

Impact of Ind AS (IFRS) on Fair Value Disclosure of Derivative Financial Instruments (DFIs) in India

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ABSTRACT

Derivative financial instruments (DFIs) may play an important role in near crumble or bankruptcies if it is not managed and priced properly. To protect the interests of the stakeholders, fair value accounting has become a relevant field of International Financial Reporting Standards (IFRS) for DFIs. In India, Indian Accounting Standard has been replaced by Ind AS (IFRS) on 1st April 2016. This study aims to determine the effect of fair value on DFIs in Indian corporate annual reports at the backdrop of introduction of IFRS (Ind As) in India. The study also looks at whether DFIs' degree of fair value disclosure is linked to their size, listing status, leverage, and other factors. This research would be extremely beneficial to corporate executives and stakeholders.

INTRODUCTION

According to International Accounting Standard Board (IASB) and Financial Accounting Standards Board (FASB), all financial instruments must be reported at their fair values in the financial statements. The pursuit of this goal has resulted in a sequence of standards that have increased the importance of fair value measurements required by IFRS and to provide more transparency to users, increased the scope and complexity of the related required disclosures. One of the primary goals of adoption of IFRS is to promote the international comparability of financial reporting. More than 120 countries have adopted the International Financial Reporting Standards (IFRS) in order to improve the accuracy and comparability of accounting data. The main factor in achieving financial statement uniformity is fair value calculation of financial instruments. In India, Accounting Standard has been replaced by Ind AS (IFRS) from 1st April 2016. Proper accounting of Derivative Financial Instruments (DFIs) becomes an important issue to keep the usage of the instrument under control. Proper disclosure of accounting information on DFIs helps to reduce information asymmetry and it becomes an indicator for investors in making their investment decision for the user companies. For a long time, the accounting of DFIs has been a major issue for various national and international accounting standard boards. Accounting guidelines on financial instruments have recently been formulated and approved to address concerns such as presenting and identifying financial instruments. The diverse

accounting treatment of complex derivative transactions necessitates the creation of a uniform accounting and financial reporting standard for DFIs.

Derivatives can be an excellent vehicle for an organisation or an entity to pass risk created by uncertainty and volatility in the underlying asset (Varma 2008, Vashishtha & Kumar 2010). According to Stulz (2004) and Verma (2008), derivative instruments have been used to effectively manage risk arising from business activities. Vshishtha & Kumar (2010) and Prabhakara (2013) both described derivatives as an effective risk management tool if, according to Selvam and Rita (2011), users of derivative instruments understand the benefits and drawbacks. Huan & Parbonetti (2019) found that the relationship between derivative use and risk management is nonlinear: moderate use of financial derivatives lowers risk, while aggressive use of DFIs raises risk. According to Prabhakara (2013), global economic developments and financial market advances have resulted in an increase in the use of financial derivative instruments, which have gained widespread acceptance and a prominent position among financial instruments. In India, the number of contracts exchanged and the volume of financial derivatives employed as risk management tools are rising (Gope 2014, Prabhakara 2013). According to Greenspan (1997), financial derivative instruments have recently been the major growth and expansion in finance. Disclosure of derivative details, according to Venkatachalam (1996), allows for a cross-

sectional analysis of an organization's risk management strategies. The ability of management to communicate risk information that reflects current and future financial performance of companies more accurately, according to Arshad & Ismail (2011), will enable users to make effective investment choices. Ernst & Young (2006) showed that, when considering investment, the majority of investors identified transparency as the key issue. According to a Bajaj et. al (2019), there is a tricky need for IFRS adoption in the area of Indian accounting curriculum. According to Achalapathi and Sireesha (2015), the transition to IFRS allows companies to maintain capital while also allowing them to hedge risk. According to Dhankar et. al. (2018), corporate sectors can use IFRS-based financial statements for internal decision-making and performance evaluation procedures in addition to outward reporting. According to Landsman (2007), fair value measurement is highly important to the investors for considering their investment decision. Mitra & Gope (2013) remarked that management needs to disclose about the efficiency of the management regarding the use of Derivative financial instruments in their business organisation. Kingsley. et. al. (2014), stated that IFRS being principles based of accounting standard prepared by the International Accounting Standards Board (IASB) is helpful to prepare the financial statements which provides qualitative, transparent and comparable useful financial information. Accounting Standards, according to Kingsley et al. (2014), are concerned with how information is delivered, what information should be presented and how assets might be valued. According to Kalra & Vardia (2016), IFRS will increase the consistency of disclosures and improve international comparability and interpretation of financial statements since it is focused on fair value standards. According to Skoda & Slavikova (2015), fair value calculation has no negative effects on economic downturns and financial crises.

