SUPPLEMENTARY

PAPER-17

CORPORATE FINANCIAL REPORTING

(Syllabus - 2016)

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA
(Statutory body under an Act of Parliament)
www.icmai.in

Study Note - 5

VALUATION, ACCOUNTING AND REPORTING OF FINANCIAL INSTRUMENTS AND OTHERS

This Study Note includes

5.3 NBFC – PROVISIONING NORMS AND ACCOUNTING

Note: IND AS is applicable to NBFCs on and from 1.4.2018.

INTRODUCTION

The financial sector in any economy consists of several intermediaries, which include the banks, investment intermediaries (viz. mutual funds, hedge funds, pension funds etc.), risk transfer entities (i.e. the insurance companies), information and analysis providers (viz. rating agencies, financial advisers, etc), investment banks, portfolio managers. All the above mentioned financial intermediaries, other than the banks, are broadly referred to as Non-Banking Financial Institutions.

Non-Banking Financial Companies (NBFCs), forms an integral part of Indian financial system, providing various financial services. In recent times, activities of NBFCs have undergone variety of changes through financial innovation. NBFC initially gets incorporated under Indian Companies Act, 2013 and later on obtains Certificate of Incorporation from RBI.

NON-BANKING FINANCIAL COMPANY (NBFC) – CONCEPT

- Non-Banking Finance Company (NBFC) is a financial institution which does not meet the legal definition of bank but carries the similar activities to that of bank like lending and making investments i.e. such an institution does not hold a banking license.
- As per Sec. 45I(f) of RBI Act, 1934, a non-banking financial company'' means:
  - (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.
- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 which is 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.

However, such a company 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.

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

CLASSIFICATION OF NON- BANKING FIANNCIAL COMPANIES (NBFCs)

NBFCs can be classified on the following bases:

[A] On the basis of Liability Structure

On the basis of liability structure, the NBFCs can be divided into two categories: NBFCs accepting public deposits (referred to as NBFCs-D), and NBFCs not raising public deposits (referred to as NBFCs-ND).

1. **Deposit taking NBFCs (referred to as NBFCs-D):** These NBFCs are subject to the requirements of Capital adequacy norms, Liquid assets maintenance norms, Exposure norms (including restrictions on exposure to investments in land, building and unquoted shares), Asset Liability Management (ALM) discipline and reporting requirements.
2. **Non-Deposit taking NBFCs (referred to as NBFCs-ND):** Till 2006 NBFCs-ND were subject to minimal regulations. However, since 2007, NBFCs-ND with assets of ₹ 100 crores and above are being classified as **Systemically Important Non-Deposit taking NBFCs (NBFCs-ND-SI).**

Presently, in the light of the overall increase in the growth of the NBFC sector, the threshold for defining systemic significance for NBFCs-ND (non-deposit taking NBFCs) has been revised. Accordingly, the NBFCs-ND-SI will henceforth be those NBFCs-ND which have asset size of ₹500 crore and above as per the last audited balance sheet.

Thus, now the NBFCs-ND shall be categorized into two broad categories in accordance with the revised threshold limit for systemic significance:

- NBFCs-ND (those with assets of less than ₹ 500 crore) and
- NBFCs-ND-SI (those with assets of ₹ 500 crore and above).

The prudential regulations, such as capital adequacy requirements and exposure norms along with reporting requirements, have been made applicable to the NBFCs-ND-SIs. The ALM reporting and disclosure norms have also been made applicable to them at different points of time.

NB: NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories i.e. NBFCs-ND and NBFCs-ND-SI. For this purpose, Statutory Auditors would be required to certify the asset size of all the NBFCs in the Group.

