BL)
 2. Middle Layer (ML)
 3. Upper Layer (UL)
 4. Top Layer (TL)
- Imp. Categorisation of NBFCs carrying out specific activity as per SBR

Back Drop

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START

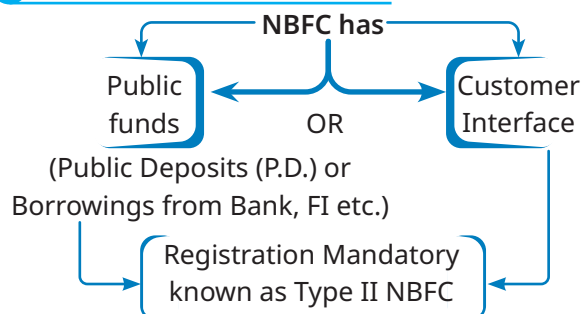


CA Final Audit

10. A. NBFC AMENDMENTS

1. Registration Exemption:

a. TYPE II NBFC (Registered)

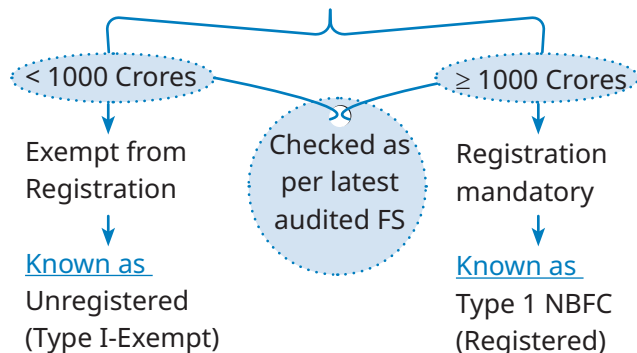


b. TYPE I NBFC (Registered or Unregistered)

NBFC with

- ✓ No Public funds (No P.D., No Borrowings from Bank/FI); and
- ✓ No Customer Interface (means mostly working as Family offices, Pvt. investment vehicles, Holding companies)

✓ Asset Size



Eg: Impact of amendment:

FC Ltd (31.3.26): BS		NBFC Ltd (31.3.26): SPL	
Total Assets (incl. IA 100, FA 500)	1000	Revenue: Financial Others	600 400
Equity	500	Expenses	...
Liabilities	500	Profits	...

Whether FC Ltd. required to register itself with RBI u/s 45 IA as NBFC?

Sol.

FC Ltd is a deemed NBFC as it meets the 50:50 Test,

$$a) \frac{FA}{(TA-IA)} \times 100 \rightarrow \frac{500}{(1000 - 100)} \times 100 > 50\%$$

and

$$b) \frac{\text{Income from FA}}{\text{Total Income}} \times 100 \rightarrow \frac{600}{1000} \times 100 > 50\%$$

Hence required to register... but now with RBI (NBFC-Reg, Exemption and framework for SBR) Amendment Directions, 2026 since NBFC has Total Assets < 1000 Crore, if it is not accessing public funds and has no customer interface then it is not required to register.

POINTS TO NOTE:

1. **Public funds Vs Public Deposits:**
Public Funds includes public deposits and borrowing from bank, FI etc.
2. **No Customer Interface:**
Essentially no customers hence usually managing / dealing in promoter funds, for compliance objectives etc.
3. **Asset Size vs Net Owned Funds:**
 - Reg. exemption is based on the Total of Assets side of BS, NOF are relevant for CRAR
4. **How to claim exemption:**
Existing NBFC + Already registered as Type 1 NBFC → That satisfy criteria of Exemption to apply for DEREGISTRATION by 31-12-26.

SJ Tips:

Since currently there was no exemption available for NBFC from registration hence all NBFC were required to register. Now NBFCs claiming exemption to apply for it.

