

**Contribution of the ANC to the questions raised by KASB
and AASB on their joint research project
“Accounting Judgment on Terms of Likelihood in IFRS:
Korea and Australia”**

Question 1 – Recommendations to the IASB

1. In this research, we identified at least 35 terms of likelihood in IFRS which may add another layer of challenges in coming to consistent application of IFRS across jurisdictions. The key recommendations to the IASB include:
 - (a) Standard setters should give considerable attention to how terms of likelihood might be interpreted and translated in different jurisdictions when developing a standard, particularly since there may be situations in which this could be expected to give rise to material differences between financial statements;
 - (b) Standard setters should narrow the number of different terms of likelihood used in standards and consideration should be given to establishing a set of terms. Unless the intended levels of likelihood are significantly different from each other, standard setters should use the same terms of likelihood in standards ; some of the approaches employed in this research project could be considered for reference;
 - (c) Consideration should be given to developing principles and guidance on terms of likelihood that could be applied consistently across the standards. The guidance could include examples;
 - (d) The IASB’s re-deliberations on revisions to the Conceptual Framework relating to neutrality (and prudence) and the asset and liability recognition criteria might be informed by the knowledge that many preparers and auditors factor in their own level of ‘conservatism’ when applying IFRS; and
 - (e) Standard-setting outreach and consultative process should explicitly seek to obtain input on translation and interpretation issues in different jurisdictions.

Do you agree? Why or why not?

ANC welcomes the Joint Research Project realized by the Korean and Australian standard setters focusing on the way accounting judgments are performed in different countries when using and giving a measure to the different IFRS’s terms of likelihood. In ANC’s views, the tentative recommendations to the IASB, based on the results of this study, are particularly clear-sighted. As a general comment, ANC supports the different key recommendations but points out some concerns, notably as regards the need that IFRS standards remain principle based under the constraint of being sufficiently specific and understandable.

In ANC views, the IASB challenges are to:

- Implement a Top-Down approach that should permit (i) specifying the general definition of likelihood in English (ii) identifying all likelihood related words used in IFRS standards and streamlining them where necessary (iii) ensuring all likelihood related terms are both translated concisely and in a way leading to the homogeneous application of the underlying concepts and principles.
- Find the right balance in order to ensure IFRS standards are at the same time principles’ based and specific enough to be understandable on a standalone basis.

Ensure the set of IFRS standards is drafted in a way taking into consideration cultural differences and related understanding bias.

(1) Comments on recommendations a, b and c – Defining likelihood and articulating the different sub-components of the likelihood concept

ANC believes that a two steps approach should be developed in order first (i) to define what is meant by likelihood, when and for what purpose it should be used, and in a second time (ii) to streamline and articulate the different sub-definitions of likelihood.

(i) Clearly define what is meant by likelihood, when and for what purpose it should be used

In accountancy, likelihood is used to assess the “chance of something happening / how likely something is to happen¹”. In a way and in the IFRS standards context, likelihood is somehow related to probability, and this view seems to be supported by the fact that the easiest way to compare the interpretations worldwide of the term of likelihood is to rely on percentages.

First of all, probability is a concept used in statistics and philosophers of Science² provide two different types of definitions. On one side, probabilities are considered to be an intrinsic quality of the world; on the other side, probabilities are considered to be a degree of belief in a context of uncertainties (Bayesian statistics)

Under an accounting point of view, it means that assessing the likelihood of an event will depend on the nature and context of the transactions:

- When the entity is able to rely on past transactions / events to determine the likelihood of a situation, it is possible to establish general principles and homogeneously apply percentage of probability.
 - For instance, when Groups face legal or tax litigations, they can rely on a probability based approach relying on past experience. Hence internal accounting policies can define a Group methodology (e.g. Accounting policies on tax litigation can for instance state that if based on past experience and Tax Administration recent positions the entity is able to determine if an error has been made (100 % provision), if it believes the interpretation of the Tax administration is incorrect (0% provision), or if it believes the interpretation remains uncertain (50% provision representing the uncertainty (average)).
- When the entity analyses the likelihood of a specific and isolated transaction the approach becomes more complex and judgmental as it cannot rely on past experience. Hence, no internal accounting principle can help determining the likelihood of such transaction. Judgment has to be exercised on a case by case basis, taking into consideration all facts and circumstances.

