

Internal Audit of NBFCs



Introduction to “NBFC”



Meaning of NBFC

A company registered under the Companies Act, 2013 engaged in:

- the business of loans and advances,
- acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature,
- leasing, Hire Purchase, Insurance Business, Chit Business **but does not include** - any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- a non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company)

Definition of NBFC

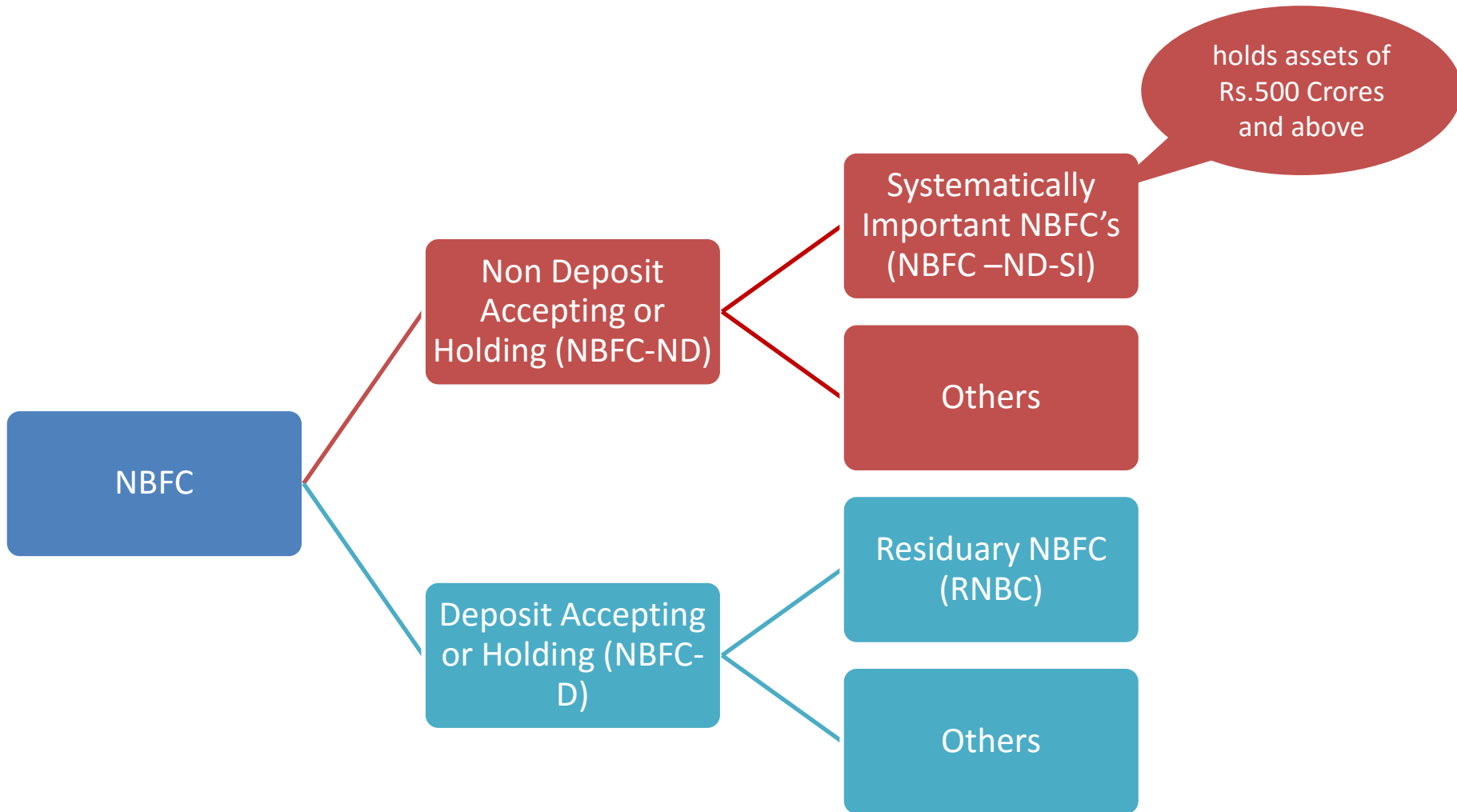
Section 45I (f) of RBI act, 1934 defines “non-banking financial company” means –

