Editorial

Margaret Woods

Nottingham University Business School, Jubilee Campus,
Wollaton Road, Nottingham, NG8 1RB, UK
E mail: margaret.woods@nottingham.ac.uk

Peter Kajüter

University of Münster, Chair of International Accounting,
Universitätsstr.14-16, D-48143 Münster, Germany
E-mail: peter.kajueter@wiwi.uni-muenster.de

Philip Linsley

The York Management School, University of York, Heslington,
York, YO10 5DD, UK
E-mail: pl521@york.ac.uk

Christos Grambovas

Post Doctoral Research Fellow,
Centre for the Analysis of Investment Risk,
Manchester Business School, The University of Manchester,
Booth Street West, Manchester, M15 6PB, UK
E-mail: christos.grambovas@mbs.ac.uk

Biographical notes: Margaret Woods is Associate Professor of Accounting and Finance at Nottingham University Business School. She is Co-ordinator of the European Risk Research Network which is responsible for the organisation of a series of international risk conferences throughout Europe. Her research interests lie in the area of risk management in financial services, risk disclosures by banks, and accounting for derivatives and financial instruments.

Peter Kajüter is Professor of International Accounting at the University of Münster, Germany, and a Visiting Professor at the European School of Management and Technology (ESMT). His research is focused on international financial reporting, international managerial accounting, risk management and corporate governance. In September 2007 he hosted the first European Risk Conference at the University of Münster. He is a member of the Working Group on Management Accounting of the Schmalenbach-Gesellschaft and served as a member of the Working Group on Interim Reporting of the German Accounting Standards Board.

Philip Linsley is a Lecturer at the University of York. He trained as a Chartered Accountant and his research focuses upon the related topics of risk management and risk reporting. Current projects include an examination of the implementation of a risk management system in a professional organisation, the

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analysis of risk management systems in the public sector, and risk disclosure patterns in FTSE 100 UK plcs.

Prior to his appointment in the Centre for the Analysis of Investment Risk at Manchester Business School, Christos Grambovas held joint positions as a Teaching and Research Fellow in the University of Wales at Bangor and Post-Doctoral Research Fellow in the University of Valencia (Spain). While undertaking his PhD (Wales), he was a Pre-Doctoral Research Fellow in the University of Valencia and at the Autonoma University of Madrid, as part of the team on the European Commission research project 'Harmonia'. This project analysed issues surrounding the harmonisation of the financial market and accounting regulations across the European Union.

The theme of this special issue is risk management in the financial services sector. Over the course of the last decade or so the companies within this sector have developed a range of new instruments and techniques for the modelling, measurement and management of risk. This does not, however, necessarily imply that all companies or business categories within financial services are to be lauded for their risk management practices, and the articles in this special issue raise some important questions about current trends.

The first paper, by Dowd et al., reports and provides critical comment upon four recent surveys of risk management practice within the UK insurance industry. The results provide a broad-ranging and detailed picture of the state of practice of UK insurers' risk management practices and how they have changed in recent years. One of the more obvious conclusions is that there is great heterogeneity of risk management in the UK insurance industry, and this heterogeneity is also evidenced in risk measurement. Nevertheless, overall, Dowd et al. reach the conclusion that insurance risks are well understood and often well handled, and the state of the art is certainly improving. In contrast, they conclude that the models used by the insurance industry to measure market and credit risks are rather less impressive, but once again there is great variety in the models used and in their degrees of sophistication.

One recurring theme in the paper's conclusion is the problem arising from a lack of qualified personnel and Dowd et al. take the view that there is no doubt that it continues to be a major obstacle towards the industry achieving good risk management standards. The problem is exacerbated by the difficulty that there is limited evidence that regulatory pressures have stimulated good risk management practice in the insurance sector and hence that some firms have not taken their risk management responsibilities seriously. If this scenario persists, the regulators may step in and create a risk management straitjacket that impedes further improvements in risk management practices. The commentaries provided by Dowd et al thus offer valuable insights into the limitations of current risk management practice within the UK insurance industry.