[B] On the basis of nature of primary activities performed

On this basis, the NBFCs can be classified into the following categories:

1. **Asset Finance company** is a company which carries on as its principal business the financing of physical assets supporting productive/economic and general purpose assets.
2. **Leasing company** is a company which carries on as its principal business, the business of leasing of equipments or the financing of such activity.
3. **Investment company** means any company which carries on as its principle business the acquisition of securities.
4. **Loan company** means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
5. **Infrastructure finance company** is a company which carries on as its principle business, the financing of the acquisition or construction of infrastructure facilities of various kinds.
6. **Infrastructure Debt Fund** is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.
7. **Venture capital company** means any company which carries on as its principle business the providing of start-up capital to new business ventures.
8. **NBFC-Factor** is a non-deposit taking NBFC engaged in the principal business of factoring.
9. **NBFC- Non-Operative Financial Holding Company (NOFHC)** is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

REGULATORY APPROACH FOR NBFCs

- **NBFCs-ND Regulatory Approach (Asset size < ₹ 500 Crore):**

The regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore will be as under:

(i) **No Regulations for No Deposits and No Customer Interface:** They shall not be subjected to any regulation either prudential or conduct of business regulations if they have not accessed any public funds and do not have a customer interface.

(ii) **Conduct of business regulations if have Customer Interface:** Those having customer interface will be subjected only to conduct of business regulations if they are not accessing public funds.

(iii) **Prudential Regulations for Public Deposits:** Those accepting public funds will be subjected to only limited prudential regulations if they have no customer interface.

(iv) **Both Regulations for Deposits and Customer Interface:** Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

(v) **Compulsory Compliance of Sec. 45-IA:** Irrespective of whichever category the NBFC falls in, registration under Section 45 IA of the RBI Act will be mandatory.

- **NBFCs-ND Regulatory Approach (Asset size > ₹ 500 Crores):**

All NBFCs-ND with assets of ₹ 500 crores and above shall have to comply with prudential regulations as applicable to NBFCs-ND-SI even if they have not accessed public funds.

However, the NBFCs-ND having assets size of ₹500 crores and more shall comply with conduct of business regulations only if customer interface exists.

MANDATORY REQUIREMENTS OF MINIUM NET OWNED FUND BY NBFC:

- In terms of Section 45 IA of the RBI Act, 1934, no NBFC can commence or carry on business of a non-banking financial institution without having a Net Owned Funds (NOF) of ₹ 25 lakhs.
- Thereafter, the requirement of NOF has been increased to ₹200 lakhs for all new companies w.e.f. April 21. 1999 vide RBI Notification No. DNBS.132 CGM (VSNM) - 99 dated April 21, 1999.
- But now all NBFCs are compulsorily required to attain a minimum Net Owned Fund of ₹ 2 crore by the end of March 2017 as per the milestones given below:
  - ✓ ₹ 1 crore by the end of March 2016
  - ✓ ₹ 2 crore by the end of March 2017
- Consequently, the companies that were already in existence even before April 21. 1999 have to attain the above minimum NOF in addition to the new companies applying for grant of COR to commence business of an NBFC on and after November 10, 2014.
- In other words, it shall be mandatory for all NBFCs to attain a minimum NOF of NOF of ₹ 100 lakh by the end of March 2016 and ₹ 200 lakh by the end of March 2017.

NB: All NBFCs, the NOF of which currently falls below ₹ 200 lakh shall submit a statutory auditor's certificate certifying compliance to the revised levels at the end of each of the two financial years as given above.

If any NBFC fails to achieve the prescribed ceiling within the stipulated time period, the Bank will initiate the process for cancellation of COR against such NBFCs.

GETTING RATING TO ACCEPT OR RENEW PUBLIC DEPOSITS FOR NBFC:

In accordance with the revised regulatory framework for NBFCs, all unrated Asset Finance Company (AFC) had to get an investment grade by March 31, 2016 otherwise they would not be allowed to renew existing or accept fresh deposits thereafter. Moreover, the limit for acceptance of deposits for rated AFCs has also been reduced from 4 times to 1.5 times of NOF.

Meanwhile i.e. till March 31, 2016, the unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity but not allowed to accept fresh deposits till they obtain an investment grade rating.

Earlier to this amendment, the unrated AFC having NOF of ₹ 25 lakh or more and maintaining capital adequacy ratio of not less than 15% were allowed to accept or renew public deposits 1.5 times of its NOF subject to ₹10 crore as per extant NBFCs Acceptance of Public Deposit (Reserve Bank) Directions, 1998.

PRUDENTIAL NORMS FOR NBFCs

The Reserve Bank of India has issued detailed directions on prudential norms, vide

- ✓ Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007,
- ✓ Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and
- ✓ Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements.

Enhanced prudential regulations shall be made applicable to NBFCs wherever public funds are accepted and conduct of business regulations will be made applicable wherever customer interface is involved.

