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IFRS 11 – Joint Arrangements: the new project by the IASB to account for joint ventures. Implications and effects on firms' financial statements.

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Alice

To All who love me…

ABSTRACT

Nowadays, alliances are regarded by CEOs as a key strategic tool to face competition. The financial consequences coming from the engagement in these business arrangements should be properly reported in firms' financial statements. In this regard, IFRS 11, the new standard issued by the IASB to account for joint arrangements, arose concerns among academicians, audit firms and organisations applying International Financial Reporting Standards. IFRS 11 was part of a short-term convergence project undertaken with the FASB in 2006 and its issuance brought considerable changes in the accounting treatment for joint ventures relative to what was previously required by IAS 31. The most controversial change introduced was the definitive elimination of proportionate consolidation to report a party's interest in a joint venture in favour of the equity method. As IFRS 11 has become an interesting research field, this work aims to provide a contribute for a comprehensive analysis of the rationale behind the decision of the Board to revise IAS 31. Furthermore, after having clearly delineated all the differences existing between IAS 31 and IFRS 11, the study will try to assess the impacts of the implementation of IFRS 11 in firms' financial statements and will focus mainly on the implications of the transition to equity method. Finally, a recommendation to the IASB will be provided in view of future possible amendments of IFRS 11 or new future convergence projects with the FASB.

Over the past 50 years, and especially since the 90s, strategic alliances and joint ventures have played a really significant role in allowing companies to enter foreign markets or new industries by combining their resources, skills, know-how, production or distribution capabilities with those of other market players. Nowadays, alliances are regarded by CEOs as a key strategic tool to face competition and pursue development objectives. Indeed, in a variable and challenging economic scenario, collaborative arrangements permit to develop new technologies or innovative products by sharing control, knowledge and expertise, while minimising at the same time costs as well as political and economic risks. As strategic alliances and joint ventures contribute to create synergies by increasing the global competitiveness of participating organisations, the financial consequences coming from the engagement in these business arrangements should be properly reported in firms' financial statements so that investors, lenders or more generally third users may assess companies' performances by considering also their involvement into these forms of business.

In this regard, *IFRS 11 – Joint Arrangements*, the new standard issued by the IASB in 2011 to account for joint ventures, arose concerns among academicians, audit firms as well as organisations applying International Financial Reporting Standards. More precisely, IFRS 11 was part of a short-term convergence project undertaken with the FASB in 2006 and its issuance brought considerable changes in the accounting treatment for joint ventures relative to what was previously required by IAS 31. The most controversial change introduced was the definitive elimination of proportionate consolidation to report a party's interest in a joint venture. As a matter of fact, while in IAS 31 the Board considered proportionate consolidation as the most suitable method and recommended its use, in IFRS 11 the IASB denied what previously affirmed and required equity method as unique accounting treatment for joint ventures, in the attempt to reduce differences between IFRSs and US GAAP.

This is the overall framework from which this research work has been developed. Since IFRS 11 has become an interesting research field for scholars, first this work aims to provide a contribute for a comprehensive analysis of the rationale behind the decision of the IASB to revise IAS 31 and change view concerning equity method. Furthermore, after having clearly delineated the differences existing between IAS 31 and IFRS 11, the study will try to assess the impacts of the implementation of IFRS 11 in firms' financial statements and will focus mainly on the implications of the transition to equity method for all joint ventures.

To accomplish this objective, as the IASB's post implementation review for IFRS 11 has not been published yet, the research will first consider the IASB's effect analysis run before the effective implementation of the standard. To broaden the analysis of the implications of the transition from PC to EM, other empirical studies such as the one of Demerens et al. (2014) or Leitner-Hanetseder and Stockinger (2014) are taken into account. More precisely, these studies involve European firms, and provide more insights about the possible effects coming from the implementation of IFRS 11 on firms' financial figures as well as financial ratios (e.g. ROE components as expressed by the Du Pont Model). Moreover, since the IASB believes that the elimination of PC would not cause a loss of information for financial statements users as disclosure requirements in IFRS 12 would provide better information, the research of Asenbrenerovà (2016), investigating whether venturers really disclose all requirements in IFRS 12 and especially the summarised financial information for each material JV, is considered. This part will be accompanied by a brief literature review supporting the fact that accounting for joint ventures has been a critical issue debated for decades.

Most studies in literature rely on pro forma financial statements to evaluate potential effects of IFRS 11, for this reason this work will present an analysis that strives to contribute to furnishing policy-relevant insights about the actual variations occurred in companies' financial statements in the first year of adoption of the standard. More precisely, the analysis will focus on those companies listed in three European indexes with large capitalisation: CAC 40, IBEX 35 and FTSE MIB, and following the example of previous analyses in literature, it will consider only those firms that used proportionate consolidation before to switch to the equity method and the analysis will concentrate on the variations occurred in total assets, total liabilities, EBIT, operating revenues and operating expenses as well as in the components of ROE as expressed by the Du Pont Model and in ROA. Finally, to broaden the analysis by Asenbrenerovà (2016), the present study will evaluate whether firms actually provided all disclosures required in *IFRS 12 – Disclosure of Interests in Other Entities* and especially those related to summarised financial information for each material joint venture.