¹ Oxford Advance Learners Dictionary

² As for instance by Ian Hacking, 1975 (2nd edition July 2006), “The emergence of probability” – Philosopher of science

In practice, ANC considers that accountancy is not an exact science, and it is the reason why standards should remain principles based. Hence, in our view we believe that when we use IFRS standards we are, based on Karl Popper's view, referring to a degree of belief and that we are assessing the propensity for an event to occur, such propensity usually being measured using percentages³ to determine the likelihood.

The ANC has already stated in the ED 2015/03 on the Conceptual Framework that *"In addition, uncertainty, even when considered with respect to reliability, is not limited to measurement uncertainty: paragraph 5.15 refers to the existence of uncertainty whilst paragraph 6.56 refers to outcome uncertainty. Therefore, it would have been useful had the IASB provided a general discussion in the ED on uncertainty (for definition, recognition and measurement purposes), instead of limiting uncertainty to measurement aspects."*⁴

As a conclusion, ANC considers that the definition of likelihood should be reviewed in order to ensure all IFRS jurisdictions agree on the meaning of the term and homogeneously apply it.

ANC also considers crucial that definitions remain principles based, giving the priority to a methodological approach with examples rather than introducing percentages or thresholds.

(ii) Streamline and articulate likelihood related words used

As a second step and in practice, ANC believes it is necessary to:

- Identify all likelihood-related terms used in the set of IFRS standards,
- Determine if likelihood-related concepts apply differently depending on the nature of the underlying assets and liabilities.

Based on this review, and in order to provide relevant and reliable financial information, ANC considers that IASB Board members will have to determine if they consider it is useful to develop a full range of likelihood sub-definitions in order to customize each term identified to the needs of type of asset and liabilities, or situations considered.

(2) Comments on recommendation (d) – Revision of the Conceptual Framework on neutrality (and prudence)

ANC fully supports the recommendation presented in paragraph (d). This recommendation is congruent with the ANC's December 2015 comment letter to the IASB on the 2015/03 Conceptual framework ED.

³ According to Karl Popper's view on probability – One of the key philosopher of sciences of the XXth century

⁴ ANC Comment Letter 2015/03 Conceptual Framework

<http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/Normes%20internationales/IASB/2015/Lettre%20à%20M.%20HANS%20HOOGERVORST%20-%20EXPOSURE%20DAFT%20ED%202015-3.pdf>

Based on the comments raised by ANC's stakeholders during working sessions on the Conceptual Framework 2015 ED⁵, it appears that *"As for EFRAG, ANC considers that prudence represents a degree of caution that generally recognizes downside risks and strongly questions whether upside potential inherent in uncertain future events should be recognized. This, in our view, implies to acknowledge that prudence plays a larger role than that proposed by the IASB in the ED. We consider therefore that prudence plays a role in the recognition criteria for assets and liabilities and results most of the time in asymmetrical recognition criteria as per our general statement above. This is evidenced in the individual standards, up to the latest standards issued (IFRS 15 and IFRS 9). In addition we note that, even in the proposed ED, there are some areas where asymmetry is informally recognized:*

- *Paragraph 4.25 and 4.26 on the definition of a liability,*
- *Paragraph 4.41 on executory contracts"*

"As a conclusion, it would be more helpful to better articulate the concept of prudence separately with the reintroduction of the notion of asymmetry"

As a conclusion, based on field experience in France and in light of the KASB and AASB study, ANC reinforces its 2015 comment and considers that the IASB should clearly have in mind the natural professional bias that affect preparers and auditors decisions when assessing likelihood (which includes a kind of "conservatism" when applying this concept). Such professional practice shared by accounting professionals worldwide should be taken into consideration when re-deliberations on the conceptual framework take place.

(3) Comment on recommendation (e) - Monitor the translation process and interpretation issues in the different jurisdiction

ANC supports the recommendation stating that the IASB should "seek to obtain input on translation and interpretation issues in different jurisdictions". ANC underlines the fact that aside from an apparent language unity between the countries using the same official language, distortions exist from one country to the other in the use and meaning of some words. As a matter of example words can have a different meaning in Canadian French, in Belgium French, in African countries French and in French from France. Indeed, words bear with them a set of underlying and unformulated meanings. Hence, local cultures, beliefs may affect the understanding of a concept/ principle / word as well as the way a word is translated.

Therefore, ANC highlights the fact that translations need to be carefully performed, notably for languages recognized as national and official language in different countries (as for instance Spanish, French, Portuguese...).