The term ‘Public Funds’ includes:

(a) Funds raised directly or indirectly through public deposits;

(b) Commercial papers;

(c) Debentures;

(d) Inter-corporate deposits; and

(e) Bank finance.

However, the term Public Funds does not includes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

APPLICATION OF PRUDENTIAL REGULATION FOR NBFCs

- **Prudential Regulations for NBFCs-ND (Assets size < ₹ 500 crores):**

  The NBFCs-ND with asset size of less than ₹ 500 crores shall be:

  (A) Exempted from the requirement of maintaining CRAR;

  (B) Exempted from complying with Credit Concentration Norms: and

  (C) Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with the Capital.

- **Prudential Regulations for NBFCs-ND-SI (Asset size > ₹ 500 Crore) and all NBFCs-D:**

Tier 1 Capital:

All NBFCs-ND which have an asset size of ₹ 500 crore and above and all NBFCs-D shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows:

✓ 8.5% by end of March 2016.

✓ 10% by end of March 2017.

ASSET CLASSIFICATION FOR NBFCs

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

(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets.

Standard Asset:

Standard Asset means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

Sub-standard Asset:

- As per the “Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015, a Sub-standard asset means:

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

(b) an asset where the terms of the agreement regarding interest and/ or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

NB: 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.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Sub-standard asset means:

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

Provided that the period 'not exceeding 18 months' stipulated in this sub-clause shall be 'not exceeding 16 months' for the financial year ending March 31, 2016; 'not exceeding 14 months' for the financial year ending March 31, 2017; and 'not exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

(b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

Doubtful Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

(a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period exceeding 18 months.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

(a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period 'exceeding 18 months' for the financial year ended March 31, 2015; 'exceeding 16 months' for the financial year ended March 31, 2016; 'exceeding 14 months' for the financial year ending March 31, 2017 and 'exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

Loss Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:

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

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

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:

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

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

Non-performing Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:

  (a) an asset, in respect of which, interest has remained overdue for a period of six months or more;

  (b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;

  (c) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

  (d) a bill which remains overdue for a period of six months or more;

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

  (f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;

  (g) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

  (h) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/ beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:

  (i) an asset, in respect of which, interest has remained overdue for a period of six months or more;

  (ii) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;

  (iii) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

  (iv) a bill which remains overdue for a period of six months or more;

  (v) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which facility remained overdue for a period of six months or more;

  (vi) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more; Provided that the period of 'six months or more' stipulated in sub-clauses (a) to (f) shall be 'five months or more' for the financial year ending March 31, 2016; 'four months or more' for the financial year ending March 31, 2017 and 'three months or more', for the financial year ending March 31, 2018 and thereafter.

  (vii) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

  Provided that the period of 'twelve months or more' stipulated in this sub-clause shall be 'nine months or more' for the financial year ending March 31, 2016; 'six months or more' for the financial year ending March 31, 2017; and 'three months or more' for the financial year ending March 31, 2018 and thereafter.

(viii) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

HORMONISATION OF ASSET CLASSIFICATION FOR NBFCs

In the interest of harmonisation, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with that of banks, in a phased manner, as provided below:

(1) Non-Performing Asset (NPA):

(A) Lease Rental and Hire-Purchase Assets:

(i) **Overdue for 9 Months as on 31st March 2016:** Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 9 months (currently 12 months) for the financial year ending March 31,2016;

(ii) **Overdue for 6 Months as on 31st March 2017:** Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 6 months for the financial year ending March 31. 2017; and

(iii) **Overdue for 3 Months as on 31st March 2018 and Onwards:**

Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

(B) Assets other than 'Lease Rental and Hire-Purchase Assets':

(i) **Overdue for 5 Months as on 31st March 2016:** Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 5 months for the financial year ending March 31, 2016;

(ii) **Overdue for 4 Months as on 31st March 2017:** Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 4 months for the financial year ending March 31. 2017; and

(iii) **Overdue for 3 Months as on 31st March 2018 and Onwards:** Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31. 2018 and thereafter.

