Black letter, gray letter games are over under IFRS

Australian companies have been used to interpreting accounting standards in a fairly legalistic manner, but that may change as a result of the adoption of international financial reporting standards, otherwise known as IFRS.

The International Accounting Standards Board (IASB) has specified in a preface to its accounting standards that it believes every word in an accounting standard has the same degree of importance in a situation where the standards are being interpreted.

Whether the text being examined is in bold type or normal body text, known as 'gray letter', is irrelevant, according to the international accounting standard setter, because all words are made equal by virtue of the fact they live in the same accounting standard.

'Standards approved by the IASB include paragraphs in bold type and plain type, which have equal authority. Paragraphs in bold type indicated the main principles,' the IASB's preface states. 'An individual standard in the context of the objective stated in that standard and this preface.'

The practice of interpreting accounting standards in Australia has centred on reading them in a legalistic manner and using the difference in type as an indicator of the status of a paragraph. Paragraphs in bold type have been traditionally regarded as being the standards to be applied and the normal text or 'gray letter' has been seen by practitioners as the equivalent of an explanatory memorandum.

The elimination of the black letter–gray letter mindset is only one of the issues covered within the IASB's preface. It is in the board's preface that users and preparers first encounter how the IASB defines its purpose and also explains its limitations.
Members of the IASB are, according to their preface, committed to:

> Develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions,
>
> Promote the use and rigorous application of those standards, and,
>
> Work actively with national standard setters to bring about convergence of national accounting standards and IFRSs to high-quality solutions.

These objectives, the preface explains, are achieved by developing, publishing and promoting the use of international accounting standards in general-purpose financial statements and other financial reporting.

‘Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users’ ability to make effective economic decisions,’ the preface states.

‘In developing IFRSs, the IASB works with national standard setters to maximise the convergence of IFRSs and national standards.’

The standards set by the IASB cover how entities should recognise, measure, present and disclose dealing with transactions and events in which they are involved, which includes the provision of specific guidance for transactions and events that occur in specific industries.

A general financial reporting framework containing high-level principles is used as a tool in setting standards. The framework sets down the definitions of concepts such as revenue, expenses, assets and liabilities and also the purpose of financial statements.

As under accepted accounting practices in Australia, the IASB framework must be used to solve problems in accounting where there is no generic or specific guidance on an accounting topic.

One of the difficulties for a jurisdiction like Australia in adopting international accounting standards is the domestic board has the responsibility for setting accounting requirements for the public or not-for-profit sector as well as the for-profit entities such as listed companies.

It places an added obligation on the Australian Accounting Standards Board to balance the interests of both sectors while the IASB only has the objective of dealing with for-profit entities.

The IFRSs are designed, the preface states, to apply to the general-purpose financial statements for profit-oriented entities.

‘Profit-oriented entities include those engaged in commercial, industrial, financial and similar activities, whether organised in corporate or in other forms,’ the preface says.

‘They include organisations such as mutual insurance companies and other mutual cooperative entities that provide dividends or other economic benefits directly and proportionately to their owners, members or participants.’

Not-for-profit entities are not covered by IASB pronouncements although the standards board does acknowledge that entities with such activities in the private or public sectors could use them as guidance in solving financial reporting problems.

‘The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) has issued a guideline stating that IFRSs are applicable to government business enterprises,’ the preface notes.

Many of the existing international standards have optional accounting treatments. This results in the same transaction potentially being accounted for in several different ways.

The IASB has committed itself to working towards the elimination of options in IFRS in order to promote consistency and comparability in financial reporting.

'In some cases, the IASC permitted different treatments for given transactions and events. Usually, one treatment is identified as the 'benchmark treatment' and the other as the 'allowed alternative treatment'', the preface says.

'The financial statements of an entity may appropriately be described as being prepared in accordance with IFRS whether the use the benchmark treatment or the allowed alternative.'

Members of the IASB have in the preface vowed to eliminate choices in accounting treatments and also to reconsider transactions and events for which older standards permit a choice of accounting methods with the ultimate objective of having only one way of accounting.