ROLE OF COST AND MANAGEMENT ACCOUNTANTS (CMAs)

(Proposed Expected Credit Loss (ECL) Framework in Indian Banks)

Abstract

The implementation of Expected Credit Loss (ECL) provisioning represents a paradigm shift in credit risk measurement for Indian financial institutions. Unlike the incurred loss model, ECL requires forward-looking assessment of credit deterioration across the life of a loan. With the proposed implementation of Expected Credit Loss (ECL) norms from 1 April 2027, financial institutions are required to adopt a forward-looking impairment framework for all financial assets.

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The Reserve Bank of India has introduced a forward-looking Expected Credit Loss (ECL) provisioning framework for scheduled commercial banks, which will replace the existing incurred loss provisioning model. This new approach requires banks to make provisions based on anticipated losses over the entire life of financial assets. The framework will take effect from April 1, 2027, with a transition period extending until March 31, 2031, to ease the adjustment process.

Under the ECL framework, banks will categorize financial assets into three stages according to credit risk and predict expected losses using probability models. These models incorporate macroeconomic scenarios and statistical factors such as:

- Probability of Default (PD).
- Loss Given Default (LGD) and
- Exposure at Default (EAD).

This framework significantly improves credit risk measurement, governance, and disclosure, creating opportunities for professionals with strong financial, analytical, and auditing expertise. Cost and Management Accountants (CMAs) are particularly well-suited to contribute in this area.

Alignment of CMA Curriculum and Skills with ECL Requirements:

The Cost and Management Accountant (India) Qualification, offered by the Institute of Cost Accountants of India (ICMAI), equips professionals with a comprehensive set of financial, analytical, auditing, and risk assessment skills that closely match the competencies needed for ECL implementation.

Key CMA Subjects and Skills Relevant to ECL:

- **Management Accounting and Financial Management**: Offers in-depth knowledge of planning, budgeting, forecasting, variance analysis, and decision-making techniques essential for estimating forward-looking credit risk and provisioning.
- **Cost and Management Audit**: Covers principles of cost audit, internal controls,

risk reporting, operational and forensic audits, which enhance governance and assurance frameworks, strengthening banks' credit risk models and data quality for ECL.

- **Corporate Accounting and Auditing**: Develops understanding of financial reporting, audit procedures, and compliance, which are critical for validating provisioning results and disclosures under the ECL framework.
- **Risk Management and Business Data Analytics**: Elective courses like Risk Management in Banking and Insurance and Business Data Analytics provide analytical tools and scenario analysis skills vital for validating ECL models and conducting stress tests.
- **Business Laws, Ethics & Corporate Law**: Provides a solid legal foundation, enabling CMAs to interpret regulatory requirements and compliance obligations under RBI guidelines.

These skills enable CMAs to excel in financial forecasting, risk measurement, internal control assessment, audit and compliance reviews, and data-driven advisory roles, all of which are central to implementing the ECL framework.

Roles of CMAs in Banks' ECL Implementation:

a) Support in ECL Model Design and Validation:

With their knowledge of statistical forecasting and modelling gained through financial management and analytics courses, CMAs are well-positioned to assist banks in:

- Designing credit risk models that incorporate forward-looking macroeconomic factors;
- Assessing model assumptions, segmentation methods, data governance, and quality controls;
- Validating PD, LGD, and EAD parameters along with stress testing scenarios to ensure model robustness and regulatory compliance.

Their analytical expertise contributes to improved risk sensitivity and consistency in provision estimates across portfolios, aligning with the RBI's emphasis on enhanced credit risk management.

b) Governance, Assurance & Internal Controls:

The Expected Credit Loss (ECL) framework demands strong governance and control mechanisms concerning data, models, and reporting. Cost and Management Accountants (CMAs) can:

- Assess internal controls related to credit data, provisioning methods, and reporting procedures;
- Perform internal audits on ECL provisioning calculations and classification methods;
- Recommend corrective measures to improve processes and address control deficiencies.

The skills of CMAs in cost and management auditing are directly applicable to reviewing credit risk functions, control environments, and compliance with model risk management standards.

c) Financial Reporting, Disclosure & Compliance:

ECL provisioning impacts a bank's financial statements and disclosures. CMAs' expertise in cost and financial accounting allows them to:

- Convert complex ECL results into precise financial disclosures;
- Ensure that provisioning accurately reflects economic conditions while adhering to RBI guidelines and applicable accounting standards;
- Coordinate with statutory auditors and regulatory bodies regarding provisioning policies and methodologies.