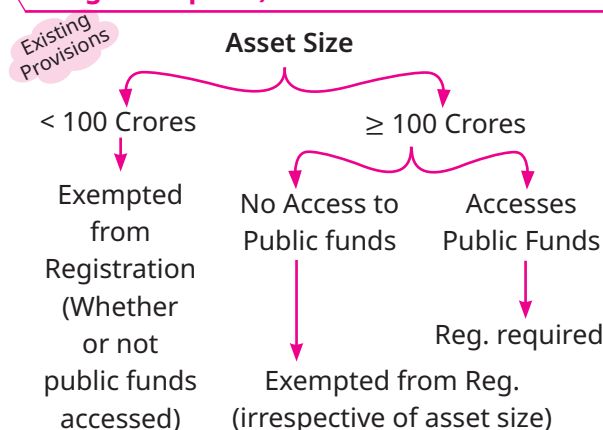
Core Investment Company - They continue to remain exempted if they meet the asset based exemption criteria.

5. **Access to Public funds: Directly or Indirectly**
No exemption even if public funds accessed indirectly through Group Entities or Associates
For Eg.: Parent Co. has public funds accessed, then its Subsidiary NBFC will be considered to have indirectly accessed public funds too.

6. SJ Tips
NBFC also not have **intention** to access public funds or have customer interface in future.

7. SJ Tips
Multiple Type 1 NBFC in a Group (Unregistered): Exemption Eligibility. Asset size of all such NBFC in a group to be < 1000 cr., else all NBFC to be registered.

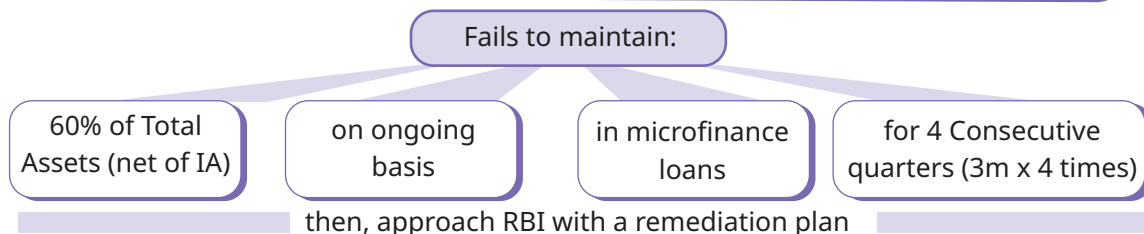
8. Core Investment Company (Existing Provisions allowing Reg. exemption)



Hence:

- ▶ CIC with public funds but asset size < 100 Crores is exempted from reg.
- ▶ CIC with no public funds but asset size > 100 Crore

B. MFI - REMEDIATION PLAN



NBFC-MFI

1 Conditions to be a MFI:

- Non-deposit taking NBFC
- Minimum 60% of Total assets are microfinance loans,
 - Total assets to be Total assets netted off by Intangible assets
 - Microfinance loans → As defined under Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022.
 - Conditions to be met on ongoing (continuous) basis

2 What if conditions not met?

- If NBFC-MFI fails to meet the criteria above for;
- 4 consecutive quarter;
- then approach RBI with remediation plan.

Eg. NBFC-MFI

NBFC-MFI whether meets the condition of being a MFI with following information as on 31-Dec-2025

Total Assets	500 Crores,	including;
Intangible Assets	50 Crores	
Financial Assets	300 Crores	including;
Micro finance loans	200 Crores	

Co. is of the opinion that condition is to be met at year end i.e. 31-Mar-2026

Sol. Condition is to met- ongoing basis.

$$\begin{aligned}
 31 \text{ Dec} &\rightarrow \frac{\text{Micro finance Loans}}{\text{Total Asset - IA}} \times 100 \\
 &= \frac{200}{(500 - 50)} \times 100 \\
 &= 44.44\% < 60\% \text{ hence}
 \end{aligned}$$

Condition not met. If this continues for 4 consecutive quarters then remediation plan to be submitted with RBI

C. CRAR: CAPITAL REQUIREMENT

NBFC - Primarily engaged in lending against GOLD jewellery

- (i) Condition for classification → Such loans $\geq$ 50% of financial assets
- (ii) Minimum Tier I Capital requirement → 12% (as against 10% in others)
- (iii) Risk weighted assets of :
 - (a) on-balance sheet and
 - (b) risk adjusted value of off-balance sheet items.
- (iv) These NBFCs shall also adhere to provisions of the Directions on treatment of DTA and DTL for computation of capital.
- (v) These NBFCs shall also ensure compliance with the instructions issued vide 'Reserve Bank of India (Lending Against Gold and Silver Collateral) Directions, 2025' as expeditiously as possible but no later than April 1, 2026.