(2) Sub-Standard Assets:

For all loan and hire-purchase and lease assets, sub-standard asset would mean:

(i) **NPA upto 16 Months on 31/03/2016:** An asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the financial year ending March 31. 2016;

(ii) **NPA upto 14 Months on 31/03/2017:** An asset that has been classified as NPA for a period not exceeding 14 months for the financial year ending March 31, 2017; and

(iii) **NPA upto 12 Months on 31/03/2018:** An asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

(3) Doubtful Asset

For all loan and hire-purchase and lease assets, doubtful asset would mean:

(i) **Sub-Standard Asset for 16 Months on March 31, 2016:** An asset that has remained sub-standard for a period exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016

(ii) **Sub-Standard Asset for 14 Months on March 31, 2017:** An asset that has remained sub-standard for a period exceeding 14 months for the financial year ending March 31, 2017; and

(iii) Sub-Standard Asset for 12 Months on March 31, 2018 and thereafter: An asset that has remained sub-standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

ACCOUNTING GUIDELINES FOR NBFCs

The issues related to accounting include Income Recognition criteria, Accounting of Investments, asset classification and provisioning requirements. These hav been provided in details in the RBI Directions, namely "Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" and "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015".

RBI has prescribed that Income recognition should be based on recognised accounting principles, however Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these Directions as "ICAI" shall be followed in so far as they are not inconsistent with any of these Directions.

Income Recognition

- The income recognition of NBFCs, irrespective of their categorisation, 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.
- Income like interest /discount /any other charges on NPAs shall be recognised only when actually realised, RBI also requires that income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA.
- The NBFCs are required to recognise income from dividends on shares of corporate bodies and units of mutual funds on cash basis, unless the company has declared the dividend in AGM and right of the company to receive the same has been established, in such cases, it can be recognized on accrual basis.
- Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on accrual basis provided it is paid regularly and is not in arrears.
- Income on securities of corporate bodies or public sector undertakings may be taken into account on accrual basis provided the payment of interest and repayment of the security has been guaranteed by Central Government.

Principles for accounting of Investments

- Investing is one of the core activities of NBFCs, hence RBI requires the Board of Directors to Frame investment policy of the company and implement the same.
- The investments in securities shall be classified into current and long term, at the time of making each investment;
- The Board of the company should include in the investment policy the criteria for classification of investments into current and long-term.
- The investments need to be classified into current or long term at the time of making each investment.
- There can be no inter-class transfer of investments on ad hoc basis later on. Inter class transfer, if warranted, should be done at the beginning of half year, on April 1 or October 1, and with the approval of the Board.
- The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
- The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored. Moreover, the depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.

Valuation of Investments

- The directions also specifies various valuation guidelines in respect of Quoted and Unquoted current investments leaving the Long term Investments to be valued as per ICAI Accounting Standards.

  It requires **Quoted current investments** to be grouped into specified categories, viz. (i) equity shares, (ii) preference shares, (iii) debentures and bonds, (iv) Government securities including treasury bills, (v) units of mutual fund, and (vi) others.

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

- **Unquoted equity shares in the nature of current investments** shall be valued at cost or break-up value, whichever is lower. However, the RBI Directions has prescribed that fair value for the break-up value of the shares may be replaced, if considered necessary. "Breakup value" means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one rupee only.

- **Unquoted preference shares in the nature of current investments** shall be valued at cost or face value, whichever is lower.

- **Investments in unquoted Government securities or Government guaranteed bonds** shall be valued at carrying cost.

- **Unquoted investments in the units of mutual funds in the nature of current investments** shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.

- **Commercial papers** shall be valued at carrying cost.

- **A long term investment** shall be valued in accordance with the Accounting Standard issued by ICAI.

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

Transactions in Government Securities

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

Preparation of Balance Sheet and Profit and Loss Account

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

- Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date. Every non-banking financial company shall finalise its balance sheet within a period of 3 months from the date to which it pertains.

- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III.

Disclosures in the Balance Sheet

- The directions specify certain disclosure requirements in the balance sheet.
- Disclosure of provisions created without netting them from the income or against the value of assets. The provisions shall be distinctly indicated under separate heads of account as (i) Provisions for bad and doubtful debts; and (ii) Provisions for depreciation in investments.
- Provisions shall not be appropriated from the general provisions and loss reserves held. Provisions shall be debited to the profit and loss account.
- The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against the provisions.
- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III.
- The following disclosure requirements are applicable only to systemically important (Asset Size more than Rs. 500 crores) non-deposit taking non-banking financial company:
  - ➢ Capital to Risk Assets Ratio (CRAR);
    - ✓ Exposure to real estate sector, both direct and indirect; and
    - ✓ Maturity pattern of assets and liabilities.”