- a Financial Institution which is a company;
- 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;
- such other Non-Banking Institution or class of such institutions, as the RBI may, with the previous approval of the Central Government and by notification in the Official Gazette, specify;

Types of NBFC



Classification of NBFC



Residuary Non-Banking Companies (RNBCs)

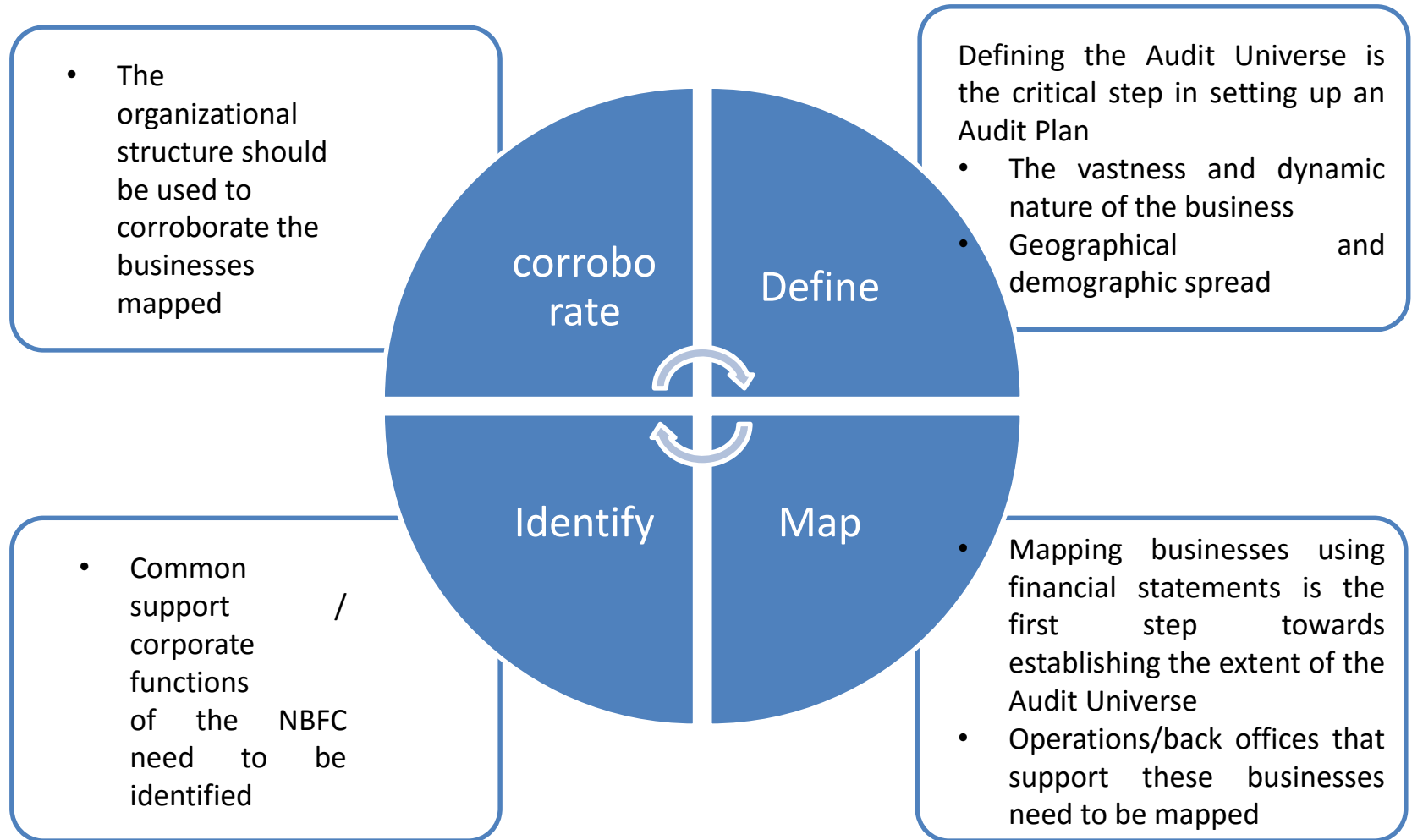
- Residuary Non-Banking Company is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company.
- These companies are required to maintain investments as per directions of RBI, in addition to liquid assets.
- The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions.
- Besides, Prudential Norms Directions are applicable to these companies also.