A. NBFC lending against gold jewellery (such loans $\geq$ 50% of total FA)		B. NBFC other than A			
		ML	UL	TL	BL
Tier 1	→ 12% at least	→ 10% at least	→ 10% at least	Same	Note 1
Tier 1+2	→ 15% minimum	→ 15% minimum	→ 15% minimum	as	
CET 1 (Note 2)	→ N.A.	→ N.A.	→ CET1 9% at least	UL	
Additional charge	→ N.A.	→ N.A.	→ N.A.	As RBI prescribes	
Tier 2 Vs Tier 1 Capital	→ T2 $\geq$ T1	→ T2 $\geq$ T1	→ T2 $\geq$ T1	T2 $\geq$ T1	

Note 3,4,5

Note 6

Note 1 | NBFC: BL (Other than into loan against gold)

- ✓ No CRAR,
- ✓ No Tier1 capital requirements
- ✓ But, LR at all times $\leq$ 7

$$\text{Leverage Ratio (LR)} = \frac{\text{Total Outside Liab.}}{\text{Owned Funds}}$$

Note 2 | CET1 Capital Ratio

1. CET1 Capital Ratio = $\frac{\text{CET1 Capital} \times 100}{\text{RWA}}$
2. CET1 Capital = Tier1 Capital
 - (-) Perpetual debt instrument
 - (-) Goodwill, other IA
 - (-) specified DTA
 - (-) Other Regulatory deductions

Note 3 | Tier1 Capital

Owned funds (-) Excess of:

- (a) Investments in other NBFC shares and
- (b) Invest. in Sh./Debt/Bonds/Outstanding loans /Deposits/Advances incl. HP & Leases with Subsidiaries and same group companies above 10% of Owned Funds.
- (+) PDI (other than BL NBFC, not accepting PD) Subject to max. of 15% of Tier1 Capital at and of P.Y.

Note 4 | Owned fund

Not defined in ICAI SM or RTP. It includes:
 ESC + CCPSC + Sec. Premium + Free Reserves
 - Accumulated losses & fictitious assets.

Note 5) Tier2 Capital

- 1.) PSC other than CCPSC
- 2.) Rev. Reserves x 55%
- 3.) General Provision incl. Std. Asset Provision
+ Loss Reserve (for unforeseen future losses and not foreseen diminution in value)
(max 1.25% of RWA)
- 4.) Hybrid Debt Capital Instruments
- 5.) Excess of PDI: In excess of considered in Tier1 Capital (N.A for BL) (N.A. of D-NBFC)
- 6.) Sub-ord. Debt: consider after discounting book value as follows

Note 6) Tier2 Capital to be not more than 100% of Tier1 capital

Example:

Case	T1%	T2%	CRAR%?	CRAR limit met?
(i)	10%	11%	20%	Yes
(ii)	14%	12%	26%	Yes
(iii)	8%	8%	16%	No, T1 min. 10% limit not met
(iv)	7%	10%	14%	No, 15% limit & 10% limit both not met
(v)	12%	2%	14%	No, 15% not met
(vi)	12%	15%	24%	Yes

Remaining Maturity Period

Upto	1 yr	2 yr	3 yr	4 yr	5 yr	
	↑	↑	↑	↑	↑	↑
Disc. @	100%	80%	60%	40%	20%	NIL

Maximum discounted sub-ord. debt to be $\leq 50\%$ Tier 1 Capital.

