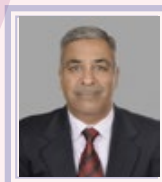


AN IRREFUTABLE CASE FOR CMAs ON THE BOARD OF BANKS

BANKING



CMA (Dr.) S K Gupta

**Managing Director
ICMAI Registered Valuers Organization**

The Perspective

Banking is the lifeline of the economy of the country. The health of the banking sector is closely integrated to the health of the economy. Banks play a vital role in the economic development of a country. They accumulate the idle savings of the people and make them available for investment. They also create new demand deposits in the process of granting loans and purchasing investment securities. They facilitate trade both inside and outside the country by accepting and discounting of bills of exchange. Banks also increase the mobility of capital. For the past three decades, India's banking system has several outstanding achievements to its credit. It is no longer confined to only the metropolitans, but has reached even to the remote corners of the country. This is one of the reasons of India's growth process. Today, the banking sector is one of the biggest service sectors in India. Availability of quality services is vital for the well-being of the economy. The focus of banks has shifted from customer acquisition to customer retention. With the stepping in of information technology in the banking sector, the working strategy of the banking sector has seen revolutionary changes.

The Indian banking system consists of 12 public sector banks, 22 private sector banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks and 96,000 rural cooperative banks in addition to cooperative credit institutions. As of November 2020, the total number of ATMs in India increased to 209,282. Asset of public sector banks stood at Rs. 107.83 lakh crore (US\$ 1.52 trillion) in FY20. During FY16-FY20, bank credit grew at a CAGR of 3.57%. As of FY20, total credit extended surged to US\$ 1,698.97 billion. During FY16-FY20, deposits grew at a CAGR of 13.93% and reached US\$ 1.93 trillion by FY20. Credit to non-food industries stood at Rs. 105.53 trillion (US\$ 1.44 trillion), as of January 15, 2021. Non-food industries grew at 5.7% in January 2021 as against an increase of 8.5% in January 2020. The banking sector is a crucial component of any economy and its stability is considered to be an important driver of any future GDP growth. When banks are good at "identifying creditworthy firms, mobilizing savings, pooling risks, and facilitating transactions", they contribute to the development of the country by speeding up the growth of its economy. For banks to be successful, it is imperative to increase their customer base, retain their existing customer and offer customers the products and services which are most beneficial to them. Banking industry in India has undergone a paradigm shift over the last decade primarily because of the ongoing deregulation in the financial

and banking sector. As a result, there has been a distinct change in the way in which banking business is being done in India.

Role of the Board in Banks

The board has ultimate responsibility for the bank's business strategy and financial soundness, key personnel decisions, internal organization and governance structure and practices, and risk management and compliance obligations. Bank directors are the guardians of financial stability, which is one of the most precious public goods. Bank directors have to ensure that the bank strategy as conceived and executed by management has an appropriate risk-reward profile; that financial data accurately represent the bank's condition; that risk mitigation measures are adequate to protect depositors' money and shareholders' funds; in sum, that management does its job without incurring excessive risk. In discharging their oversight responsibilities, bank directors often find it essential to work with bank supervisors in an alliance to protect financial stability.

Banks are different from the generality of companies in that their collapse affects a far wider circle of people and moreover may undermine the financial system itself, with dire effects for the whole economy. This places a special responsibility upon a bank's directors. This responsibility remains with them even though they operate under the supervision of a regulatory authority whose task is to ensure their business is conducted in a way that is conducive to stability. Their regulators' concern will be with the quality of the bank's management, starting with the board of directors itself.

Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Banks perform a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the banking sector and the economy as a whole.

Corporate governance determines the allocation of authority and responsibilities by which the business and affairs of a bank are carried out by its board and senior management, including how they:

- set the bank's strategy and objectives;
- select and oversee personnel;
- operate the bank's business on a day-to-day basis;
- protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders;
- align corporate culture, corporate activities and behavior with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and
- establish control functions

The Basel Committee's October 2010 Principles for enhancing corporate governance represented a consistent development in the Committee's long-standing efforts to promote sound corporate governance practices for banking organizations. The 2010 principles sought to reflect key lessons from the global financial crisis that

began in 2007, and enhance how banks govern themselves and how supervisors oversee this critical area.