The final goal of this work is to evaluate whether IFRS 11 brought a concrete alignment with US GAAP or whether differences still persist even though the new standard IFRS 11 was thought to be a convergence project with the FASB.

To conclude, a recommendation to the IASB Staff will be provided in view of future possible amendments of IFRS 11 or new future convergence projects with the FASB.

All in all, this study will revolve around three main questions:

- *Why has the IASB decided to review IAS 31 and eliminate proportionate consolidation?*

- *Which effects and implications have occurred in companies consolidated financial statements following the introduction of IFRS 11?*

- *Is it possible to affirm that the IASB has reached a real convergence with the FASB as far as the accounting treatment for joint ventures is concerned?*

CHAPTER 1.

JOINT VENTURES AND STRATEGIC ALLIANCES: BUSINESS ARRANGEMENTS TO ATTAIN DEVELOPMENT OBJECTIVES

1.1 Joint Ventures and Strategic Alliances: rationale and benefits

The accelerated globalisation of businesses, technological breakthroughs, the demographic and social changes in the 21st century have had a considerable impact in the way firms operate. In this constantly evolving scenario, where competition is becoming sharper and organisations need to react and keep up with the ever-changing needs of customers, many companies decide to expand their business operations inorganically through mergers and acquisitions or by forming alliances[1].

Strategic alliances are voluntary collaboration agreements between two or more organisations involving the exchange, sharing or co-development of resources, technology development or the provision of services to pursue mutual objectives (Gulati, 1998)[2]. Anand and Khanna (2000) refer to cooperative strategies as any type of agreement between two or more companies, contractual or otherwise, involving forbearance towards one or more goals by providing knowledge, technology, managerial talent, capital or other valuable assets under the control of the said firms[3].

Despite being inorganic strategic growth alternatives, alliances and M&A present important differences, which may render investments in M&A not always feasible and effective. As a matter of fact, companies are moving beyond the traditional acquisition/disposal model and using more frequently joint ventures or other forms of strategic business alliances to achieve their business development goals[4]. Unlike M&A, where the acquiring or majority party takes operational control, alliances entail a more flexible structure where parties act jointly, hence sharing benefits and risks[5]. Moreover, while M&A bring the involved firms to take on all the assets of the acquired company, including failing business operations, alliances provide companies the opportunity to collaborate only in those areas considered beneficial. Thus, alliances may create "win-win" situations among

[1] PwC. *Mergers & Acquisitions – a snapshot. Alliances: Innovative transaction structures in a changing economic environment*. (2016).
[2] Lin, H., Darnall, N. *Strategic Alliance Formation and Structural Configuration.* Springer Science + Business Media. (2014).
[3] Beamish, P. W., Lupton, N. C. *Cooperative strategies in international business and management: Reflections on the past 50 years and future directions*. Journal of World Business. (2016).
[4] PwC. *Joint Ventures and Strategic Alliances, Examining the keys to success.* (2016).
[5] PwC. (2016).

parties giving the chance to concentrate the efforts on the common goals of participants (Parkhe, 1998)[6].

However, differences exist between joint ventures and strategic alliances. Indeed, a strategic alliance is less involved and usually less permanent than a joint venture, in which two companies typically pool resources to set up a separate legal entity. In a strategic business alliance, each firm maintains its own autonomy while obtaining new opportunities to develop more efficient operating processes, expand into new markets or develop advantages over a competitor[7]. Another conceptual framework subdivides the general concept of *alliances* into two broad groupings of agreements: **equity** and **non-equity alliances**. The most common form of equity alliance entails the creation of a joint venture, that is a separate corporation, whose stock is shared by two or more partners, each expecting a proportional share of dividends as compensation. More precisely, joint ventures are co-operative business activities set up by separate firms for strategic goals, which constitute legally independent entities and allocate ownership, operational responsibilities, financial risks and rewards to each partner, while preserving each own identity[8]. Non-equity alliances, instead, entail more flexible inter-firm cooperative agreements, for instance, R&D collaborations, co-production contracts, technology sharing, marketing agreements, exploration consortia or supply agreements[9].

Strategic alliances take place across a wide range of industries. Pharmaceuticals, chemicals, electronic equipment, computers, telecommunications, airlines, financial or business services have been listed as examples of industries with a relative high frequency of strategic alliances (Kang and Sakai, 2000).