Audit of NBFCs

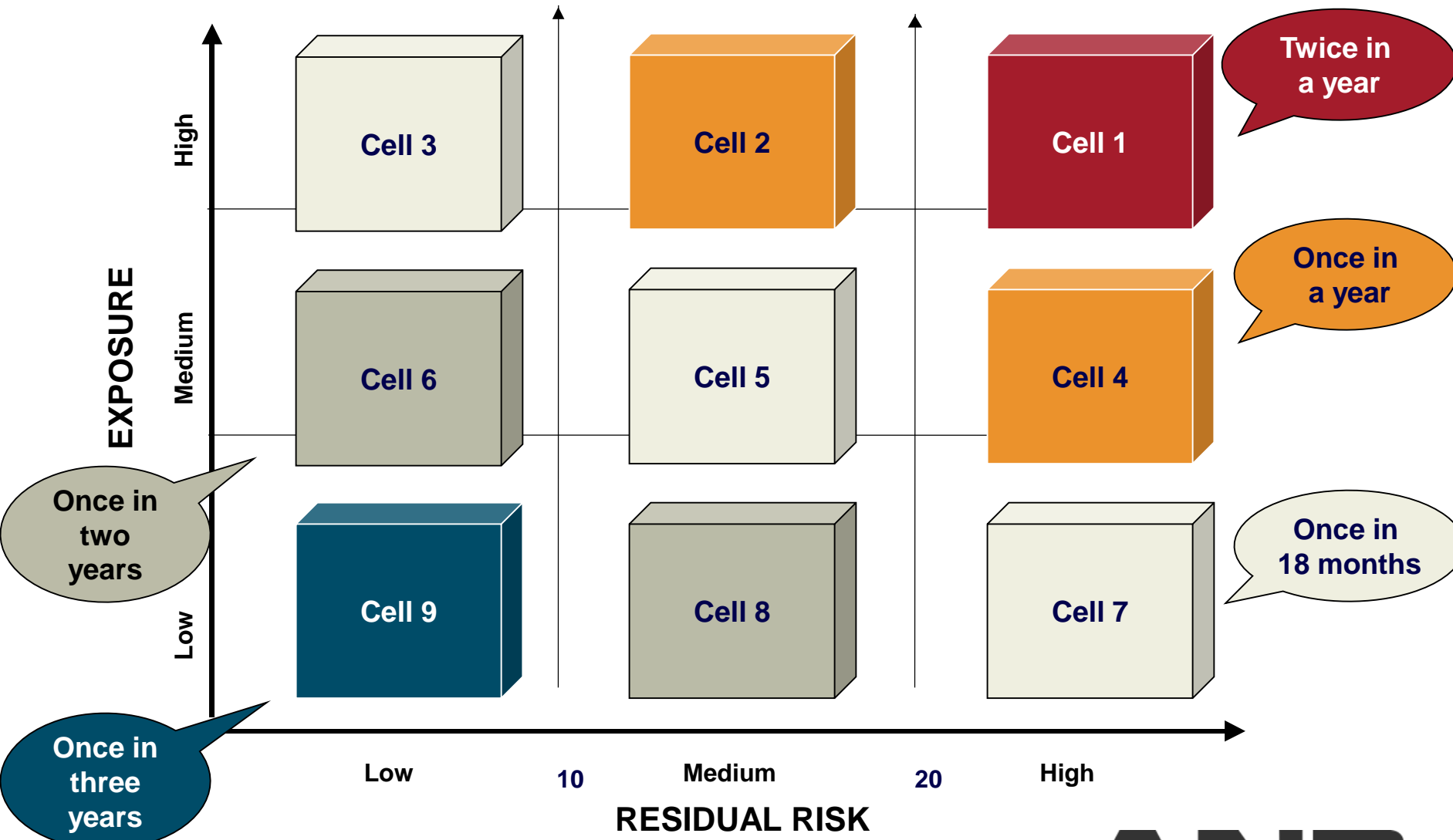


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Key Elements of Audit Universe



Risk Map



Audit of Asset Finance company



Audit of Asset Finance company

Product Life Cycle audit:

- Product Policy >> Standard Operating Procedures
- Sourcing - Direct Marketing Agents, Direct walk-ins , Sales team
- Credit Policy – Norms, Authorisations, Deviation Matrix
- Security Creation
- Operations
- Collections
- Post disbursement documentation – Invoice, Insurance, Registration
- Account Monitoring
- Compliance to Regulatory guidelines – such as Concentration of Credit