Their background in accounting, auditing, and corporate law supports clear and defensible reporting practices.

d) Strategic Advisory for Credit Risk Mitigation:

With their skills in management accounting and strategic cost analysis, CMAs can offer senior management and boards valuable insights on:

- Trends in portfolio risk and the strategic effects of provisioning;
- Cost-benefit evaluations of credit risk mitigation approaches;
- The broader economic impacts on loan loss provisioning and capital adequacy planning.

These insights help develop robust credit strategies under the new ECL framework.

CMAs as Statutory Cost Auditors-Additional Roles Under the Companies Act, 2013:

Apart from their role in ECL implementation within banks, practicing CMAs are authorized to conduct Cost Audits under the Companies Act, 2013, and related Cost Records and Audit Rules. Only qualified Cost Accountants, i.e., members of ICMAI, can be appointed as cost auditors to examine and report on companies' cost records.

Although banks and financial institutions are generally **exempt from** cost audit requirements due to their regulated status and separate audit systems, CMAs' expertise in cost audits enhances their capability to:

- Audit and evaluate cost structures, internal cost controls, and operational efficiency;
- Provide assurance on costing procedures, cost allocations, and performance indicators relevant to credit risk and provisioning;
- Advise non-banking companies indirectly affected by ECL-related credit conditions (such as corporate borrowers) on cost optimization and risk management.

Their statutory authority to perform cost audits reinforces their broader role as trusted assurance professionals within India's financial sector.

Practical Examples: Role of CMAs in Implementing Expected Credit Loss (ECL) in Indian Banks:

Example 1: Portfolio Segmentation for ECL Based on Cost and Risk Factors.

Context: A public sector bank holds a ₹ 25,000 crore MSME loan portfolio. For ECL purposes, loans need to be grouped into homogeneous risk categories.

Role of CMA: A CMA in the Credit Risk Department uses cost accounting and management analysis techniques to:

- Segment MSME loans according to:
  - Industry-specific cost structures (manufacturing, trading, services).
  - The proportion of fixed versus variable costs.
  - Operating leverage and breakeven points.
- Identify borrowers with limited cost flexibility, making them more susceptible during economic downturns.

Outcome:

- More detailed ECL staging (distinguishing between Stage 1 and Stage 2 migrations).
- Enhanced accuracy in estimating Probability of Default (PD).
- Risk differentiation compliant with RBI guidelines.

CMA Skills Applied: Management Accounting | Cost Analysis | Strategic Cost Management

Example 2: Estimating Probability of Default (PD) Using Cost Behaviour Analysis.

Context: The bank needs to estimate the 12-month PD for a mid-sized manufacturing borrower.

Role of CMA: The CMA examines:

- Historical cost statements provided by the borrower.

- Contribution margins and breakeven analysis.
- Profit sensitivity to fluctuations in input prices (such as steel, power, and fuel).

By applying Cost-Volume-Profit (CVP) analysis, the CMA determines:

- The level of revenue decline at which the borrower starts incurring cash losses.
- The likelihood of default under stressed macroeconomic scenarios.

Outcome:

- PD estimates grounded in actual operating economics.
- Reduced dependence on purely statistical credit scoring models.

CMA Skills Applied: Cost Accounting | Financial Management | Business Analytics

Example 3: Estimating Loss Given Default (LGD) Using Cost Audit Methods.

Context: The bank must calculate LGD for a term loan secured by plant and machinery.

Role of CMA: Leveraging experience in Cost Audit and Valuation, the CMA:

- Reviews capacity utilization and idle capacity.
- Evaluates the recoverable value of machinery considering:
  - Replacement cost.
  - Remaining useful life.
  - Historical maintenance expenses.
- Adjusts LGD estimates to account for high dismantling and transportation costs.

Outcome:

- More accurate LGD figures rather than inflated collateral valuations.
- Lower supervisory risk during RBI inspections.

CMA Skills Applied: Cost Audit | Valuation | Capital Cost Analysis

Example 4: Computing ECL for Agricultural Loans (Kisan Credit Card and Crop Loans).

Context: Agricultural Non-Performing Assets (NPAs) follow special recognition norms, making ECL calculation complex.

Role of CMA: A Cost and Management Accountant:

- Separates crop-wise cultivation cost data.
- Analyses:
  - Input costs such as fertilizers, labour, and irrigation.
  - Minimum Support Price (MSP) versus actual market price realization.
- Helps estimate expected shortfall rather than relying solely on overdue status.

Outcome:

- ECL provisions that reflect actual economic loss instead of mechanical overdue criteria.
- Compliance with RBI's forward-looking regulatory approach.

CMA Skills Applied: Cost Accounting | Applied Economics | Risk Management.

Example 5: Stage-2 Identification Using Early Warning Cost Signals.

Context: Under the Expected Credit Loss (ECL) framework, banks are required to detect Significant Increases in Credit Risk (SICR).