The second paper, by Gebhardt, deals with the issue of the accounting rules for the reporting of credit risk, and the extent to which accounting regulations influence the level of loan loss provisions that are reported in a company's annual accounts. The scale of provisions for impaired loans made by a bank has important implications for its perceived value within the capital markets and there is a risk that excessively high provisions may have wider implications for an economy's overall stability. The problem of evaluating credit risk and determining 'appropriate' levels of provisions is clearly evidenced in

the current global stock market volatility arising out of the problems in the market for US housing loans.

Contrasting the German national GAAP and the IFRS rules on accounting for loans, Gebhardt argues that casual empiricism suggests that credit risks are not timely enough and/or not sufficiently reflected in the financial statements of banks and also demonstrates that the regulations encourage institutions to delay making provisions for loan losses. Gebhardt questions the usefulness of the rules within IAS 39, which requires only the provision for *incurred* as opposed to *anticipated* losses. He argues that the rules may lead to either delayed expense recognition or accelerated revenue recognition, and favour the hidden accumulation of credit risks in the financial statements of banks. The analysis suggests that the picture revealed within the financial statements is distorted by accounting regulations and also that it leaves ample room for earnings management.

The problems created by accounting regulations in respect of the reporting of the risk exposure in financial institutions is also the subject of the third paper, by Woods, Dowd and Humphrey, on value at risk. This paper demonstrates how the accounting regulations on the reporting of market risk in financial statements reflect the developments in internal risk measurement systems within the industry and also the information required within bank supervisory reports. In a response to crises caused by a series of internal control failures in financial institutions, and the rapid growth of new forms of market traded financial instruments the accounting regulators decided that Value at Risk (VaR) was a useful measure for inclusion in the annual financial statements. Its reporting, however, raises a range of issues about the validity of VaR as a risk measure, as well as questions about the extent to which it is understood by users of the financial statements and the feasibility of requiring an external audit of the VaR valuation and underlying model. Woods et al. conclude that there is a risk attached to risk reporting and they have a strong suspicion that published VaR figures provide little real information about firms' financial risks.

Linsley and Kajüter also address the question of the extent to which financial institutions are willing to publicly admit their exposure to risk, by reviewing the relevant discretionary disclosures published by Allied Irish Banks plc (AIB) following the discovery of a major fraud at its USA subsidiary, Allfirst, in 2002. The fraud was widely reported at the time of its occurrence and caused considerable harm to the reputation of AIB. The paper demonstrates the way in which AIB sought to re-establish the legitimacy and reputation of the organisation via the initiation of a comprehensive list of strategic actions aimed at influencing stakeholder opinion via impression management. The disclosures represented a method for reducing the negative impact of the Allfirst fraud and managing the reputational risk associated with the event, but ultimately the case study concludes that the objective of restoring legitimacy was not fully met.

The last paper in this special issue is by Dobler, and is also concerned with the usefulness of certain disclosures for decision making, this time in respect of voluntary management forecasts. In the case of forecast information, it is difficult for either regulators or market discipline to be effective in ensuring any specific level of ex ante accuracy, but verification of ex post accuracy is useful as a way of encouraging the disclosure of useful and reasonably accurate information. It is inevitable that forecasts will create a degree of uncertainty, but if it is seen that management engage in a real attempt to produce credible forecasts of their economic performance then these

forecasts will enhance their company's market credibility and as such may prove useful for decision making.

In addressing the theme of risk management in financial institutions, the papers in this special issue reach a number of common conclusions which provide a rich basis for future research. Firstly, there is the extent to which risk management practice is still evolving and also varies in quality across organisations. Secondly, the evidence which suggests that new risk measures and new risk management practices are creating problems in respect of personnel and skill sets. Thirdly, the papers raise important questions about the usefulness of the risk information that is provided within annual reports and financial statements. All of these issues extend beyond the financial services sector and it would be interesting to see much more academic research in these areas.

The editors would, therefore, like to thank all of the authors who have contributed to this issue and helped raise important issues for debate, as well as the anonymous referees who advised authors on how to improve their work. All of these people have played an extremely important role in helping this issue come to fruition and we jointly hope that it will stimulate fruitful academic debate and further research.