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## QUALITY OF ACCOUNTING INFORMATION – BETWEEN UNCERTAINTY AND AMBIGUITY

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**Abstract:** *The parameters of the effectiveness of information are determined by the degree of subjectivity-objectivity, by the user's commitment to it, by the temporal duration taken as a reference, but also by qualitative and quantitative aspects, the most expressive example being the notion of "accounting information". A utility value is associated with information, representing the possibility of savings, and this is calculated on the basis of the difference between the effects of a decision promoted with and without the knowledge component. The utility value is directly influenced by the physical and moral depreciation that takes precedence. Information is exposed to a high degree of degradation, which is automatically included by the actions of production and diffusion resulting from the diversified and polyvalent interaction with the sum of information in a given environment.*

**Keywords:** *accounting information, accounting standard, uncertainty, benefits, paradigm*

### Challenges of Uncertainty in Accounting Standards

Accounting standards are essential parts of the accounting language. Using International Financial Reporting Standards ( IFRS ) as an example, up to 156 jurisdictions consider IFRS as the global financial reporting language, and 144 of them require IFRS Standards for all or most publicly accountable domestic entities (IFRS Foundation, 2019).

IFRS are principles-based accounting standards designed for interpretation and professional judgment (Bradbury & Schröder, 2012). Previous studies have highlighted that IFRS has no guidelines on how to use uncertainty expressions (Du & Stevens, 2011; Huerta, Petrides, & Braun, 2016; Salleh, Gardner, Sulong, & McGowan, 2011). For example, in measuring the fair value of an asset, a reporting entity should reasonably assess the alternative assumption or expected cash flow from the accounting. The terms reasonable possible and expected are expressions of uncertainty and the significance of these subject to interpretation and professional (Chesley, 1986; Davidson & Chrisman, 1994; Doupnik & Richter, 2003).

Because of their dependence on professional interpretation, expressions of uncertainty are often consistently missing and such meanings and inconsistencies will reduce comparability between companies and financial statements (Simon, 2002).

Such deviations between meanings and interpretations could affect the effectiveness of communication in accounting (Laswad & Mak, 1997). Several concerns about the use of uncertainty expressions and their negative impact on judgment have also emerged and decisions (Chand et al., 2012; Piercey, 2009). Although evidence highlighting problems with the use of uncertainty expressions in accounting has accumulated, regulators and accounting practitioners have yet to propose a solution. For example, IFRS 5 provides little guidance on the meaning of uncertainty, stating that „likely = more likely than not” and „highly likely = significantly more likely than not”. Consequently, this leads to a critical question about the fundamental meanings of uncertainty expressions and how they can be used effectively to facilitate financial reporting and decision making.

IFRS contains a significant amount of uncertainty expressions. A detailed review of IFRS reveals the use of over 40 different uncertainty terms covering almost every aspect of financial reporting, such as the decision on the accounting recognition of items. Similarly, entities that have adopted IFRS also use similar terms in their financial and annual reports, either those directly quoted from IFRSs or similar.

Due to the IFRS principles-based approach, the use of uncertainty expressions under IFRS provides benefits for accounting communication: it facilitates professional judgement and allows for adjustments between different jurisdictions (e.g. countries) with different economies and cultural scales (Weiss, 2008; Zeff, 2007). However, the use of uncertainty expressions

also creates significant challenges in achieving consistent accounting judgment (Chand et al., 2012; Erb & Pelger, 2015).

First, preparers of accounting information using accounting standards need to understand the meaning of the uncertainty expressions they choose to use, including how they represent the level of uncertainty and, if applicable, how they are interpreted numerically.

Each reader may perceive verbal uncertainty expressions differently (see Brun & Teigen, 1988; Juanchich et al., 2012) and previous studies have already shown that language and personal attributes could significantly influence how they are interpreted see Chand et al., 2012; Davidson & Chrisman, 1994; Huerta, Petrides, & Braun, 2013).