A widely range of reasons push companies to set up alliances with different market players, among whom suppliers, firms from other industries or competitors. First, organisations opt to join forces with a partner to gain access to new markets and complementary capabilities or to fill the lack in management skills and information. Alliances enable companies to enter markets in which they lack production or distribution channels or where laws prohibit 100% foreign ownership of a business[10]. In fact, in some emerging markets like China, the only way to overcome legal barriers and entry the market is by partnering with a local company[11]. A research by Paul H. Folta (2005)

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[6] Kang, N., Sakai, K. *International Strategic Alliances: Their Role in Industrial Globalisation.* OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).
[7] PwC. (2016).
[8] Kang, N., Sakai, K. OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).
[9] Kang, N., Sakai, K. OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).
[10] DePamphilis, D. *Mergers, Acquisitions and Other Restructuring Activities*. Chapter 15, *Business Alliances. Joint Ventures, Partnerships, Strategic Alliances and Licensing.* Elsevier. (2015).
[11] PwC. (2016).

confirms that, despite the attractiveness of China, the country is not an easy place to do business. Thus, foreign companies, willing to internationalise their activities, should consider the possibility to set up equity joint ventures or contractual joint ventures with a local partner which benefits from the government support and has easy access to licenses, suppliers or distribution facilities[12].

Another traditional key driver is the possibility to secure future production by sharing raw materials, when threats of possible shortages emerge. This is what usually happens among chemical companies. Firms may also benefit from accessing tangible assets such as production facilities or distribution networks[13]. The establishment of a jointly held facility may reduce manufacturing and operating costs and lead partners to benefit from economies of scale[14]. Usually, this type of strategic alliances happens among automobile manufacturers, for example, in the 90s, Nissan and Ford built a plant in Spain where to jointly produce vans[15].

Nowadays, in an era of ongoing technological progress, the continuous need to innovate, the growing ease of communication, the cost of research and the need for international standards are prompting firms' decision to partner. As a consequence, organisations decide to share know-how or intellectual resources and commit to work on common R&D projects[16]. In this way, companies can strengthen their innovation capabilities and reduce both the risk and the amount of resources they would have to sustain if they were to take up innovative projects on their own[17]. Indeed, risk sharing encourages organisations to follow new or innovative paths that they may have otherwise rejected (Lyons, 1991). This is the reason why high-technology firms with expertise in a specific technology often combine their efforts with those of other companies with complementary skills and know-how.

Balakrishnan and Koza (1993) demonstrate that joint ventures create value with significant returns when participating organisations operate in businesses with technological and managerial differences, so that they have the chance to ripen and then implement complementary skills. In so doing, companies can accelerate product introduction and reduce the risk of failing to develop the "right" technology before competitors[18]. Lin and Darnal (2014) talk about alliances that emphasise exploration learning as well. Also, in their view, these alliances are likely to push companies to make far-reaching, radical and transformative changes bringing to the formulation of new markets along with the identification of sustainable new means to serve the already existing ones (Etzion, 2007).

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[12] Folta, P. H. *Cooperative Joint Ventures*. The China Business Review. (2005).
[13] Kang, N., Sakai, K. OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).
[14] DePamphilis, D. Chapter 15. Elsevier. (2015).
[15] Walters, B., Peters, S., Dess, G. *Strategic alliances and joint ventures: Making them Work*. Business Horizons. (1994).
[16] PwC. (2016).
[17] DePamphilis, D. Chapter 15. Elsevier. (2015).
[18] DePamphilis, D. Chapter 15. Elsevier. (2015).

Alliance learning might lead also to what is called *exploitation learning* (Koza and Lewin, 1998; Rothaermel and Deeds, 2004) which concentrates on refining existing business activities to obtain the approval of regulatory, industry and community constituents and decrease public scrutiny over current business practices[19].

Examples of strategic alliances for R&D are focused on knowledge-intensive sectors such as information & communication technology and pharmaceuticals. Unlikely, among more traditional manufacturing sectors, the automobile industry has shown a remarkable tendency towards R&D alliances starting from the 90s. In fact, developing new vehicles is becoming increasingly expensive, accordingly, exploiting facilities, leading-edge technologies and specific types of expertise of other companies is fundamental to achieve savings in time and costs[20].

At present, speaking about JVs and cooperative strategies seems a today's topic. Indeed, as early as the Post-World War II, JVs became a common vehicle for pushing economic development through resources sharing[21]. For sure, anyway, starting from the 90s, joint ventures have become a popular strategic choice in response of pressures coming from political restrictions, globalisation and markets saturation.

All in all, alliances may provide an opportunity for sharing costs, risks and knowledge[22], while accessing new technologies, industries and markets[23]. Hence, joint ventures and generally strategic alliances might create synergy effects, strengthen the international competitiveness of participating companies as well as consolidate overlapping capabilities and business activities on a global scale[24].