Fair value accounting, according to Kaur (2013), is a radical transformation in the focus of financial reporting that shifts it away from a conventional accounting structure, which becomes more relevant in the field of accounting. Cairns et al. (2011) examine the use of fair value assessment by 228 publicly traded firms in the United Kingdom and Australia following the adoption of IFRS. They looked at how much fair value estimation had progressed in relation to both mandatory and optional IFRS standards. In relation to mandatory requirements, they observed the expected increase in use of fair value measurement for financial instruments and share-based payment, leading to increases in within and between country comparability.

This development, the implementation of converged Indian Accounting Standards or IFRS in India, lays the groundwork for this study's opportunities in the field of fair value disclosure of derivative financial instruments (DFIs). First, the study investigates the effect of DFIs providing fair value

disclosure before and after the implementation of IFRS (Ind As) in India; second, it considers whether other factors like size of the company, firm's leverage, listing status in stock exchange and foreign institutional investors (FII) are associated to improve the level of fair value disclosure in the corporate annual reports.

METHOD

The literature review shows asymmetric views on disclosure practices of IFRS user companies and there is no shortage of clear studies on IFRS and Derivative Financial Instruments separately, but the field of IFRS (Ind AS) relating to DFIs impact study has still not been exhausted on fair value disclosure of the DFI's. Thus, the hypotheses are then formulated as follows:

Ho1: No differences exist between the levels of fair value disclosure of DFIs provided pre and post introduction of IFRS (Ind As) in India.

Ho2: Fair value disclosure of DFIs in the companies' annual reports is not related with size of the company, firm's leverage, stock exchange (Exch) and foreign institutional investors (FIIs).

To continue the analysis the following research methodology has been applied:

- **Selection of sample**

The information has been gleaned from the annual reports of a number of NIFTY companies of the National Stock Exchange (NSE). The stocks that make up the NIFTY index are India's top firms, and they are industry leaders in terms of equity and derivatives trading volume as well as market capitalization. Out of the 50 firms, ten are in the banking or belongs to financial services sector, and three companies have not used derivative instruments in the years 2014-15 and/or 2018-19. As a result, we have 37 companies in our survey.

- **Data Collection**

The study's data has been gathered from selected annual reports of companies. The content analysis methodology is used to determine the degree of fair value disclosure of DFIs. This is done identifying the existence of disclosures required by IFRS 9 for DFIs.

- **Index of Disclosure**

One of the essential parameters of good corporate governance is the disclosure of details in annual reports (Htay et al., 2011). According to Hassan & Marston (2010), a disclosure index may include both mandatory and voluntary details. The disclosure score index has been developed using existing accounting literature and includes the following key features:

Binary:

Each firm's score is calculated as follows:

$$T_s = \sum_{i=1}^n d_i$$

“Impact of Ind AS (IFRS) on Fair Value Disclosure of Derivative Financial Instruments (DFIs) in India”

Where the corporation is allotted a 1 if the item is revealed and a 0 if it is not, making it binary in nature.

Unweighted

The score has been calculated using the ‘financial derivative instruments disclosure score index table without allotting any kind of weight.

• **Statistical Tool**

Descriptive statistics, t-tests, and regressions are used to evaluate the hypotheses. The linear regression model is used to see if the Fair value of DFIs is affected by other factors. The model is used in which the dependent variable is Fair value of DFIs and the independent variables are Ind AS (DISINDEX), Size of the company (Size), leverage of the company (Leverage), listed stock exchange (Exch) and foreign institutional investors (FII). The regression model is as follows:

$$\text{Fair value of DFIs (Fair value)} = a + b1 \text{ Disindex} + b2 \text{ Size} + b3 \text{ Lev} + b4 \text{ Exch} + b5 \text{ FII}.$$

Where-

Disindex indicates disclosure Index Score which is the impact of Ind AS (IFRS), Size represents the log value of total assets of each selected company. Lev indicates the ratio of total debt to total equity. Stock Exchange is a dummy variable which is used to represent the companies listed whether in India only in foreign country as well.

RESULTS AND DISCUSSION

The data is derived from the annual reports of the select companies. The study has been conducted with selected 37 companies’ annual reports, considering both the stage before and after the introduction of IFRS (Ind AS) in India. That is 74 annual reports of two financial year vis-a-vis, 2014-15 & 2018-19 have been studied and content analysis has been done to find out quantitative data on fair value disclosure of DFIs.