The formats for the above disclosures are also specified by RBI.

- Ministry of Corporate Affairs vide Notification dated 11 October 2018 made amendments in Schedule III inserting Division III for NBFC whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rule,2015.

Division III provides a format of the Balance Sheet and Statement of Profit and Loss and sets out the minimum requirements of disclosure.

- Balance sheet items are to be classified as Financial and Non-financial and are allowed to be arranged in order of liquidity. Specific disclosure is required for derivative financial instruments and subordinated liabilities. Separate disclosure is required for Receivables which have significant increase in Credit Risk and that are Credit Impaired. Receivables and Loans are classified as follows:

Receivables shall be sub-classified as:

(a) Receivables considered good - Secured;

(b) Receivables considered good - Unsecured;

(c) Receivables which have significant increase in Credit Risk; and

(d) Receivables - credit impaired

A break up of the total loans should also be disclosed as:

(a) Secured by tangible assets

(b) Secured by intangible assets

(c) Covered by Bank/ Government Guarantee

(d) Unsecured

An NBFC shall disclose the following in the Notes under the head ‘Loans’:

(i) Bills purchased and bills discounted

(ii) Loans repayable on demand

(iii) Term Loans

(iv) Leasing

(v) Factoring

(vi) Others

- NBFCs are specially required to disclose Statutory Reserve in Other Reserve as part of Other Equity. Additional disclosure should be made for the conditions or restrictions for distribution from Statutory Reserve.
- Items of Revenue from Operations and Other Comprehensive Income are to be disclosed on the face of the statement of profit and loss instead of as parts of notes. In addition to disclosure of all material items in financial statements, a note for every item of Other Income or Other Expenditure should be given if it exceeds 1% of the total income.

The format of Balance Sheet and Statement of Profit and Loss of the NBFC as per Division III is shown below.

Part I: Balance sheet

Assets

Financial assets

(a) Cash and cash equivalents

(b) Bank Balance other than included in (a) above

(c) Derivative financial instruments

(d) Receivables

  (I) Trade Receivables

  (II) Other Receivables

(e) Loans

(f) Investments

(g) Other Financial assets (to be specified)

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

Financial Liabilities

(a) Derivative financial instruments

(b) Payables

(I) Trade Payables

(i) total outstanding dues of micro enterprises and small

- enterprises

(ii) total outstanding dues of creditors other than micro

- enterprises and small enterprises

(II) Other Payables

(i) total outstanding dues of micro enterprises and small

- enterprises

(ii) total outstanding dues of creditors other than micro

- enterprises and small enterprises

(c) Debt Securities

(d) Borrowings (Other than Debt Securities)

(e) Deposits

(f) Subordinated Liabilities

(g) Other financial liabilities (to be specified)

Non-financial Liabilities

(a) Current tax liabilities (Net)

(b) Provisions

(c) Deferred tax liabilities (Net)

(d) Other non-financial liabilities (to be specified)

EQUITY

(a) Equity Share capital

(b) Other Equity

Total Liabilities and Equity

PART II – STATEMENT OF PROFIT AND LOSS

Revenue from operations

(i) Interest Income

(ii) Dividend Income

(iii) Rental Income

(iv) Fees and commission Income

(v) Net gain on fair value changes

(vi) Net gain on derecognition of financial instruments under amortised cost category

(vii) Sale of products(including Excise Duty)

(viii) Sale of services

(ix) Others (to be specified)

(I) Total Revenue from operations

(II) Other Income (to be specified)

(III) Total Income (I+II)

Expenses

(i) Finance Costs

(ii) Fees and commission expense

(iii) Net loss on fair value changes

(iv) Net loss on derecognition of financial instruments under amortised cost category

(v) Impairment on financial instruments

(vi) Cost of materials consumed 32

(vii) Purchases of Stock -in -trade

(viii) Changes in Inventories of finished goods, stock -in - trade and work -in - progress

(ix) Employee Benefits Expenses

(x) Depreciation , amortization and impairment

(xi) Others expenses (to be specified)