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[19] Lin, H., Darnall, N. Springer Science + Business Media. (2014).
[20] Kang, N., Sakai, K. OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).
[21] During the 60s, at least 1,131 US firms had been involved in the formation of over 520 domestic joint ventures in the manufacturing, chemicals, drugs & medicines sectors. Harrigan, K. R. *Joint Ventures and Competitive Strategy*. Strategic Management Journal. Vol. 9. (1988).
[22] Baker, H., Kiymaz, H. *The Art of Capital Restructuring: Creating Shareholder Value Through Mergers and Acquisitions*. Chapter 25, *Joint Ventures and Strategic Alliances: Alternatives to M&A*. John Wiley & Sons. (2011).
[23] PwC. (2016).
[24] Kang, N., Sakai, K. OECD Science, Technology and Industry Working Papers, 2000/05. OECD Publishing, Paris. (2000).

1.2 Joint Ventures and Strategic Alliances: the accounting implications

Alliances take form through a variety of arrangements, ranging from contractual agreements such as supply agreements or distribution agreements to more structured collaborations implying the creation of a separate entity. As participants seek to build flexibility, usually these arrangements might take a high level of complexity, which in turn poses great challenges to be managed. Trust, transparency, mutual respect as well as sensible compromise are key words for a successful alliance as they permit to go beyond cultural and decision-making differences[25]. To this regard, from the outset, parties should be clear in shaping the structure of their alliance by outlining fairly parties' contribution to the arrangement and the due remuneration.

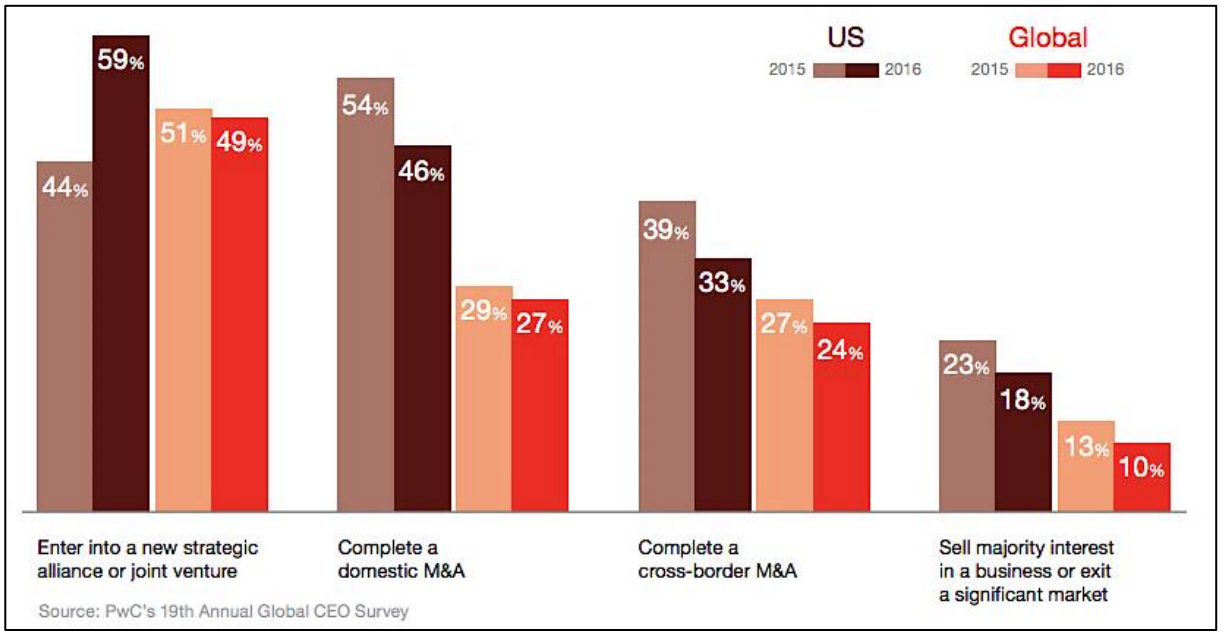
Participants should be aware of the form their alliance would take, as this brings to important accounting considerations. In fact, each type of structure presents its own accounting treatment, which may differ depending on the accounting reporting requirements applied[26]. Therefore, parties, prone to set up a strategic alliance or a joint venture, should arrange compatible internal accounting procedures and audits to report their investment in the financial statements in full compliance with the applied accounting standards[27].

1.3 Cooperative Strategies: a brief look at the global trend

As introduced above, alliances play a key role in corporate growth strategy. The importance of these strategic alternatives is proved even by the PwC's 2016 Global CEO Survey, which shows that 49% of global CEOs were expecting to make strategic alliances in 2016, down only slightly from 2015. In the US, instead, there was a noteworthy increase in CEO interest, with 59% saying they were planning to initiate a strategic alliance in 2016, a jump of 15% over 2015[28] (see Figure 1.3.1).

