

Chapter 1: Executive Summary

1.1 As a consequence of the recommendations of the Expert Group on Designing a Supervisory Framework for NBFCs (Chairman: Shri P.R.Khanna) and amendments to RBI Act in 1997, it was decided, in consultation with The Institute of Chartered Accountants of India (ICAI), to design and prescribe separate formats of financial statements for the NBFCs (Para 2.2 & 2.3).

1.2 In the post-1997 period, the main thrust of the Reserve Bank's policy has primarily been to continue to provide indirect protection to the depositors through strengthening the financials of NBFCs and creating an environment where they function on healthy lines (Para 3.3 to 3.5).

1.3 The multifarious categories of companies with *inter se* classification based on the nature of their activity and deposit acceptance modalities have resulted in a somewhat diverse regulatory regime. The consolidation process has, however, begun with entry point barriers and putting in place comprehensive deposit regulation measures. This is expected to streamline the functioning of the sector and, over a period, enable the regulators to introduce the decategorisation measures and bring in homogeneity in the sector (Para 3.2).

1.4 The formats of financial statements, specified in Schedule VI to the Companies Act, 1956 (presently used by the NBFCs for preparing their financial statements) have been principally designed in the context of non-banking non-financial companies and do not focus on capturing the type of activities specific to NBFCs. In view of this, the financial statements prepared by NBFCs in terms of the provisions of the Companies Act are considered to be inadequate (Para 4.7 to 4.9).

1.5 Section 45MA(1A) and 45Q of the RBI Act read with the proviso to Sub-Section (1) and (2) of Section 211 of The Companies Act, 1956 gives sufficient powers to Reserve Bank to prescribe a separate set of financial statements to NBFCs (Para 4.11).

1.6 It is recommended that NBFCs should prepare their financial statements in the formats proposed in the Annexure to this Report. It has been suggested in the proposed formats that in case of composite companies, i.e., companies whose principal business is financial but which are also engaged in non-financial business, details relating to their non-financial business should be furnished additionally as per the requirements of Schedule VI to the Companies Act, 1956. The proposed formats which would be prescribed by Reserve Bank should only substitute Schedule VI and the other relevant provisions of the Companies Act would continue to apply *mutatis mutandis* (Para 4.12 to 4.17 & 5.3).

1.7 The proposed formats should be made applicable to all the NBFCs which are required to be registered with the Reserve Bank irrespective of their net owned fund or asset size. Consequently, it is recommended that prudential norms directions be also made applicable to all the NBFCs (Para 4.18).

1.8 The proposed formats of financial statements need not be made applicable to such NBFCs as are exempted (viz. Miscellaneous Non-Banking Companies, Nidhis, Housing Finance Companies) from registration with RBI and other core provisions of the RBI Act/Directions issued thereunder (Para 4.19).

1.9 There is a need to frame guidelines defining the term 'Principal Business' for the purpose of identifying an NBFC (especially in case of composite companies). Having regard to all the relevant aspects, the Committee feels that the 'Principal Business' of a company should be determined using solely the asset criteria and accordingly a company should be treated as an NBFC if it has financial assets to an extent of not less than 40 per cent of the total tangible assets. Once identified as an NBFC it should remain so classified till a period of three years or till such time it brings down its public deposits to the level prescribed under the Companies (Acceptance of Deposits) Rules, 1975 whichever is later (Para 4.20 to 4.27).

1.10 While the proposed formats of financial statements for NBFCs broadly follow the formats in Schedule VI to the Companies Act, 1956, there are some important additional disclosures that have been recommended; which are:

- (a) Maturity profile of assets and liabilities
 - (b) Concentration of assets and liabilities
 - (c) Classification of liabilities based on nature and source
 - (d) Overdue loans and other credits
 - (e) Amount of Non-Performing Assets under various asset type
 - (f) Details of valuation of investments
 - (g) Provisioning for NPAs and diminution in value of investments
 - (h) Cash flow statement
 - (i) Statement of Net Owned Fund (NOF) as per the RBI Act
 - (j) Statement of Capital Adequacy Ratio
 - (k) Details of SLR compliance
- (Para 5.6 to 5.19)

1.11 It is recommended that the amount of provision to be made in respect of accounting for taxes on income should be made in accordance with the tax effect accounting methods as per the guidance note/accounting standard issued by ICAI, instead of the existing tax payable method (Para 5.17).

1.12 For the sake of uniformity in the entire financial system, the Committee recommends that all NBFCs should prepare the audited financial statements as of March 31, every year (para 5.23).

1.13 It is recommended that NBFCs having assets size of Rs. 50 crore and above should constitute an Audit Committee of the Board (Para 6.5).

1.14 As specific directions have been issued to the statutory auditors of NBFCs under the RBI Act, the Committee does not recommend any Long Form Audit Report (on the lines of banks) to be submitted by the auditors (Para 7.1).