Table-1: Descriptive Statistics

Details	Mean	N	Std. Deviation
FAIRPOST	3.73	37	.508
FAITRPRE	1.51	37	.901
DIXPOST	16.08	37	2.510
SIZE	4.8384	37	.58459
LEVERAGE	.9200	37	.73869
FII	13.7086	37	13.71879
STOCKEX	1.43	37	.502

The Paired Samples t-test shows that the value is acceptable at 1% level, rejecting the null hypothesis, proving that the

introduction of the International Financial Reporting Standard (IFRS) has strengthened DFI fair value disclosure.

Table-2: Paired Samples t-test

Fair value disclosure Pre & Post introduction of IFRS (Ind As) in India	Paired Differences					t	df	Sig (2-tailed)
	Mean	Std. Deviation	Std. Error Mean	Level of confidence 95%				
				Lower	Upper			
	2.216	.886	.146	1.921	2.512	15.212	36	0.000

Regression analysis is performed to test the second hypothesis, to test whether the fair value declaration of DFIs in the firms' annual reports is reliant on Ind AS (IFRS). According to Swain (2008) multiple regressions explain variance in one dependent variable in terms of other independent variables, claims Swain (2008). It cannot reveal

anything about underlying casual relationships because it is fundamentally a relational method. All of the aforementioned independent variables have been taken into account in the model, and multiple regression analysis has been performed to test all of the hypotheses simultaneously.

Table 3: Model Summary

	‘R’	‘R’ Square	Adjusted ‘R’ Square	Std. Error of the Estimate
1	.547 ^a	.299	.186	.459

a. Predictors: (Constant), FII, SIZE, DIXPOST, LEVERAGE, STOCKEX

Table-3 shows the R value, which indicates the degree of correlation (0.547). The R square value measures the total variation in the dependent variable caused by the independent variables.

The regression model (Table- 4) predicts the dependent variable significantly well. Here, p=0.042, which is less than 0.05, and indicates that, overall, the regression model statistically significantly predicts the outcome variable (i.e., it is a good fit for the data).

Table 4: ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	2.779	5	.556	2.643	.042
Residual	6.518	31	.210		
Total	9.297	36			

a. Predictors: (Constant), FII, SIZE, DIXPOST, LEVERAGE, STOCKEX

b. Dependent Variable: FAIRPOST

From the Table- 5, it is observed that the hypothesis is rejected only for the independent variable of implementation of Ind AS (IFRS) for DFIs at 1% level of significance and for the other variables the hypotheses are accepted. Thus the

statistical result implies the fair value disclosure of DFIs in the companies’ annual reports is improved due to enforceable of IFRS or Ind AS only:

Table 5: Results of Regression

Independent Variables	Unstandardised Coefficients (B)	S Unstandardised Coefficients (Std. Error)	Standardized Coefficients (Beta)	t	Sig.
(Constant)	1.643	.823		1.997	.055
DISINDEX	.126	.037	.624	3.409	.002
SIZE	.069	.139	.080	.498	.622
LEVERAGE	-.019	.111	-.027	-.168	.868
STOCKEX	-.197	.189	-.195	-1.040	.306
FII	.001	.006	.037	.235	.816

However, the fair value disclosure level of DFIs in the firms' annual reports is not positively correlated with the company's size, leverage, stock exchange, or number of foreign institutional investors (FII).

Managerial implications

Management must report how effective they are at using derivative financial instruments in their business. On the other, fair value measurement of DFIs' is highly important for investors when making their investment decisions. In corporate sectors, IFRS-based financial statements are prepared not only for internal decision-making and performance evaluation processes, but also for stakeholders. The IFRS as a principles-based accounting standard that aids

in the preparation of financial statements provides qualitative, transparent, and comparable useful financial information.

The findings show that fair value clarity in DFIs is related to Ind AS (converged IFRS), which is enhanced as a result of IFRS or Ind AS just being enforced. The application and disclosure of fair value accounting to DFIs in the financial statements are therefore necessary to provide transparent and high quality fair value measurement related information for the investors in particular, the stakeholders in general. Management therefore needs to apply fair value accounting Ind AS (converged IFRS) to the interests of both the investors and their enterprises.

CONCLUSION

Although adoption of the International Financial Reporting Standards (IFRS) for DFIs brings uniformity in the reporting and disclosure of DFIs across countries, the degree of disclosure varies from company to company (Gope & Mitra, 2015). The current study looks at how the International Financial Reporting Standards (IFRS) affect DFIs' fair value disclosure in Indian corporate annual reports. The study's results indicate that the extent of transparency on DFIs' fair value is linked to Ind AS (IFRS), but not to the firm's size or listing status or leverage or to FIIs.

The study does have certain shortcomings, though. Even though the disclosure index score is carefully calculated, mistakes may still happen when creating the index score card and when identifying the information that is disclosed in annual reports because of the different ways that qualitative information is presented in the reports.

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