Concentration of Credit/Investment (NBFC-D and NBFC-ND-SI

Single / Group* Exposure Limits	Lending	Investment	Both
Single Borrower	15%	15%	25%
Single Group of Borrower	25%	25%	40%
Infrastructure Loan / Investment			
Single Borrower	Addl 5%	Addl 5%	Addl 5%
Single Group of Borrower	Addl 10%	Addl 10%	Addl 10%

- Group companies are to be determined as per Companies Act, 1956 and limits are to be computed as percentage of owned funds
- Additional limit of 5% is available to Asset Finance Company.
- Ceiling applicable for funding to NBFC's own group as well as borrower group.
- An Investment in Debentures is treated as loan and not investment.
- NBFCs not accepting 'public funds' or 'not issuing guarantees' may apply to RBI for modification in above limits.

Audit of Investment company



Audit of Investment company



Audit of Investment company

Valuation of Investments:

- All Investments should be marked to market
- Quoted Current Investment shall, for the purpose of valuation, shall be valued at cost or market value, whichever is lower.
- Quoted current investments shall, for the purposes of valuation, be grouped into the following categories, viz.,
- (a) equity shares, (b) preference shares, (c) debentures and bonds, (d) government securities including treasury bills, (e) units of mutual fund, and (f) others.
- Unquoted equity shares in the nature of current investment shall be valued at cost or break-up value, whichever is lower.
- Investments in unquoted Government securities or Government guaranteed bonds shall be valued at carrying cost.

Audit of Investment company

Valuation of Investments:

- 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.
- 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.
- Long term Investment shall be valued in accordance with Accounting Standard issued by ICAI.

Other Audit Areas

- Branch Audits
- Borrowings:
 - Lines of Credit
 - Other instruments
 - Public Deposits in case of NBFCs taking public deposits
 - Compliance to regulatory norms
- Support Functions such as HR, Legal, Accounts & Finance etc.
- Compliance Audit
- Systems Audit both from a General IT controls and Functionality

Thank You

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Types of NBFC

Asset Finance Company



1. Carry principal business of Financing of Physical assets supporting productive/economic activity such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machine.
2. Principal Business implies income arising from the above activity is not less than 60% of its total assets and total income respectively.

Investment Company



Any company which is a financial institution carrying on as its principal business the acquisition of securities.

Loan Company



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.

Types of NBFC

Core Investment Companies



Systemically Important Core Investment Company (CIC-ND-SI) carries the business of acquisition of shares and securities which satisfies the following conditions:-

- Its Asset size is Rs.100 crore or above
- It holds 90% or more of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
- Its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
- It does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment
- It accepts Public Funds

Types of NBFC

Infrastructure
Finance Company



- Deploys at least 75 per cent of its total assets in infrastructure loans,
- Has a minimum Net Owned Funds of Rs.300 crore,
- has a minimum credit rating of 'A 'or equivalent and a CRAR of 15%.

Infrastructure Debt
Fund - MF



- To facilitate the flow of long term debt into infrastructure projects.
- It raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity.
- Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs

Factors



- It is a non-deposit taking NBFC engaged in the principal business of Factoring.
- The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

Mortgage Guarantee
Company



- Has at least 90% of the business turnover is mortgage guarantee business or
- Has at least 90% of the gross income is from mortgage guarantee business and net owned fund is Rs.100 crore.

Types of NBFC

Micro Finance Institutions



- It is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:
- Loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs.1,00,000 or urban and semi-urban household income not exceeding Rs.1,60,000;
- Loan amount does not exceed Rs.50,000 in the first cycle and Rs.1,00,000 in subsequent cycles;
- Total indebtedness of the borrower does not exceed Rs.1,00,000;
- Tenure of the loan should not be less than 24 months for loan amount in excess of Rs.15,000 with prepayment without penalty;
- Loan to be extended without collateral;
- Aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;
- Loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower

Housing Finance Companies



National Housing Board set up by the Government of India is the Apex authority regulating the Housing Finance Company. NHB Directions, 2010 deals with the matters relating to acceptance of deposits by Housing Finance Companies, Prudential norm for income recognition, asset classification, accounting standards, provision for bad and doubtful debts etc.