(IV) Total Expenses (IV)

(V) Profit / (loss) before exceptional items and tax (III - IV)

(VI) Exceptional items

(VII) Profit/(loss) before tax (V -VI)

(VIII) Tax Expense:

(1) Current Tax

(2) Deferred Tax

(IX) Profit / (loss) for the period from continuing operations (VI I -VIII)

(X) Profit/(loss) from discontinued operations

(XI) Tax Expense of discontinued operations

(XII) Profit/(loss) from discontinued operations(After tax) (X -XI)

(XIII) Profit/(loss) for the period (IX+XII)

(XIV) Other Comprehensive Income

(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

Subtotal (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

Subtotal (B)

Other Comprehensive Income (A + B)

(XV) Total Comprehensive Income for the period (XIII+XIV) (Comprising Profit (Loss) and other Comprehensive Income for the period)

(XVI) Earnings per equity share (for continuing operations)

- Basic (₹)
- Diluted (₹)

(XVII) Earnings per equity share (for discontinued operations)

- Basic (₹)
- Diluted (₹)

(XVIII) Earnings per equity share (for continuing and discontinued operations)

- Basic (₹)
- Diluted (₹)

PROVISION REQUIREMENTS FOR NBFCs

[A] Provision against sub-standard assets, doubtful assets and loss assets

Every 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:

1. On loans, advances and other credit facilities including bills purchased and discounted

Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for;	
Doubtful Assets	(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the non-banking financial company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis;	
	(b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. Estimated realisable value of the outstanding) shall be made on the following basis:	
	Period for which the asset has been considered as doubtful:	Per cent of provision
	- Up to one year	20
	- One to three years	30
	- More than three years	50
Sub-standard assets	A general provision of 10 per cent of total outstanding shall be made	

2. On Lease and Hire Purchase assets

As per the RBI Directions, the provisioning requirements in respect of hire purchase and leased assets shall be as under:

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

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

- **Additional provision for hire purchase and leased assets**: In respect of such assets, additional provision shall be made as under:

(a)	Where hire charges or lease rentals are overdue upto 12 months	Nil
(b)	Where hire charges or lease rentals are overdue for more than 12 months but upto 24 months	10 per cent of the net book value
(c)	Where hire charges or lease rentals are overdue for more than 24 months but upto 36 months	40 per cent of the net book value
(d)	Where hire charges or lease rentals are overdue for more than 36 months but upto 48 months	70 per cent of the net book value
(e)	Where hire charges or lease rentals are overdue for more than 48 months	100 per cent of the net book value

  - On expiry of a period of 12 months after the due date of the last instalment of hire purchase/ leased asset, the entire net book value shall be fully provided for.

Notes:

1. The amount of caution money/ margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security available in pursuance to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.
2. The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.
3. It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.
4. An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xxv) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.
5. The balance sheet to be prepared by the NBFC may be in accordance with the provisions contained in sub-paragraph (2) of paragraph 11.

6. All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.

7. In case of NBFC-MFIs, if the advance covered by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

[B] Provision against Standard Assets

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provision for standard assets at 0.25 percent of the outstanding, which shall not be reckoned for arriving at net NPAs.
- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provisions for standard assets at 0.25 per cent by the end of March 2015; 0.30 per cent by the end of March 2016; 0.35 per cent by the end of March 2017 and 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. Thus, the provision for standard assets for NBFCs-ND-SI and for all NBFCs-D has now been increased to 0.40% (at present 0.25%). The compliance to the revised norm will be phased in as given below:
  - ✓ 0.30% by the end of March 2016
  - ✓ 0.35% by the end of March 2017
  - ✓ 0.40% by the end of March 2018
- 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.

Illustration 1:

While closing its books of accounts on 31stMarch, a NBFC has its advances classified as follows –

Particulars	**₹ Lakhs**	**Particulars**	**₹ Lakhs**
Standard Assets	8,400	Unsecured Portion of Doubtful Debts	87
Sub-Standard Assets	910	Loss Assets	24
Secured Portions of Doubtful Debts:			
- Up to one year	160		
- One year to three years	70		
- more than three years	20		

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	**Loan (₹ Lakhs)**	**Provision (%)**	**Provision (₹ Lakhs)**
Standard Assets	8,400	0.40	33.6
Sub- Standard Assets	910	10%	91
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32
- 1 year to 2 years	70	30%	21

- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	87	100%	87
Loss Assets	24	100%	24
Total			298.6

Note: Percentage of provision for Standard Asset is 0.25 as per Non-Banking Financial Company - Non Systemically Important Non-Deposit taking Company.