[25] PwC. (2016).
[26] PwC. (2016).
[27] PwC. (2016).
[28] PwC. *Joint Ventures and Strategic Alliances, Examining the keys to success.* (2016).

FIGURE 1.3.1 – **ALLIANCES ON THE RISE**



Source: PwC's 19th Annual Global CEO Survey. (2016)

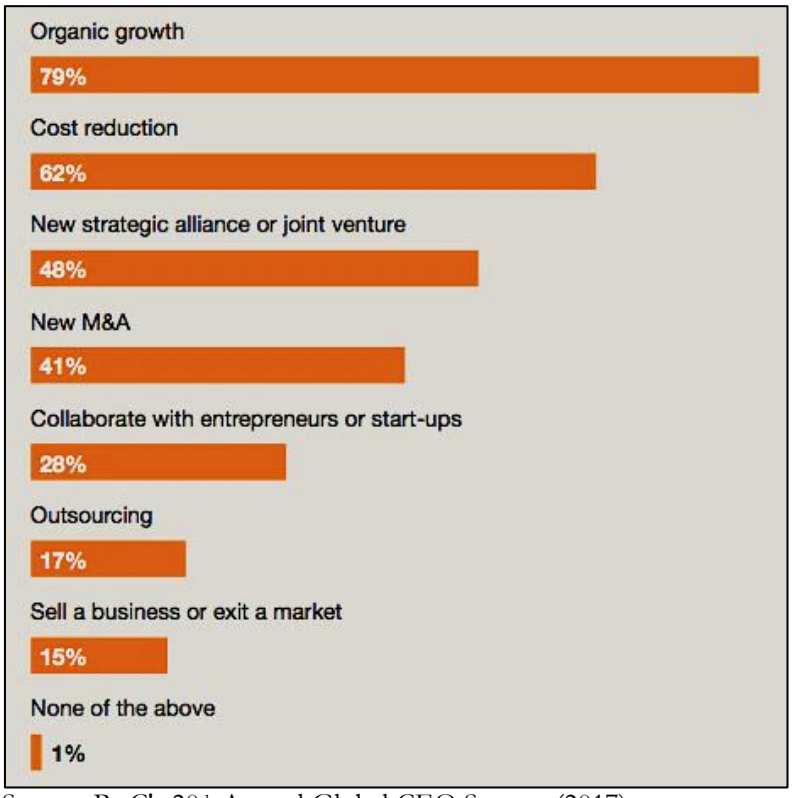
In these last years, PwC, one of the Big Four audit companies, has affirmed to see alliances forming across three predominant areas:

- companies willing to gain expansion into emerging markets such as China, Southeast Asia, Latin America and Africa;
- capital intensive industries as for instance: oil & gas, chemicals, manufacturing, automotive, power & utilities and mining;
- businesses striving to build innovation capabilities and access new technologies, such as firms in financial services, technology and digital telecommunications, pharma, biotech, medical devices and airline companies[29].

[29] PwC. (2016).

The positive global trend towards alliances and JVs is confirmed even by KPMG. In its 2016 Global CEO Outlook, it highlights how partnering was perceived by global CEOs as the proper strategic tool to achieve development goals and remain competitive in the market[30]. In this regard, even the 20th PwC's CEO Survey published in 2017 proves that, at least in the next three years, global CEOs are willing to face part of the challenges due to uncertain economic growth, over-regulation, social instability, speed of technological change, availability of key skills and changing in consumer behaviour by forming partnerships, alliances and joint ventures with competitors, innovative start-ups as well as universities. This trend is confirmed by Figure 1.3.2, where 48% of all the entrepreneurs interviewed across 2016 during the 20th PwC's CEO Survey (in total 1,379 in 79 countries all over the world) replied to be willing to build new strategic alliances or joint ventures within 12 months starting from the interview moment to drive corporate growth and profitability[31].

FIGURE 1.3.2 – **CEO'S PLANNED ACTIVITIES TO STRIVE FOR GROWTH AND PROFITABILITY**



Source: PwC's 20th Annual Global CEO Survey. (2017)

[30] KPMG. *Now or never. 2016 Global CEO Outlook.* (2016).
[31] PwC. *20th CEO Survey. 20 Years inside the mind of the CEO…What's next?.* (2017).

CHAPTER 2.

IFRS 11 – A NEW PROJECT TO ACCOUNT FOR JOINT VENTURES

2.1 A background introduction - the significant role of financial accounting and standard-setters around the world

It is worth drawing attention to the significant role played by accounting and standard-setters around the world, before to consider the new project undertaken by the IASB to account for joint ventures (IFRS 11).

The purpose of accounting is to help stakeholders, namely parties interested in the activities of a company, make better business decisions by providing them with sound financial information. Therefore, accounting consists of measuring business activities, interpreting financial information and then communicating the results to management, investors or other decision makers. It is not feasible to run a company or make sensible investment decisions without timely, accurate financial information[1].

