Disclosure of Joint Ventures and Associates in Financial Statement under IFRS

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Abstract:

This article deals with disclosure of associates and joint venture in financial statement. In May 2011 the IASB issued new standard IFRS 12 Disclosure of interest in other entities. This standard, compared with IAS 28 and IAS 31, requires to disclose more detail information about joint ventures and associates. The reason is elimination of proportionate consolidation for joint ventures and also users of financial statements requested improvements to the disclosure of a reporting entity's interests in other entities. The introductory section discusses the equity method and proportionate consolidation, which is followed by a chapter dealing with the disclosure of information relating to joint ventures and associates in the financial statements. The last part is devoted to an analysis of disclosed information relating to joint ventures associates in the financial statements of companies that are listed on the Prague Stock Exchange.

Key words: IFRS 12; Associates; Joint Ventures; Financial Statement.

JEL classification: M41.

1 Introduction

In recent years, there has been a common project of consolidation, in which IASB and FASB were involved. The result of this project was issuing 3 new standards deals with the field of consolidation. One of the significant changes was prohibiting proportionate consolidation for joint ventures. In accordance with the new standard IFRS 11 Joint arrangement (hereafter IFRS 11) can joint ventures be accounted only for using equity method. Some users of financial statements were concerned that the elimination of proportionate consolidation would result in a loss of information (see IASB, 2011). Therefore, users of financial statements requested more detailed disclosures of joint ventures. Proportionate consolidation has supporters not only among users of financial statements but also among academic researches. The main reason is that proportionate consolidation provides more informative financial statements. Graham et al. (2003) shown on that the consolidated accounting treatment appears more useful in predicting future returns on shareholders. And Kothavala (2003) finds that proportionally consolidated

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financial statements are more risk relevant than equity method statements in explaining price volatility. IASB responded by including additional disclosure requirements about joint ventures and associates in the new standard IFRS 12 Disclosure of Interests in other Entities (hereafter IFRS 12).

This article focuses on disclosure requirements of equity investments and investigates whether the investors in their financial statements disclose all the requirements of IFRS 12. Analysis of financial statements is focused on companies that are listed on Prague Stock Exchange.

The article is organised as follows. After the introduction, relevant literature dealing with proportionate consolidation and equity method is reviewed. The next chapter deals with the topic of disclosure requirement for joint ventures and associates. The main part of this article is an empirical study. Firstly, there is stated a methodology followed by the analysis of financial statements. In the conclusion there are summarised the main findings, the limitations of the study are outlined, and the future stream of research in the area is proposed.

2 Equity Method versus proportionate consolidation

In May 2011, the IASB issued 3 new standards regarding consolidation. One of them was IFRS 11, which supersedes IAS 31 Interest in Joint Ventures (hereafter IAS 31). In new IFRS 11 there is the only accounting treatment for joint ventures, the equity method. Now the investors cannot choose between proportionate consolidation and equity method. The evidence suggests that in accounting for interests in jointly controlled entities approximately half of the entities applying IFRSs use proportionate consolidation and half use the equity method (IASB, 2011). The aim of elimination of proportionate consolidation was increasing accounting comparability. This view do not hold everyone and proportionate consolidation has its supporters.

Dieter and Wyatt (1978) reveal that the proportionate consolidation presents a more comprehensive view of the venture financial position and of its incumbent risk and rewards. Laurenco et. al. (2012) show on that the transition to the equity method seems to deprive investors of a set of information on recognized assets and liabilities, which might not be comparable to information presented in the notes. Richardson et al (2012) document that the removal of financial reporting choice does have value-relevance implications and that the requirement of additional disclosure of joint venture assets and liabilities may offset, to some extent, the costs of the reduction in choice.

On the other hand, elimination of proportionate consolidation also has its supporters. They argue that there is no theoretical basis for including jointly controlled assets and liabilities with those fully controlled by the investor (Catuogno et al, 2015). In addition, Lim et al. (2003) document that, when supplementary disclosure of joint ventures is provided, the equity method is associated with a significant decline in information asymmetry.

The IASB believes that the elimination of proportionate consolidation will not cause a loss of information for users of financial statements and helps increase accounting comparability. This opinion is based on new disclosure requirements in IFRS 12, when compared with IAS 31, it will improve the quality of the information provided to users relating to an entity's interest in joint ventures (IASB, 2011). Also Dima and Saccon (2015) concur that more disclosure on joint ventures encourages the reduction of information asymmetry.

3 Disclosure of joint ventures and associates

The disclosure requirements in IFRS 12, compared with IAS 28 Investment in Associates (hereafter IAS 28) and IAS 31, are extended. IASB focused on summarised financial information that should be disclosed for each material joint venture or associate. The IASB initially intended an extension of disclosure mainly for joint ventures. The users of financial statements stated that there was a need for a detailed breakdown of current assets and current and non-current liabilities (in particular, cash and financial liabilities excluding trade payables and provisions), which would help them to understand the net debt position of joint ventures. They also required a more detailed breakdown of amounts presented in the statement of comprehensive income (such as depreciation and amortisation) that would help when valuing an entity's investment in a joint venture (IASB, 2011). Users of financial statements recommended that the disclosures for associates should be aligned with those for joint ventures because investments in associates can be material and are often strategic to an investor with significant influence. According to this recommendation, the IASB decided that summarised financial information should also be provided for each material associate.