This comment also applies to countries using IFRS standards in English whether because they are English speakers whether because they consider it is easier to directly work on the documents

5 ANC Comment Letter on the 2015/03 ED on the Conceptual Framework
<http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/Normes%20internationales/IASB/2015/Lettre%20à%20M.%20HANS%20HOOGERVORST%20-%20EXPOSURE%20DAFT%20ED%202015-3.pdf>

published in English. It must be noted that English as for all other languages, can be differently used and understood across the world, and this understanding also depends on the level of expertise in English of each IFRS' user.

Even if IFRS were written in relatively simple English, refined nuances of some concepts or words may not be clearly and correctly understood by stakeholders that do not fully master the language.

(4) Warning – Finding the right balance between additional guidance and principle based standards

ANC agrees with the fact that increasing the number of examples in the standards and developing guidance on how to use the terms of likelihood might be helpful to preparers and auditors.

However, ANC wants to underline the limits of this approach and raises the following warnings:

- As first recommendation, all IFRS standards need to remain principles based and judgmental approaches should not be driven by examples or situations presented in the guidance. Interpretational conflicts may in some instances arise between the standard and the non-authoritative guidance leading whether to additional divergence in the application of the standard or on rules based accounting practice. However, ANC agrees that finding the right balance will be difficult to reach.
- In addition and as already experienced with some other standards, examples provided are often relatively simple and in some cases even too simple to be analogized with a real life situation.

As a conclusion, ANC believes that a right balance need to found between a more detailed approach and a principle based approach.

Actually, ANC considers that the methodology and reasoning permitting to determine the likelihood of an event should be described in order to ensure the same approach is applied in different countries. For instance, the standard could help distinguishing situations where the event is isolated from situations where the event can be analysed as regards past experience.

(5) ANC additional recommendation – Developing a cross-standard glossary (also answers question 2)

In addition and as first and quick remediation solution, the ANC recommends that a general glossary of “defined terms” is developed in order to centralize the words and concepts used across the set of standards proposing clear and homogeneous definitions.

ANC also points out that other terms remain ambiguous when translated into foreign languages such as stewardship, substance over form, business model, “fair” of the fair value model...

Question 2 – Other comments

2. Are there any comments you would like to make in regard to (a) terms of likelihood or other key terms in IFRS and (b) use of language in IFRS generally?

Comments on the cultural bias existing when using IFRS standards or translating them

In our views, one of the main merits of this study is to underline the difficulties the IASB and IFRS Foundation will have to face when developing a “single set of global financial standards” to be applied around the world.

“The goal of the IASB and the IFRS Foundation is to develop a single set of global financial reporting standards that bring transparency, accountability and efficiency to financial markets around the world.”... “This goal was reaffirmed by the IFRS Foundation Trustees in their 2012 strategy report. ⁶”

ANC believes that one of the key question IFRS standards will have to face is how to deal with the intercultural differences in order to ensure IFRS are consistently applied worldwide, providing transparent and comparable financial information. The question evidenced as regard likelihood interpretation is not limited to the use and translation of that specific word, but is a wider question that affects all IFRS standards’ key words. ANC points out the fact that cultural diversity is a key parameter that affect the way IFRS standards are understood and applied. Hence, such diversity should be taken into consideration when aiming at developing a single set of accounting standards to be applied across the world.

This comment is based on the paragraph 2 of the Charter of the United Nations⁷ acknowledging the existence of diversity around the world such as “...race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.”. In other words, and in a more anthropological approach these criteria have, according to the philosopher and essayist B. Rizk⁸ been synthesized into four basic key parameters “religion, race, language and moral code” , which refer to parameters already developed about 2500 years ago by Herodotus. The key anthropological message is that those parameters are even more prominent in a context of globalization as they keep on structuring the identity and the way of thinking of each group of individuals, impacting behaviors and concepts and theories’ interpretations.

In addition, and as regards the specific language parameter, the twentieth century cognitive psychology developments partly resulting from the nineteenth century philosopher W. von

6 The global reach of IFRS is expanding - 02 September 2015 - By Paul Pacter *Paul Pacter, PhD, CPA (inactive), is a former member of the IASB and currently manages the IFRS Foundation's study of IFRS use around the world. From 1973 to 2010 he was a staff member of the FASB, the IASC and the IASB. He is also a member of the CPA Journal Editorial Board. This is adapted from an article by Pacter, which first appeared in the CPA Journal in July 2015.*

<http://www.ifrs.org/Features/Pages/Global-reach-of-IFRS-is-expanding.aspx>

7 Universal Declaration of Human Rights

http://www.ohchr.org/EN/UDHR/Documents/UDHR_Translations/eng.pdf

8 "The Parameters of Herodotus, or Collective Cultural Identities" (published in French), 2009, Les éditions L'Orient-Le jour - B. Rizk is an essayist, lawyer, professor, and cultural attach to the permanent delegation of Lebanon to UNESCO in Paris.