Indeed, it is the accountant who prepares financial information[2], by applying the accounting standards required in the regulation into force in the country where the firm operates. Accounting standards are the norms governing the preparation of financial statements and play a key role in the appropriate functioning of capital markets. Better financial reporting allows investors to make sound evaluations of organisations' financial situation, especially of those listed companies, where shareholders are widespread and have no or limited access to inside information[3]. Furthermore, accounting requirements are not pre-fixed or unchangeable. They may be modified over time by standard-setters, whose task consists in searching and issuing the optimal accounting treatments for each single balance sheet or income statement account with the purpose of ensuring a faithful representation of the financial situation of an organisation. Then, financial information will be used by either internal users, the management, who can monitor how the company is performing, or by external users such as investors, financial analysists, capital lenders or banks, who are interested in understanding if a certain company is profitable and may represent a good and sound investment choice.

[1] Collins, K. *An introduction to business.* Chapter 12, *The role of accounting*. Saylor Academy. (2012).
[2] Collins, K. Chapter 12. Saylor Academy. (2012).
[3] Vèron, N. *Keeping the promise of global accounting standards.* Peterson Institute for international economics. (2011).

It is well-known that for long time financial accounting had been developed and regularised on a national basis by national standard-setters[4], leading to lots of difficulties in the comparison of financial information between companies operating in the same industry, but located in different countries[5], along with burdens on multinational firms which had to prepare financial statements for their subsidiaries following different local regulations. In such scenario, the internationalisation of businesses and the globalisation of financial markets fostered the need to harmonise financial information and issue a global set of accounting standards. This happened soon after the second world war when there was a rapid growth in international trades and investments. In fact, American companies were taking over European firms and investing in Europe, while streams of European investments were flowing into the United States. In this way, starting from the 50s, the increasing economic integration promoted the interest in international accounting and at the end of the 60s the demand for an internationally accepted set of standards became stronger[6]. Hence, mainly under the pressure of the British accountancy profession, precisely the Institute of Chartered Accountants in England and Wales[7], the accountancy bodies of United Kingdom, Canada, France, Germany, Japan, Mexico, Australia, Ireland, Netherlands and United States of America founded in 1973 the International Accounting Standards Committee (IASC)[8], based in London and replaced in 2001 by the International Accounting Standards Board (IASB)[9].

The IASB defines itself as the standard-setting body of the IFRS Foundation, *an independent, privately organised, not-for-profit organisation* based in London, whose mission is promoting the adoption of a single global set of accounting standards to foster trust and long-term financial stability in the world economy[10]. In such a perspective, the IASB develops the International Financial Reporting Standards (IFRS), which so far are applied by 150 jurisdictions[11] worldwide. The purpose is to bring transparency, by enhancing international comparability; strengthen accountability, by reducing the information gap existing between capital providers and firms' management and contribute to more

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[4] Standard-setters are generally accounting professionals by background, they try to find the best measurement and disclosure principles for financial statements to give investors the information they need. Despite financial reporting had common basis on double-entry book-keeping, differences became evident as of the middle of the 20th century due to divergent company laws, different corporate finance, taxation and strength of the accountancy profession.

[5] Karlström, A. *IFRS vs K3. A Liljedahl Group Perspective*. Jönköping University. (2013).

[6] Camfferman, K., Zeff, S. A. *Financial Reporting and Global Capital Markets: A History of the International Accounting Standards Committee, 1973-2000*. Oxford University Press. (2007).

[7] Henry Benson, who during the 60s was the President of the Institute of Chartered Accountants in England and Wales (ICAEW), was considered the guiding spirit behind the foundation of the IASC. The ICAEW desired an accounting body in which the British could take the lead to prevent a predominance of US GAAP.

[8] The IASC was the international standard-setter, which developed International Accounting Standards (IAS).

[9] Camfferman, K., Zeff, S. A. Oxford University Press. (2007).

[10] IFRS Foundation. *Who we are and what we do*. (2017). www.ifrs.org.

[11] IFRS Foundation. *Analysis of the IFRS jurisdiction profiles*. [Number of jurisdictions per region: Europe 44, Africa 23, Middle East 13, Asia and Oceania 33, Americas 37]. (2017). www.ifrs.org.

efficiency, by supporting investors to identify opportunities and avoid risks across the world; hence permitting businesses to reduce the costs of financing[12].

Among jurisdictions applying IASs/IFRSs, there are the EU member states[13]. Through the enactment of *Regulation no. 1606/02* of the European Parliament and of the Council, the European Union requested to all European companies listed on a regulated stock market the compulsory application of IASs/IFRSs for consolidated financial statements from 2005 onwards. In addition, individual EU member states could expand the adoption of IASs/IFRSs, as endorsed by the EU, for the preparation of separate financial statements of listed companies, and for consolidated as well as individual financial statements of all or some companies whose debt or equity is not traded on a regulated market[14].