Role of the CMA: The Cost and Management Accountant (CMA) develop cost-based Early Warning Indicators (EWIs), including:

- Increasing employee costs as a percentage of sales.
- Decreasing contribution margins.
- Rising finance cost absorption ratios.

These EWIs are incorporated into the bank's credit monitoring system.

Outcome:

- Early transition to Stage-2 classification.
- Proactive provisioning to avoid shocks after defaults.

Relevant CMA Subjects: Performance Management | Management Information Systems & Control Systems.

Example 6: Validation of ECL Models-CMA as Internal Risk Auditor.

Context: The Reserve Bank of India (RBI) mandates robust model governance and validation.

Role of the CMA: Acting within Internal Audit or Risk Assurance functions:

- Reviews the assumptions used in ECL models.
- Ensures consistency among:
  - Cost data.
  - Cash flow forecasts, and
  - Credit risk parameters.
- Verifies audit trails and documentation.

Outcome:

- Reduced risk associated with models.
- Strong defense during RBI supervisory reviews.

Relevant CMA Subjects: Cost & Management Audit | Internal Audit | Corporate Governance.

Example 7: ECL Impact on Profitability & Capital Planning.

Context: ECL provisioning has a significant effect on profit and loss statements and capital adequacy.

Role of the CMA:

- Develops scenario-based forecasts for provisioning.
- Evaluates impacts on:
  - Return on Assets (ROA), Return on Equity (ROE).
  - Capital buffers, and
  - Profitability of business lines.
- Advises management on repricing strategies and portfolio rebalancing.

Outcome:

- Informed strategic decision-making supported by cost-risk analysis.
- Improved alignment between credit growth and capital planning.

Relevant CMA Subjects: Strategic Financial Management | Budgeting & Forecasting.

Example 8: CMA Support During Statutory and RBI Inspections.

Context: Banks must justify their ECL assumptions during RBI inspections.

Role of the CMA:

- Provides documentation linking borrowers' cost structures to ECL estimates.
- Explains provision variances using operational economics.
- Supports statutory auditors and audit committees.

Outcome:

- Quicker completion of inspections.
- Fewer supervisory observations.

Relevant CMA Subjects: Audit & Assurance | Corporate Laws | Ethics.

Example 9: Advisory Role for Corporate Borrowers (Indirect Impact).

Context: Higher ECL requirements prompt banks to demand greater financial transparency from borrowers.

Role of the CMA (in practice):

- Assists corporate clients in enhancing cost efficiency.
- Prepares cost-based projections acceptable to banks.
- Lowers borrower risk perception, leading

to reduced Probability of Default (PD) and lower ECL.

Outcome:

- Beneficial outcomes for both banks and borrowers.
- Strengthened credit ecosystem.

Conclusion:

The RBI's implementation of the Expected Credit Loss (ECL) provisioning framework represents a fundamental change in how Indian banks manage credit risk, requiring a combination of forward-looking analysis, model oversight, rigorous auditing, and financial reporting skills. The ECL framework goes beyond being just an accounting adjustment; it signifies a transformation in risk management, economics, and governance.

Cost and Management Accountants (CMAs), with their distinctive expertise in cost analysis, auditing, forecasting, and statutory authority, are well-equipped to:

- Connect credit risk models with actual business economics.
- Enhance governance, assurance, and transparency.
- Help Indian banks effectively and credibly comply with the RBI's ECL requirements.

Starting from April 1, 2027, CMAs will move from being peripheral participants to becoming central drivers of resilient and forward-thinking banking. Their comprehensive training, analytical skills, and statutory audit responsibilities, CMAs are uniquely qualified to assist Indian commercial banks in:

- Developing, evaluating, and validating ECL models.
- Strengthening internal controls and governance related to provisioning.
- Ensuring accurate provisioning disclosures and regulatory compliance.
- Providing strategic advice in response to changing credit risk conditions.

Amid a changing regulatory landscape, the CMA profession is set to play a vital role in fostering robust and transparent credit risk management practices within Indian Banking and beyond. MA

References

1. *Reserve Bank of India (Proposed). Expected Credit Loss Framework – Directions effective from 1 April 2027. ECL on Agriculture Segment Loans*
2. *RBI. Prudential Norms on Income Recognition, Asset Classification and Provisioning- Advances.*
3. *Basel Committee on Banking Supervision. Guidance on Credit Risk and Accounting for Expected Credit Losses.*

Obituary

The Institute and its members deeply mourn the demise of CMA Mohan Lal Lahiry, our Beloved Member of the Institute on December 7, 2025 at Kolkata.

May God bless the family to have the courage and strength to overcome the irreparable loss.

CMA Mohan Lal Lahiry