Sub Limits	Limits	Disc.
① PSC	N.A.	N.A.
② Rev. Res.	N.A.	45%
③ Gen. Prov.	1.25% of RWA	N.A.
④ Conv. Debt	N.A.	N.A.
⑤ PDI	NIL for D, BL	N.A.
⑥ Subord. Debt	50% of Tier1	100/80/60/ 40/20%

NBFC-Lending against gold jewellery

Example:

Whether following NBFC regarded as NBFC lending against gold jewellery required to maintain 12% in Tier I Capital?

Total Assets	500 Crores including
• Intangible Assets	50 Crores
• Financial Assets:	300 Crores including
Loan against gold jewellery	150 Crores
Loan against gold	50 Crores

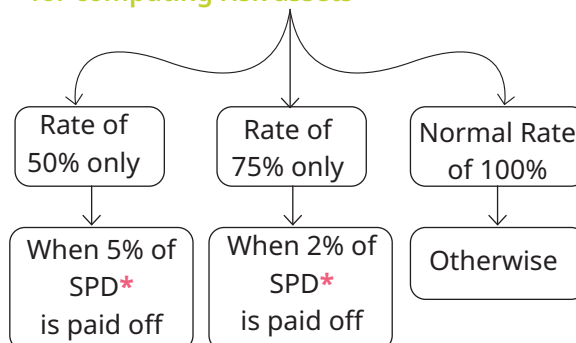
Ans.

$$\frac{\% \text{ of loan agst. gold jewellery}}{\text{Financial Asset}} = \frac{150}{300} \times 100$$

hence Tier I capital 12% required.

D. CRAR: RISK WEIGHTED ASSETS

① Concessional Rate for High Quality Infra Project for computing risk assets



* Sanctioned project debt

Terms:

- a) High Quality Infra Projects : RBI defines basis
- b) SPD: Initial amount sanctioned excluding additional top ups, if any

Review:

Project will be reviewed every year before 31 March, and the risk weight may change due to ratings change, not later than earlier of:

- a) Next Review
- b) 31-3 of next F.Y.

② ROU Asset:

Added in risk weight table with risk weight 100%.

E. STANDARD ASSET PROVISIONING:

1. For ML and BL

- ▶ ML- 0.40% including microfinance loans
- ▶ BL - 0.25%

2. For UL:

a) Individual's Housing loans	0.25%
b) SME Loans (Small & Micro)	0.25%
c) Housing loan at Teaser rates (lower initial rates)	0.40% to 2%
→ Till the year when rates reset to normal	2%
→ One year after the rate rests to normal and if the account remains PA	0.40%
d) Advance to Commercial Real Estate (CRE): Residential Housing (RH)	0.75%
e) Advance to CRE (not RH)	1%
f) Resolution of Stressed Advance	As per resolution of Stressed Asset Directions
g) Stressed Asset restructured then	5% additional provision per restructuring (max 100%)
→ When 20% of o/s. amt. paid post restructuring and if account does not slip to NPA	Excess Prov. released
h) all other loans (including loan to medium Enterprise)	0.40%

NOTE:

***DLG:** If Direct Loss Guarantee (DLG) Cover available, consider it in Computation of Expected Credit Loss.

Example:

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.

Sol.

Standard asset provision

$$= (200 \times 0.25\%) + (50 \times 1.00\%) + (100 \times 0.4\%)$$

$$= ₹ 0.50 \text{ crore} + ₹ 0.40 \text{ crore}$$

$$= ₹ 1.40 \text{ crore.}$$

SJ Tips

Que.

NBFC has Standard Assets of 1000 crores, all to Medium Enterprises.

- Provision to be as per Ind AS or RBI norms?
- What if DLG available for 50 crores?

Ans:

RBI norms based provision = 40 Crores (1000 crores x 0.40%)

Now this is the minimum required provision.

Now as per Ind AS, NBFC computes 12m ECL and RBI clarifies in such Ind AS based computation of impairment loss DLG be considered.

So if ECL is 70 crores as per Ind AS and DLG is 50 Crores then as per Ind AS requirement to recognise impairment loss of 20 (70 - 50) only.

But RBI norms being minimum 40 crores provision will be made.

[Note: RBI provision will not be (1000 - 50 DLG) X 0.40%]