Humbolt's theories, evidenced that individuals' thoughts and thinking are in some ways structured by the language used.

The effects of cultural diversity on IFRS standards accounting practice

Applied to the specific field of accountancy and IFRS standards, some of the cultural parameters identified are more relevant than others. However, religion, language and moral code (taken in its larger sense) remain key affecting accounting judgments performed and representing natural bias impacting financial statements reliance and comparability. Therefore, it is clear that the language and interpretation issue raised when analyzing the way the term "likelihood" is interpreted in different cultures, is actually a much wider issue and should be generalized.

In ANC views we believe that cultural bias and interpretation issues arise each time judgments need to be exercised when IFRS standards are applied in a context of uncertainty or need to be interpreted.

As IFRS are principle based, exercising the professional judgment is often required and is a central step of the financial statements process, or of IFRS' interpretation when accounting for complex or specific transactions. In practice, judgments exercised are cultural constructs relying more specifically on language, accounting practice, economic and legal environment; and even in some countries on religious frameworks and beliefs, notably when religion is part of the Law.

Below a few examples are presented:

Discussions relating to "substance over form"

- The legal economical and legal environment may require to structure transactions and to develop complex financial tools to reach the same economic effects across the world, raising uncertainty and interpretational issues as the referential used is not directly applicable to the cultural context. For instance, we can note that the type of trust that exists in anglo-american law do not match as described the "continental" law (for instance in France) legal environment. Therefore, sets of contracts identified as "synthetic trusts⁹" have to be developed to approximate the same economic effects. For instance, applying the control principle and the example provided in IFRS 10 standard raises interpretation and application issues (as the standard mostly relies on REITs examples). As economic effects are identical, accountants need to interpret and supplement the standard to find the way to account for the transaction and to evidence in Financial Statements the economic and legal reality.
- Another example is that the IFRS IC had to face in 2014-2015 a debate on how to apply "substance over form" to IFRS 11 joint ventures. The question arose due to the fact that some accounting professionals were considering that the term "substance" was referring to the economic substance whatever the legal form (e.g. some accounting professionals in France). The IFRS IC evidenced that we are referring to the legal substance of a transaction,

⁹ We identify as « synthetic trusts » sets of contracts which objective is to reach the same economic effects under French law than the trusts defined by Law in anglo-american countries.

but this interpretation was not straight forward as the accounting practice have, in the previous decade and in some non-English speaking countries differently defined the meaning of this principle.

- In addition, we cannot set aside the issues raised by countries having to apply Islamic Finance, this latest relying on a very different vision of the world and finance. The last decade debates notably evidenced that countries applying Islamic finance may differently understand and experience IFRS concepts (such as for instance, the substance over form principle).

Interpretations across countries and amongst the different types of IFRS' users

- Within a country, interpretational divergences exist depending on how each individual or each group monitors uncertainty and business/professional risks. The interpretational differences between auditors and preparers basically result from the existing divergence between their objectives and risks when preparing or issuing an unqualified report on financial statements. This divergence of views often results in auditors being more conservative than preparers.
- Across the world, the level of risk preparers or auditors accept to take when interpreting standards in a context of uncertainty differ, depending on the legal context and more specifically on sanctions that could be taken by the regulator or the auditors' supervisor in case of misinterpretation.

These two examples evidence that within a country and across the world, each individual or group of individual understand concepts under its own prism, distorting in some instances what the IASB was initially meaning.

Conclusion

In a context where the IASB and the IFRS Foundation are developing a single set of IFRS standards to be applied around the world, ANC considers that the main difficulty is to issue principles and standards homogeneously understood and implemented. To reach this objective, IASB should rely on a process acknowledging and taking into account the underlying requirements and limits of cultural identities. In our view and in practice, the bias resulting from cultural diversity between the IFRS Foundation constituent should anticipated and integrated. Such approach should help reaching a single set of IFRS standards homogeneously understood and applied around the world. In our view, such cultural bias has to be considered from inception and all levels such as:

- At research level
- At staff level (when preparing agenda papers, exposure drafts and standards)
- At Board's or IFRS IC's meetings...

As a conclusion, ANC believes that when developing IFRS standards, the international standard setter should take into considerations the different parameters presented and should also rely on research (including linguistic, anthropology, psychology... aspects) as well as local field tests, studies, and quality reviews in order to assess how words and concepts are locally used and understood.