Second, the use of verbal uncertainty expressions in accounting standards may not have had consequences for the handling of information. Because people perceive verbal uncertainty expressions differently and because accounting standards regulators have not issued standardized numerical scales, preparers of accounting information may be able to take advantage of ambiguity in verbal expressions to disguise adverse risks and deals (Kelton & Montague, 2018; Piercey, 2009). Piercey, (2009, p. 331).

Third, and perhaps most controversially, the use of verbal uncertainty expressions in accounting standards would affect the effectiveness of communication, thereby reducing the quality Wright, an economist at the University of Chicago, was the best known author of *Risk, Uncertainty and Profit. Uncertainty Expressions in Accounting* (Laswad & Mak, 1997; Simon, 2002). Simon, (2002) argued that many expressions of verbal uncertainty lack consensus in interpretation and therefore result in low communication effectiveness in financial reporting. Theoretically, people can use verbal and numerical uncertainty expressions interchangeably. According to Hardman and Macchi, (2003), research on uncertainty expressions includes three major paradigms: translation, semantics and pragmatics. Most uncertainty expressions studies are based on the translation paradigm: finding the most efficient translation method verbal probabilities into numbers. A general method is to give a percentage from 0 to 100 corresponding to verbal phrases, which Reagan et al. (1989, p. 433) refer to as „word to number conversion”. Another method is to judge the degree of uncertainty on the [ 0, 1 ] scale or p-value in a specific context, which is called the membership function (Wallsten, Fillenbaum and Cox, 1986).

Similar studies have been conducted in forecasting (See - Marom, 1982) and organizational behavior (Brun & Teigen, 1988). In particular, a research approach based on the translation paradigm has been particularly popular in accounting (see Chand et al., 2012; Chesley, 1986; Davidson & Chrisman, 1994; Doupnik & Riccio, 2006; Doupnik & Richter, 2003; Doupnik & Richter,

2004; Hu, Chand, & Evans, 2013; Laswad & Mak, 1997 ). A typical context in accounting research is the investigation of cross-national and cross-variation of word-to-number conversion. The example below is drawn from a study of conversion in the 2003 Douppnik and Richter study (p.32):

For example, when deciding on options for a business strategy, “Strategy A is somewhat possible success” directs one to anticipate a positive outcome, while “Strategy B success is uncertain” directs one to anticipate an adverse outcome. As evident in the previous literature, possible and uncertain share similar numerical meanings, but differ significantly in directional meanings. As a result, research results based on the semantic paradigm might be problematic compared to those based on the translation paradigm.

Moreover, some studies focus on understanding the effect of uncertainty expressions in decision making: the so-called pragmatic paradigm. This paradigm, which has borne fruit in experimental psychology, is mainly based on laboratory experiments.

### **Accounting solutions**

Definitions and discussions found in the literature suggest that expressions of uncertainty can be used in different contexts when providing objective or subjective information. The reason for using uncertainty expressions to communicate objective information can be attributed to a lack of accurate knowledge about the value of a measurement, such as the outcome, error, and quality of the information. Instead, the rationale for using uncertainty expressions to communicating subjective information is mainly due to personal interpretations of uncertainty, such as confidence, opinion and understanding. Based on these differences, this study proposes two strategies for the use of uncertainty expressions in accounting: Verbal-Numerical (V-N).

Strategy at scale addresses objective uncertain accounting information. The V-N disclosure strategy relates to subjective uncertain accounting information. As discussed above, the specific application of uncertainty expressions in accounting is based on accounting information that is objective or subjective. This paper develops two separate strategies - objective and subjective - for reporting, communicating, and estimating uncertain accounting information using uncertainty expressions.

One of the key functions of accounting information is to support managers in decision-making. Depending on the uncertainties and other characteristics related to the decision situation, accounting information can have different roles, from a response machine to a source of inspiration (Burchell et al., 1980). As the potential roles of accounting information in decision making

vary, so do the requirements for information to support reporting. It is worth noting that accounting information often fails to sufficiently support managers: irrelevant or useless.

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