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

Jerry Edwards
Senior Advisor on Accounting and Auditing Policy
Financial Stability Forum
Basel, Switzerland
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 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.)?
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 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
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

Jerry Edwards
Senior Advisor on Accounting and Auditing Policy
Financial Stability Forum
Basel, Switzerland