Summarised financial information should be presented on ´100 per cent´ basis. This presentation would be appropriate only when the information is disclosed for each joint venture or associate. The reason for this, is that aggregating financial information for all joint ventures or associates would not result in useful information when entity holds different percentage of ownership interests in its joint ventures or associates.

4 Methodology and data of empirical study

The study investigates if the entities disclose all requirements of IFRS 12, especially the new required summarised financial information about joint ventures and associates. The empirical study is focused on the first year after implementation of IFRS 12. In European Union countries applying of IFRS 12 was postponed for annual period beginning on or after 1 January 2014. Financial statements prepared for annual period beginning between 1 January and 31 December 2014 are the subject of the empirical study.

The subject were financial statements of companies that are listed on Prague Stock Exchange up on December 31, 2015. There were 83 such companies. Three criteria were chosen for the selection of the companies:

- company has significant influence or joint control over another entity,
- the interest in associate or joint venture is accounted for using equity method,
- associate or joint venture is material to the reporting entity.

18 companies had a significant influence over another entity. The following companies were excluded from this sample:

- Apollon Property investiční fond s proměnným základním kapitálem, a.s.,
- Central European Media Enterprises,
- O2 Czech Republic, a.s,
- Raiffeisen Centorbank.

The company Apollon Property was exluded because this company prepared financial statement for the year 2014 in accordance with Czech accounting standard. The company Central European Media Enterprises was excluded because company prepares financial statement in accordance with US GAAP. The other two companies were excluded because the interest in associate is not accounted by using equity method.

Joint control over another entity had 10 companies. From this sample, Vienna Insurance Group was excluded because joint venture is not material to the reporting entity.

You can find the selected companies in following table.

Tab. 1: List of the companies

Associates	Joint Ventures
BigBoard Praha, a. s.	České dráhy, a.s.
Cetelem ČR, a. s.	ČEZ, a.s.
České dráhy, a. s.	ČSOB, a.s.
ČSOB, a. s.	Deutche Telekom AG
Deutsche Telekom AG	ING BANK N.V.
Erste Group Bank AG	J & T Banka, a.s.
Home Credit B. V.	O2 Czech Republic, a.s.
ING Bank N.V.	RMS Mezzanine, a.s.
J & T BANKA, a. s.	Škoda Transportation, a.s.
Kofoala S. A.	České dráhy, a.s.
Komerční banka, a. s.	ČEZ, a.s.
Raiffeisenbank, a. s.	ČSOB, a.s.
Vienna Insurance Group	Deutche Telekom AG
VGP NV	ING BANK N.V.

Source: authorial computation.

In the empirical study the disclosure requirements are divided into 5 groups:

1. general information about associate or joint venture,
2. valuation of interest in associate and joint venture,
3. information about significant influence or joint control,
4. summarised financial information about the associate or joint venture,
5. risk associated with interest in associate or joint venture.

5 Analysis of financial statements

The IFRS are designed to provide relevant financial information to wide range of users (Dima – Saccon, 2015). The IASB issued the new IFRS 12 for the purpose of make consistent the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and present those requirements in a single IFRS (Beyersdorff, 2015). New disclosure requirement for joint ventures and associates should also ensure that the elimination of proportionate consolidation will not cause the loss of information. To achieve this assumption it is necessary that the entities disclose the requirements in financial statements. The objective of analysis of financial statements is to verify whether the requirements are disclosed.

5.1 General information about associates or joint ventures

This information was newly required to disclose but almost all companies disclosed requirements of IFRS 12 in this category. It should be added that even before applying of IFRS 12 there were also disclosed names and principal places of business of associates or joint ventures (Ašenbrenerová, 2015).

Tab. 2: General information about associates or joint ventures

An investor shall disclose:	Associates	Joint ventures
The name	14 / 14	9 / 9
The nature of the entity's relationship with the associate or joint venture	14 / 14	9 / 9
The principal place of business	14 / 14	8 / 9

Source: Beyersdorff, M. (2015) and authorial computation.

5.2 Valuation of interest in associates or joint ventures

In this category, compared to IAS 28 and IAS 31, there are not significant changes. The only difference is that in accordance with IFRS 12 an investor shall disclose whether the investment is measured using the equity method or at fair value. In accordance with IAS 28 an investor shall disclose the fact that an associate is not accounted for using the equity method and in accordance with IAS 28 should investor disclose the method it uses to recognise its interests in jointly controlled entities.

Tab. 3: Valuation of interest in associates or joint ventures

An investor shall disclose:	Associates	Joint ventures
Whether the investment is measured using the equity method or at fair value	14 / 14	9 / 9
The fair value of its investment, if there is a quoted market price for the investment	1 / 14	1 / 9
The date of the end of the reporting period, if is different from that of the investor	n / a	n / a
The reason for using a different date or period	n / a	n / a

Source: Beyersdorff, M. (2015) and authorial computation.

