What's the difference between 'likely' and 'probable'?

The Korea Accounting Standards Board and the Australian Accounting Standards Board have conducted research into the different terms of 'likelihood' in International Financial Reporting Standards (IFRS). We looked into their research and considered whether it is extremely unlikely, unlikely, possible, expected, likely, probable, reasonably certain, highly probable or virtually certain that the different terms of likelihood are creating issues for financial reporters.

The research

The Boards identified 35 different terms in the Standards that convey the probability of an event occurring. These range from 'virtually certain' and 'no realistic alternative' to 'virtually none' and 'not genuine', with a plethora of terms in between. Having identified the different terms used in the Standards, the Boards selected 13 and surveyed accounting professionals in both Korea and Australia to ask how the different terms were applied.

The results were published in July 2016 (Accounting Judgments on Terms of Likelihood in IFRS: Korea and Australia, July 2016).

How are terms being interpreted?

The report highlights that there is diversity within each jurisdiction in how the terms are currently interpreted. For example, different preparers and auditors in Australia may interpret the term 'possible' to mean anything between a 35% chance of occurring and a 65% chance of occurring. That's a big range. 'Possible' obligations give rise to contingent liabilities which should be disclosed in the financial statements. So some preparers may disclose contingent liabilities if there is a 45% chance of the obligation occurring, while others may decide that it's not 'possible' and therefore no disclosure is necessary.

Diversity in interpretations within one country creates a risk of inconsistencies when comparing companies. However, the risk should hopefully be alleviated by auditors ensuring consistent application.

Due to different cultural backgrounds and historical generally accepted accounting principles (GAAP), diversity across countries is more likely and possibly more problematic. Korean interpretations of 'possible' range from 25% chance of occurring to 45% chance of occurring. While the range is smaller, a multinational company with operations in both Korea and Australia could have local Korean management disclosing possible obligations that have a 25% chance of occurring and their Australian colleagues waiting until there is a 65% chance of those obligations occurring. Both are using the same IFRS standards, both are interpreting them consistently with their local jurisdictions, and both interpretations may be accepted by their local auditors – but there is a large diversity in outcomes.

If there can be diversity across two countries on how one term is applied, what about a large multinational with operations across 100 countries using all 35 terms of likelihood in IFRS? Shouldn't the consolidated financial statements be prepared using consistent accounting policies? The onus is on the group finance teams in multinational companies to ensure that local finance teams are interpreting the Standards in the same way as the group team.

It’s also apparent from the report that IFRS uses many different terms to express likelihood. While linguaphiles may love the fact that the English language has such variation, accounting standards probably aren’t the best place to display this variation. Do ‘remote’ (IAS 37), ‘minimal probability’ (IFRS 4) and ‘extremely rare’ (IAS 1 and IAS 37) mean different things? While it may not matter to a native English speaker and hopefully one would treat them all similarly, problems may occur when those for whom English isn’t their first language read the Standards in English or when the Standards are translated into foreign languages. Translation variations might increase the prevalence of interpretation variations.

What does the report mean for the future?

While the report has been shared with the IASB, it’s highly unlikely (another IFRS term) that the IASB will publish probability thresholds for each of the terms of likelihood they use. If this was the intention of the IASB, they would have started 2 years ago when IFRS 15 *Revenue from Contracts with Customers* was published and it was highlighted that ‘probable’ means different things in IFRS and US GAAP (the IFRS ‘highly probable’ is equivalent to the US GAAP ‘probable’). Probability thresholds would be rules, but IFRS are principles-based rather than rules-based.

It’s also unlikely that the IASB will completely rationalise the terms of likelihood in the existing Standards and replace them with a narrow set of, say, 10 terms in one big revision to the Standards. While it would be a quick fix, any changes to the Standards are more likely to come over a number of years as the IASB completes its work on the Conceptual Framework and publishes amendments as part of its ongoing improvement programme.

Hopefully, when drafting new Standards, Interpretations or Amendments, the IASB will bear the research in mind and use a narrow set of terms of likelihood. Those who feed into the Standard-setting process, should be vigilant and highlight to the IASB where draft Standards are adding to an issue rather than minimising it.

With regards to a difference between ‘likely’ and ‘probable’, for the Australian accounting professionals surveyed the mean results were that these terms meant a 64% and 62% chance of occurring, respectively. For the Korean accounting professionals, the mean results were that the terms meant a 58% and 71% chance of occurring. So all we can say is there *possibly* is a difference… or *possibly not*.

For more information or for a deeper discussion on how these issues might affect your business, contact your usual PwC advisor or:

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