Illustration 2:

While closing its books of account on March 31st of a financial year, a Non-banking Finance company has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	16,800
Sub- Standard Assets	1,340
Secured Positions of Doubtful Debts:	
- Up to one year	320
- one year to three years	90
- more than three years	30
Unsecured Portions of Doubtful debts	97
Loss Assets	48

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	**Loan (₹ Lakhs)**	**Provision (%)**	**Provision (₹ Lakhs)**
Standard Assets	16,800	0.40	67.2
Sub- Standard Assets	1,340	10%	134
Secured Portion of Doubtful Debts:			
- Up to one year	320	20%	64
- 1 year to 2 years	90	30%	27
- more than 3 years	30	50%	15
Unsecured Portion of Doubtful debts	97	100%	97
Loss Assets	48	100%	48
Total			452.4

Illustration 3:

While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	10,000
Sub- Standard Assets	1,000

Secured Positions of Doubtful Debts:	
- Up to one year	160
- one year to three years	70
- more than three years	20
Unsecured Portions of Doubtful debts	90
Loss Assets	30

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	**Loan (₹ Lakhs)**	**Provision (%)**	**Provision (₹Lakhs)**
Standard Assets	10,000	0.40	40
Sub- Standard Assets	1,000	10%	100
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32
- 1 year to 2 years	70	30%	21
- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	90	100%	90
Loss Assets	30	100%	30
Total			325

Illustration 4:

Samvedan Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.3.14. few machines were sold on hire-purchase basis. The hp price was set as ₹100 lakhs as against cash price of ₹ 80 lakhs. The amount was payable as ₹ 80 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.3.15, but could not collect the second installment which was due on 31.3.16. the company was finalizing accounts for the year ending 31.3.16. till 15.5.16, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10.42%.

Required:

(a) What should be the principal outstanding on 1.4.15? Should the company recognise finance charge for the year 2015-16 as income?

(ii) What should be the net book value of assets as on 31.3.16 so far Samvedan Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

(iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

Solution:

(i) Since, the hire-purchaser paid the first installment due of 31.3.15, the notional principal outstanding on 01.04.2015 was ₹ 50.25 lakhs. [WN: 1]

(ii) In the year ended 31.3.16, the installment due of ₹ 16 lakhs has not been received. However, it was due on 31.3.16 i.e. on the Balance Sheet date, and therefore, it will be classified as Standard Asset. Samvedan Ltd. will recognise ₹ 5.24 lakhs as interest income included in that due installment as this should be treated as finance charge.

(iii) The net book value of the assets as on 31.3.2015

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs x 3)	48
	64
Less: Finance charge not matured and not credited to P/L A/c [4.11+2.88+1.52]	(8.51)
	55.49
Less: Provision as per NBFC prudential norms	7.49
∴ Net Book Value of assets for Samvedan Ltd.	48.00

(iii) Amount of Provision

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs x 3)	48
	64
Less: Finance charge not matured and not credited to P/L A/c [4.11+2.88+1.52]	(8.51)
	55.49
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%)	48
Provision as per NBFC prudential norms	7.49

Since, the installment of ₹ 16 lakhs not paid, was due on 31.03.2016 only, the asset is classified as standard asset. Therefore, no additional provision has been made for it.

Workings:

It is necessary to segregate the installments into principal outstanding and interest components by using IRR @10.42%

Time	Opening outstanding amount (a)	Cash flow (b)	Interest @ 10.42% (c) = (a) × 10.42%	Principal repayment (d) = (b) – (c)	Closing outstanding (e) = (a) – (d)
31.3.14	—	60	—	—	60
31.3.15	60	16	6.25	9.75	50.25
31.3.16	50.25	16	5.24	10.76	39.49
31.3.17	39.49	16	4.11	11.89	27.6
31.3.18	27.6	16	2.88	13.12	14.48
31.3.19	14.48	16	1.52	14.48	0