Chapter - 9

Major Findings and Suggestions

9.1. Major findings of the study

- The analysis of quantitative derivative accounting guidelines by RBI with BIS shows that there is less gap in general quantitative information when compared to other quantitative information types.

- There is a major gap in quantitative information related to market risk, credit risk and liquidity risk that needs to be minimized in the current derivative accounting guidelines by RBI.

- Quantitative Information on earnings from derivative trading activities has to be enhanced in the present RBI guidelines.

- General qualitative, risk management and information relating to accounting and valuation methods are comparatively better than other qualitative information types.

- There is a major gap in qualitative market, credit and liquidity risk information type in the current RBI guidelines.

- Major respondents of the survey are investors in bank securities who go through the annual reports of banks.

- Majority of respondents consider derivative accounting information important for taking informed decisions and in assessing the use of derivatives and its exposures to banks.
• Bank annual reports are considered as the most important source of derivative accounting information, while the quarterly reports get the second rank.

• In case of quantitative derivative accounting information, all information types are considered as significant items by the respondents.

• Hedging strategy and the impact of hedge ineffectiveness on earnings and quantitative information on market risk exposure are considered as most important quantitative derivative accounting information by the respondents.

• The respondents treat most of the qualitative derivative accounting information types as important.

• Qualitative Information elaborating and providing depth on quantitative information and overall business objective of trading and derivatives activities and strategies for achieving those objectives are considered as significant by the users of bank annual reports.

• The users perceive that the present derivative accounting information could be improved with greater explanation of the purpose for which derivatives are used and the risks associated with derivatives.

• The need for enhanced market risk information associated with derivative activities is reflected in the comments of user.

• Awareness should be created on the usage of derivatives by banks, risks and rewards associated among the users of bank annual reports.

• The users of derivative accounting information are of the opinion that, the derivatives related information by banks should be comparable at national and international level.
• The sample banks show consistency in the level of compliance with quantitative derivative accounting guidelines for the period of five years.

• The level of compliance with quantitative derivative accounting information is positively and insignificantly affected by the size and ownership of banks.

• The level of quantitative derivative accounting guidelines is negatively and significantly affected by age of banks i.e., as the age of the bank increases the quantitative derivative accounting compliance score decreases and vice versa.

• There is an inconsistency in the level of compliance with quantitative derivative accounting guidelines within large and small size banks.

• The sample banks show consistency in level of compliance with qualitative derivative accounting guidelines over the period of five years.

• The level of compliance with qualitative derivative accounting guidelines is positively and significantly affected by the size and ownership of banks i.e., as the size and private ownership of banks increases banks tend to provide more qualitative derivative accounting information.

• The level of compliance with qualitative derivative accounting guidelines is negatively and significantly affected by the age of the banks i.e., as the age of the bank increases the qualitative derivative accounting information score decreases and vice versa.

• There is consistency among the sample banks in complying with overall derivative accounting guidelines in their annual reports over the period of study.
- The level of compliance with the overall derivative accounting guidelines by banks is positively and significantly affected by size as measured by market capitalization and ownership of banks.

- The level of compliance with the overall derivative accounting guidelines by banks is negatively and significantly affected by age of banks as measured by number of years in business.

- Size of banks as measured by market capitalization, age as measured by number of years in business and ownership of banks are all significant determinants of the level of compliance with overall derivative accounting guidelines by Indian banks.

- There is a significant difference in the level of compliance with quantitative and qualitative derivative accounting guidelines by banks.

- The compliance study reveals that the qualitative derivative accounting information are generic in nature, while the quantitative derivative accounting information reported are incomplete in nature. It will be difficult for the users of such information to assess the bank’s risk profile with lack supportive qualitative and incomplete quantitative derivative accounting information in bank annual reports.
9.2. Suggestions

The following suggestions are listed out both for the regulatory authorities and banks with derivative activities. These suggestions are made based on the major findings of the present study.

9.2.1. Suggestions to the Regulatory Authorities

- The analysis of Indian derivative accounting guidelines with the international recommendations by Bank for International Settlements show that there is a significant difference in the current derivative accounting guidelines.

- The gap in the quantitative information related to market risk, credit risk and liquidity risk needs to be minimized with incorporation of guidelines that help in improving the quantitative derivative accounting information by banks.

- Guidelines that help in improving the quantitative derivative accounting information relating to the earning from derivative trading activities have to be enhanced.