The adoption of International Financial Reporting Standards was a concrete step to move towards a single set of global accounting principles in Europe, given the difficulty of achieving an own European Framework. Therefore, after the entry into force of the Regulation, all IASs/IFRSs existing at that time were endorsed by the EU, and consequently, the EU officially renounced its regulatory sovereignty in accounting[15]. Even today, when the IASB issues a new standard or an amendment to an existing standard, an adoption or endorsement process takes place. International standards can be adopted only if they are not in contrast with the fundamental principles set by the EU accounting directives (e.g. the true and fair view principle). In such a process, the European Commission requests endorsement advice to the European Financial Reporting Advisory Group (EFRAG), that is a technical advisor made up of member states representatives. In this respect, the EFRAG holds consultations with interest groups and then issues to the European Commission an advice regarding the suitability of a certain standard with the EU criteria of endorsement. Only in a second moment, the European Commission proposes a draft endorsement regulation, which after having been approved by the Accounting Regulatory Committee (ARC) as well as favourably accepted by the Parliament and the Council is published in the Official Journal of the European Union and becomes effective[16].

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[12] IFRS Foundation. *Who we are and what we do.* (2017). www.ifrs.org.
[13] 28 Member States.
[14] IFRS Foundation. *IFRS Application around the world. Jurisdictional profile: European Union.* (2016). www.ifrs.org.
[15] Maystadt, P. *Should IFRS be more "European"? Mission to reinforce the EU's contribution to the development of international accounting standards.* European Commission. (2013).
[16] IFRS Foundation. *IFRS Application around the world. Jurisdictional profile: European Union.* (2016). www.ifrs.org.

In the international accounting arena, beside the IASB, there is another influential standard-setter, the US standard-setter, known as Financial Accounting Standards Board (FASB)[17]. Unlikely those jurisdictions which have adopted IASs/IFRSs as international standards in favour of a major financial accounting comparability across countries, the *Securities and Exchange Commission* (SEC)[18] does not permit its domestic issuers to use IFRS standards to prepare their financial statements, as well as the FASB has never renounced its authority in developing accounting principles for the US market. As a matter of fact, the SEC recognises the financial accounting and reporting standards of the FASB, the US GAAP (Generally Accepted Accounting Principles) as acceptable and reliable for the US market, and all US listed companies must comply with these standards[19]. Thus, while the IASB has achieved worldwide acceptance in these last ten years, the largest capital market in the world, the US, appears still reluctant to fully incorporate IFRSs into its financial reporting system[20]. Anyway, the SEC permits, even if it does not require, foreign private issuers, operating in the US market, to use IFRS standards as issued by the IASB in preparing their financial statements. Accordingly, starting from September 2016, more than 500 foreign private issuers with a market capitalisation higher than US $7 trillion file with the SEC financial statements prepared following IFRS standards[21].

Nonetheless, in September 2002 the FASB and the IASB decided to conclude the Norwalk Agreement, also known as the *Memorandum of Understanding,* with which they committed to remove the main differences between IFRSs and US GAAP in the attempt of developing high-quality fully compatible accounting standards for both the domestic and cross-border financial reporting[22]. In subsequent meetings, the two boards reaffirmed once again their commitment to the convergence of US GAAP and IFRSs, declaring as long-term strategic priority the realisation of a common set of accounting standards. To this purpose, as of 2006, the IASB and the FASB issued a *roadmap of convergence* with which they agreed to work together to reduce differences in accounting treatments through the accomplishment of short-term and long-term convergence projects[23]. Most of these

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[17] The FASB was established in 1973. It is the independent, private-sector, not-for-profit organisation based in Norwalk, Connecticut, establishing reporting standards for public and private companies as well as not-for-profit organisations. The FASB publishes its standards (US GAAP) in the FASB Accounting Standards Codification™. Finally, the FASB operates as part of the Financial Accounting Foundation (FAF), a private sector, not-for-profit organisation established in 1972, which oversees and supports the standard-setter's activity. www.fasb.org.

[18] The SEC is the independent agency of the US federal government established in 1934. Its mission is to protect investors, maintain fair and efficient markets and facilitate capital formation. It is responsible for administering and enforcing the federal securities laws, moreover it prescribes the methods to be followed in the preparation of accounts as well as the content and the form of financial statements of US companies. www.sec.gov.

[19] IFRS Foundation. *IFRS Application around the world. Jurisdictional profile: United States of America.* (2017). www.ifrs.org.

[20] Bogopolski, A. *Does IFRS have a future in the US?* (2015). IFAC (International Federation of Accountants).

[21] IFRS Foundation. *IFRS Application around the world. Jurisdictional profile: United States of America.* (2017).