Accordingly the board should :

- actively engage in the affairs of the bank and keep up with material changes in the bank's business and the external environment as well as act in a timely manner to protect the long term interests of the bank;
- oversee the development of and approve the bank's business objectives and strategy and monitor their implementation;
- play a lead role in establishing the bank's corporate culture and values;
- oversee implementation of the bank's governance framework and periodically review that it remains appropriate in the light of material changes to the bank's size, complexity, geographical footprint, business strategy, markets and regulatory requirements;
- Establish, along with senior management and the CRO, the bank's risk appetite, taking into account the competitive and regulatory landscape and the bank's long-term interests, risk exposure and ability to manage risk effectively;
- oversee the bank's adherence to the risk policy and risk limits;
- approve the approach and oversee the implementation of key policies pertaining to the bank's capital adequacy assessment process, capital and liquidity plans, compliance policies and obligations, and the internal control system;
- oversee the integrity, independence and effectiveness of the bank's policies and procedures for whistleblowing.
- The board should ensure that transactions with related parties (including internal group transactions) are reviewed to assess risk and are subject to appropriate restrictions (eg by requiring that such transactions be conducted on arm's length terms) and that corporate or business resources of the bank are not misappropriated or misapplied.
- In discharging these responsibilities, the board should take into account the legitimate interests of depositors, shareholders and other relevant stakeholders. It should also ensure that the bank maintains an effective relationship with its supervisors.
- The board should take an active role in defining the risk appetite and ensuring its alignment with the bank's strategic, capital and financial plans and compensation practices.

The Indian banking industry plays an important role in the economic development of the country and is the most dominant segment of the financial sector. Banks help channel savings to investments and encourage economic growth by allocating savings to investments. It has become important that banks keep a constant vigil over the enterprises being financed by them. On one hand, it has to be monitored that funds are being properly utilized in business, while on the other hand it has to be ensured that the enterprise does not fail because of poor management despite the best intentions of the entrepreneur. Thus the banks now have to take over the reins of the enterprises and play a constructive role in ensuring the ultimate viability of each enterprise. They have to

develop the infrastructure and skill to assist the entrepreneurs.

Role of effective cost based MIS in Banks

Accurate meaningful and timely management information is the key to ensuring the sustained profitability of a bank over a long term. Cost information is a critical component of any profitability, strategic planning or decision-making equation. It is, therefore, important that the Board understands the cost structure of a bank as well as the main cause-and-effect relationships that affect operating costs in a bank. This process can only be achieved if management adopts a total cost management strategy. In order to understand costs, management should identify costs and the causes (drivers) thereof at the lowest level, namely an activity. The availability of accurate and meaningful cost information depends entirely on the existence of a sound product costing methodology in a bank. These four interrelated products/services share different activities, products, responsibility centers, associated employees/computers, etc, making it hard to understand exactly how to allocate these costs. Therefore, choosing the right type of costing system that fits this type of cost structure is crucial, as it could reflect if a bank takes the most efficient decisions and measures, for example, in terms of pricing and lending policy

The purposes of costing in a bank can be summarized as : Information for the planning and control of ongoing operations; The calculation of customer, product and segment profitability; Establishing an improved decision-making process through the utilization of recognized costing techniques to evaluate alternative courses of action; Evaluating the viability of new products. This calls for specialized and expert guidance by the Board for Continuous evaluation and monitoring of Business performance: The basic emphasis shall be on strategic management of costs on a continuous basis. It should not be a routine function for maintaining cost accounting records and for control of costs. Such a system shall facilitate on-going evaluation and monitoring of operational performance and should ensure excellent operational efficiency and productivity. This in turn necessitates : (i) elimination of wastes and deficiencies in the system (ii) use of improved methods, systems and procedures (iii) better and tighter control of costs on a continuous basis (iv) more efficient use of human and physical facilities and also more efficient operations.

CMA on the Board of Banks – A key imperative

the effective governance of the business requires the board to strike a balance at a high standard of effectiveness, between driving the business forward and controlling it prudently. This in turn requires a balance on the board. Keeping in view the dynamics and dimensions of the banks operations and functions it seems imperative for every bank to nominate/appoint a Cost and Management Accountant as a director on its Board as they possess expertise in the following key areas and they can create huge value to the bank :

Risk management in Banks : The expertise of the Cost & Management Accountants in Risk Based Supervision Consulting Process includes: Design and development of appropriate organizational structure Advisory services to document systems and procedures for undertaking business in alignment with the requirements of risk based supervision. To identify gaps in management information systems and suggest remedial measures.