- Guidelines that help in improving the quantitative derivative accounting information relating to the earning from derivative trading activities have to be enhanced.

- The gap in qualitative market, credit and liquidity risk information type has to be minimized through proper inclusions in the present RBI guidelines.

- The results of the survey reveals that, users rate most of the qualitative and quantitative derivative information types important, hence, regulatory bodies at the national level should consider the recommendations for international best practice while formulating derivative accounting information guidelines.
The regulators should pay more attention towards increasing the quality and usefulness of annual reports to its varied user groups or stakeholders. The respondents to the survey have rated the annual reports as the most important source of derivatives accounting information for decision making by different user groups. Thus, the regulatory authorities should pay more attention towards improving the quality of such reports and their usefulness to various stakeholders (Alfraih & Almutawa, 2014). This may have a positive impact on the quality of user’s decisions and improve the confidence in bank’s derivative activities.

The regulators should consider updating the derivative accounting guidelines in line with the extent of usage of derivatives by banks for trading or non-trading purpose.

The regulators like RBI should strongly encourage enhanced disclosures and reward such institutions for showing good market discipline. Regulators and standard setters should continue to monitor improvements in bank’s derivative accounting practices over the coming years.

Banks that provide lesser derivative accounting information should be encouraged to provide the type of information provided by their peers at the National level.

The quality of derivative accounting information can be enhanced if the standard setters focus on the users of these information at the time of framing standards, through;

- Participation of users in standard setting process has to be taken care of.
- Including professionals like accountants/preparers, auditors along with users in the standard setters group.

- Increasing the long-term benefits of financial reports by increasing the usefulness of information provided, rather than merely focusing on formulation and implementation of standards.

- As suggested by Akhtaruddin (2005), a compliance assessment committee has be formed that represents the wider user group of annual reports to assess the efficiency of banks in meeting the required information regulations and give their recommendations. This would ensure and restore the confidence in the traditional means of communication between banks and its stakeholders.

9.2.2. Suggestions for Practice by Banks

There is a lot of disparity among the banks with regard to the amount of derivative accounting information in the annual reports under the period of study. A major amount of banks maintain to inform little about their derivative and trading activities.

- As annual reports of banks are considered as an important source of derivative accounting information, its usability can be improvised through enhanced quantitative and qualitative derivative accounting information.

- As the users of bank annual reports consider most of the quantitative and qualitative derivative accounting information significant, the respective information in bank annual reports should be provided in a most effective manner.

- Banks are expected to improve or expand their derivative accounting information over the period of study. More enhanced management discussion
on the risks associated with the derivatives usage and the methods used in managing such risks should be informed.

- Derivatives accounting and valuation techniques have to be discussed in detail.
- Comprehensive qualitative derivative accounting information has to be provided.
- Incomplete and non-explanatory quantitative derivative accounting information have to be replaced with complete and well justified quantitative derivative disclosures.
- Greater explanation of the purpose for which derivatives are used and the associated risks involved is required.
- Derivative accounting information should be more simple and understandable avoiding jargons to serve the purpose of public reporting.
- Enhanced market risk information associated with derivative activities should be provided.
- Awareness about the risks and rewards associated with the usage of derivatives by banks to the users should be provided.
- Derivative accounting related information should be such that they should be comparable at national and international level.
- As quantitative derivative accounting information are found to be incomplete and misleading (Susan, 1994) without supportive qualitative derivative accounting information, banks should provide more qualitative derivative
accounting information in support of quantitative derivative accounting information.

- As there is a difference in the quantitative and qualitative derivative accounting information available in the bank annual reports, it is suggested that the limited qualitative derivative accounting information should be enhanced, so that the users can combine both qualitative and quantitative derivative accounting information to assess the bank’s risk profile.

9.2.3. Suggestions for future research

Future research of this nature is suggested as this is an emerging topic in the field of financial reporting. This study serves as a benchmark for future researchers in the field. With the introduction of new International Financial Reporting Standards (IFRS) converged accounting regulations in the coming years, both financial and non-financial firms will be affected to a greater extent. A comparative study of derivative accounting information by banks covering the period before and after convergence with IFRS would provide evidence on identification of gaps in derivative accounting information. While the respondents for the survey conducted in this study were majorly stock brokers, similar studies including other professional users of annual reports would provide additional information regarding the derivative accounting information by Indian banks.