Abstract

Derivatives are used by the banks for risk management. The growing complexity, diversity, higher value and volume of derivatives require accounting for derivatives. International Accounting Standards Board and National Standard setting bodies have issued International Financial Standards and Accounting Standards for recognition, measurement and disclosure of derivatives. Bank for International Settlements (BIS) and Reserve Bank of India (RBI) have issued quantitative and qualitative guidelines for derivative accounting disclosures by banks.

The use of derivatives by banks and the extent of information provided in bank annual reports are considered to be opaque and are less assessed for transparency in reporting practices. Many of the past studies have focused on derivative accounting practices for non-financial institutions which are single year studies. Again, derivative accounting practices around the world are under scrutiny as derivatives were blamed for having a role in the recent financial crisis.

Thus, there exists a need to study and present derivative accounting practices by Indian banks to understand the derivative accounting regulations and guidelines for Indian banks, identify the user’s requirements and examine the level of compliance with the prescribed guidelines. The study analyzes the quantitative and qualitative derivative accounting guidelines for banks issued by BIS with RBI. A gap in both quantitative and qualitative guidelines for information on market, credit and liquidity risks associated with derivative activities and information on earnings from trading activities is observed. Derivative accounting guidelines by RBI for banks are limited, not reflecting the internal risk management models and methods adopted, which limits the users understandability of bank annual reports. This shows that there is need to enhance quantitative and qualitative derivative accounting guidelines for Indian banks.
The study identified the quantitative and qualitative derivative accounting information needs of users. Hundred responses from the users of bank annual reports are collected through execution of survey questionnaire. Bank annual reports are rated as the most important source of derivative accounting information by users. Quantitative information like hedging strategies, hedge ineffectiveness on earnings and market risk exposure and qualitative information elaborating on the depth of quantitative information, explanation on the objectives of using derivatives and policies adopted for measuring and managing market risk are rated as the most important information types. Users attach significant importance to most of the information items included in the research questionnaire showing that there is a scope for enhancement of both quantitative and qualitative derivative accounting information provided in the bank annual reports.

To examine the level of compliance with quantitative and qualitative derivative accounting guidelines by the sample banks, content analysis of twenty NSE listed bank’s annual reports for five years is carried out through a self constructed relative derivative accounting compliance index. Banks show higher level of compliance with quantitative derivative accounting guidelines. Size and ownership of banks show a positive and significant association, while age of banks shows a negative and significant association with the level of compliance with overall derivative accounting guidelines.

The present derivative accounting information guidelines for Indian banks are very minimal and banks show insufficient derivative accounting information in their annual reports. Regulators and organizations that set standards in India like ICAI and RBI need to frame better financial reporting requirements reflecting the risks and rewards associated with bank’s derivative activities.