To review and strengthen reporting and control system : To design and develop appropriate risk focused internal audit model To assist bank in setting up compliance units CMA's specialized Professional & consulting

service ensure compliance of internal audit with the International Standards on Auditing (ISA), relevant banking regulations and other legal requirements, ensuring the adequate professionalism and conformity with the ethical principles.

Providing specialized guidance to the Board: The Cost and Management Accountants with their specialized professional skill and expert knowledge and analytical capabilities can provide an in-depth service in Risk based audit in Banks and the services inter-alia includes the following functional areas: SWOT Analysis, Risk Assessment for Project Evaluation, Bank Supervision/Audit Mechanism, Credit Risk Management and Credit Portfolio Evaluation Customer Due Diligence, Project Techno-economic Feasibility Studies and Project Monitoring Borrower Credit Appraisal and Working Capital Assessment Borrower Security Evaluation, Asset and Liability Management System and Management Information System, NPA Management Advisory Services, Business Valuations and Asset Valuations, Information Systems/EDP Audit, Software Evaluation, Bank Staff Training, Preparation of Instruction Manuals for Credit, Audit and other bank functions

Product Discontinuation : A critical prerequisite for any bank in terms of setting pricing and product policies is a sound knowledge and understanding of its own cost structures and the main causes of cost. The role that costing should play in this regard is to ensure that management does not market an unprofitable product because of understated costs that lead to an inadequate pricing structure. When you have to cut off dead wood, which branch you will take out? Continuous evaluation of profitability, suitability of all the products is of high importance nowadays. No financial institution can afford to continue with the products, which are not giving net positive return. Moreover, considering the resource constraint, ranking of the net positive revenue generating products is also important. Cost accountants will be of great help regarding this. CMAs possess expertise in Product, Service, Market, Customer Profitability Analysis.

Credit Risk Appraisal: The Banks and Financial Institutions have a systematic credit appraisal methodology, which is being constantly reviewed in the light of the experiences gained from time to time. However, the basic standards for working capital facilities, both fund based and non-fund based, and term facilities are well understood. Certain basic parameters have evolved over the years. Appraisal of Credit for Project Financing involves analysis of the following risks and mitigation thereof: Environment Risk; Country Risk; Industry Risk; Company Risk; Competition Risk; Market Risk; Project Risk; Product Risk; Supply Risk; Funding Risk; Interest Rate Risk; Currency Risk Analysis of basic financial parameters may be considered as one of the strong pillars for mitigation of Credit Risk while appraising credit proposal. The basic financial parameters, which form the foundation of the Bank's credit appraisal, are as follows: Capital Gearing; Liquidity; Net Working Capital; Non-current assets; Turnover; Profitability; Cash Accrual. Appropriate Credit Risk guidance by CMAs can help the banks in controlling Non Performing assets.

Asset Quality

The major cause of a bank failing or a crisis in a bank is poor asset quality. The single most important reason for the collapse of banks is bad loans. Foreign exchange, deposits, maturity mismatches and open positions may cause worry and sleepless nights, but they do not normally lead to the closure of a bank. That is done by poor asset quality. Poor asset quality is reflected in the loans written off or loans loss ratio. This ratio shows the loan loss experience of the bank in an attempt to give an analyst an idea of the quality of the assets of the bank.

The Cost and Management Accountants possess expertise in carrying out sensitivity analysis and efficiency evaluation of a project and can raise alert before the account becomes Non Standard through the perspective of Activity Based Costing, Target costing , Kaizen costing, Lifecycle Costing.

Conclusion

The modern economies of the world have developed primarily by making best use of the credit availability in their systems. India is on the march; far reaching socio-economic changes are taking place and Indian banks should come forward to play this role in the process. The role of banks has been important, but it is going to be even more important in the future. Banking is becoming so complex that its risks cannot be monitored only by bank supervisors. And bank regulation cannot try to respond to every single financial innovation. The safety and soundness of banking requires the appropriate mix of nominations on the Board where it is imperative to have Cost and Management Accountant so as to provide insight and vision for effective performance management of the bank.