

Risk in Financial Reporting:

Status, Challenges and Suggested Directions

By Claudio Borio and Kostas Tsatsaronis, BIS

A Discussant's Observations

BIS Workshop on Accounting, Risk
Management, and Prudential Regulation

Basel, Switzerland

11-12 November 2005

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Observations on Paper *Risk & the Ideal Information Set*

❖ Paper recommends three key aspects:

- First moment information

- Financial Statement (F/S) information

- Risk measures

- Firm-wide earnings at risk, value at risk

- Measurement error (*measures of uncertainty*)



Observations on Paper *Risk & the Ideal Information Set*

❖ Observations and Questions:

- Is this recommendation targeted at all companies; major market participants; financial or non-financial firms; specific industries?
- Answer to above may raise certain issues:
 - *Cost of internal systems & related disclosures?*
 - *Experts available to smaller companies?*
 - *Need to develop key consensus on risk and uncertainty measures, and related disclosure?*
 - *Capacity of auditors to verify (non-F/S info.)?*



Observations on Paper

Risk & Unbiased Valuations

- ❖ **Key objective: unbiased estimates (not deliberately conservative ones)**
 - Embed in fuller information set; coordinate with regulators
 - Summarises measurement error issues when accounting has forward-looking aspects
 - Stresses verification, but notes its meaning varies across the components of pricing
 - Stresses need for transparency of measures



Observations on Paper

Risk & Unbiased Valuations

❖ Observations and Questions:

- Verifiability continues to be important here
 - *Bottom up or top down? (can affect cost, etc.)*
- Are there corporate governance/other internal measures that could enhance verifiability?
 - *Independent groups that test risk & uncertainty measures & report to the Board of Directors - should they also report to the public?*
- Role of prudential regulators-*reporting; verifiability?*
- Role of external auditors-*verifiability (CPA vs. CVA)?*



Observations on Paper *Risk & Artificial Volatility*

- ❖ **Recognises how artificial volatility arises:**
 - Accounting definitions for assets, liabilities
 - Accounting criteria for recognition
 - Different valuation measures for B/S items
- ❖ **Encourages reasonable integration of:**
 - Accounting, risk management approaches
 - “Differences of objectives, degrees of freedom”

Constructive Dialogue



- ❖ **Constructive IASB dialogue – recent examples:**
 - FAAC that advised IASB on ED7, IFRS 7
 - Dialogue between BCBS, IASB, ECB, Banks on FVO
- ❖ **Dialogue needed on many of the paper's issues:**
 - Possible areas for integration of R/M, accounting
 - Enhancing FVs, risk disclosure, verifiability, consensus
 - Ensuring understanding by users of F/S, risk disclosure

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