The fair value of the investment in associate or joint venture disclosed only one company. Other companies claimed that the market price is not quoted or there was no information to this disclosure. The different date of the end of reporting period did not disclose any company.

5.3 Information about significant influence or joint control

The new requirement of IFRS 12 is that an investor shall disclose significant judgements and assumptions it has made in determining that it has joint control or significant influence. This disclosure was mostly in accounting policies of companies.

The proportion of ownership interest or participating share was disclosed in all cases. This information disclosed investors also before application of IFRS 12.

Tab. 4: Information about significant influence or joint control

An investor shall disclose information about:	Associates	Joint ventures
Significant judgements and assumptions it has made in determining that it has joint control of an arrangement or significant influence over another entity	14 / 14	9 / 9
The proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held (if applicable)	14 / 14	9 / 9
Why does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity	n / a	- / -
Why has significant influence even though it holds less than 20 per cent of the voting rights of another entity	1 / 14	- / -

Source: Beyersdorff, M. (2015) and authorial computation.

Note: - / - means that disclosure is not required.

5.4 Summarised financial information about associates and joint ventures

This area has seen significant changes. The requirements were extended and are more detailed. IFRS 12 requires this disclosure because of an elimination of proportional consolidation. Some users of financial statements were concerned that the elimination of proportionate consolidation would result in a loss of information and these new requirements should ensure that elimination will not cause the loss of information.

The analysis of financial statements shown that the summarised financial information are not disclosed in financial statements. The greatest weakness appeared in disclosure of assets and liabilities. Only 4 from 14 investors disclosed the current and non-current assets and liabilities of associates. The rest of the investors disclosed only total assets and total liabilities. There was no better situation in the case of joint ventures. Only 2 from 9 venturers disclosed the assets and liabilities in accordance with IFRS 12. The rest of investors disclosed mostly total assets and total liabilities but this disclosure is not in accordance with IAS 31 either. IAS 31 required that the venturer shall disclose current and non-current assets and liabilities.

Tab. 5: Summarised financial information about associates and joint ventures

An investor shall disclose for each material associate or joint venture:	Associates	Joint ventures
Current assets	5 / 14	2 / 9
Cash and cash equivalents included in current assets	- / -	3 / 9
Non-current assets	5 / 14	2 / 9
Current liabilities	4 / 14	2 / 9
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	- / -	2 / 9
Non-current liabilities	4 / 14	2 / 9
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	- / -	2 / 9
Revenue	12 / 14	9 / 9
Profit or loss from continuing operations	14 / 14	7 / 9
Post-tax profit or loss from discontinued operations	n / a	n / a
Other comprehensive income	6 / 14	3 / 9
Total comprehensive income	3 / 14	3 / 9
Dividends received from the associate or joint venture	8 / 14	3 / 9
Depreciation and amortisation	- / -	3 / 9
Interest income	- / -	3 / 9
Interest expense	- / -	3 / 9
Income tax expense or income	- / -	3 / 9

Source: Beyersdorff, M. (2015) and authorial computation.
Note: - / - means that disclosure is not required.

5.5 Risk associated with interest in associate or joint venture

In this category, no entity disclosed any risk associated with interest in associate or joint venture. Appropriately in this case, it can be considered disclosing that there are no risks associated with interest in associate or joint venture.

6 Conclusion

One of the reasons for new disclosure requirements about joint ventures and associates in IFRS 12 was elimination of proportionate consolidation. According to IASB the aim of elimination of proportionate consolidation was an increasing accounting comparability. But this view do not hold everyone and proportionate consolidation has its supporters.

Some users of financial statements were concerned that the elimination of proportionate consolidation would result in a loss of information. The new disclosure requirements (e. g. summarised financial information) should ensure that the elimination of proportionate consolidation will not cause the loss of information.

The empirical study investigated, whether all requirements, especially new ones, are disclosed. The results are not satisfactory. The biggest lack of information was in category of summarised financial information. More than half of the entities did not disclose this information in accordance with IFRS 12. Disclosure of associate was in many cases in accordance with IAS 28 although for the year 2014 IFRS 12 should have been applied. Disclosure of summarised financial information about joint ventures is also wanted. Only 2 from 9 venturers disclosed all summarised financial information about joint ventures. The most disclosed ones were only total assets, total liabilities, expenses, revenue and profit.

Another group of new required information was also general information. In this category almost all companies disclosed requirements of IFRS 12. It should be also added that name and principal place of business of associate or joint venture were disclosed even before applying the IFRS 12. In other categories the disclosure was on better level and more sufficient.

This article has also some limitations resulting from limited exchange market in the Czech Republic and with this small sample of investigated entities associated. Secondly, the empirical study includes only financial statements for the year 2014 and it was not possible to compare progression of disclosure in time.

Future research would be appropriate to focus on disclosure in the next years and it would also be useful to enlarge the research sample by companies listed in other markets.

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