[22] FASB – IASB. *Memorandum of Understanding.* (2002). www.ifrs.org.

[23] FASB – IASB. *A Roadmap for Convergence between IFRSs and US GAAP-2006-2008*. (2006). www.ifrs.org.

short-term projects required one of the two boards to revise its requirements to better align them with those of the other board[24]. Among these projects there was even the one involving the IASB in revising its approach to account for joint ventures[25], which constitutes the central topic of this research work.

Even if the roadmap played a relevant role in the removal of the reconciliation requirement for non-US companies, so far, despite almost fifteen years have passed, the process of convergence between IFRSs and US GAAP does not seem to have reached a decisive result [26]. This is proved, for instance, by the SEC's Strategic Plan for Fiscal Years 2014-2018, in which it is mentioned that the SEC will continue to work closely with regulatory international organisations with the goal of fostering high quality financial reporting and promoting convergence worldwide, if appropriate. However, it does not mention a concrete willingness to effectively incorporate or endorse IFRSs (and IASs) into the US financial reporting system[27].

A possible explanation to this reluctance might rely on some deficiencies on the part of the IASB's standards pointed out by the SEC Staff already in 2012 in the *Work Plan for the consideration of incorporating Financial Reporting Standards into the Financial Reporting System for U.S. Issuers*. Some of the highlighted shortcomings are quoted below:

- *The standards that are issued by the IASB are generally perceived to be high quality by the global financial reporting community. However, there continue to be areas that are underdeveloped (e.g. the accounting for extractive industries, insurance, and rate-regulated industries). By comparison, U.S. GAAP also contains areas for which guidance is in need of continued development (e.g. push-down accounting and government grants), but the perception among U.S. constituents is that the "gap" in IFRS is greater* [28].
- *IFRS is not comprehensive with respect to certain industries or types of common transactions (e.g. utilities). The absence of guidance may be problematic for issuers in certain U.S. industries for which financial reporting under existing U.S. GAAP standards provides users with more relevant information* [29].

[24] FASB – IASB. *Joint Update Note from the IASB and the FASB on Accounting Convergence.* (2012). www.ifrs.org.
[25] FASB – IASB. *A Roadmap for Convergence between IFRSs and US GAAP-2006-2008*. (2006). www.ifrs.org.
[26] In 2007, the SEC abolished reconciliation requirements.
[27] SEC. *Draft SEC Strategic Plan for 2014-2018*. www.sec.gov.
[28] SEC. *Work Plan for the consideration of incorporating Financial Reporting Standards into the Financial Reporting System for U.S. Issuers.* Exploring a possible method of incorporation – Staff Paper. (2011). – Final Staff Paper. (2012). www.sec.gov.
[29] SEC. *Work Plan for the consideration of incorporating Financial Reporting Standards into the Financial Reporting System for U.S. Issuers.* Exploring a possible method of incorporation – Staff Paper. (2011). – Final Staff Paper. (2012).

- *U.S. GAAP is a mature body of standards that has been specifically tailored to the needs of the business, reporting, and regulatory environment in the United States over its development. By contrast, the IASB has not historically issued industry-specific guidance, preferring instead that issuers use its generally-applicable (i.e. industry-neutral) principles* [30].

All things considered, it seems evident that the strategic priority of achieving a common set of global accounting standards is far to be reached within the forthcoming future and even in the case of an IFRSs incorporation, certainly, the SEC along with the FASB will not renounce to have an active as well as authoritative role in intervening and imposing their view in the standard-setting process to protect the efficient functioning of the US regulated market and the interests of the US investors and constituents[31].

2.2 Why the IASB undertook the revision project: an issue of convergence

Accounting for joint ventures has been a critical issue for several decades and, still, it is the central topic of vibrant discussions[32]. Since the percentage of this form of business has increased during last decades, the need to understand well the related accounting issues has become a relevant subject to investigate[33]. Already in the 90s, bright debates among international standard-setters were focused on identifying the appropriate method of reporting for investments in JVs, although an international consensus in this regard has never been reached[34].

There are essentially two methods widely used to report an interest in a joint venture: equity method[35] and proportionate consolidation[36]. Indeed, yesterday as well as today, discussions revolve

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[30] SEC. *Work Plan for the consideration of incorporating Financial Reporting Standards into the Financial Reporting System for U.S. Issuers.* A comparison of U.S. GAAP and IFRS. (2011). www.sec.gov.

[31] SEC. *Work Plan for the consideration of incorporating Financial Reporting Standards into the Financial Reporting System for U.S. Issuers.* Exploring a possible method of incorporation – Staff Paper. (2011). – Final Staff Paper. (2012).

[32] Richardson, W., Roubi, R., Soonawalla, K. *Decline in Financial Reporting for Joint Ventures? Canadian Evidence on Removal of Financial Reporting Choice.* European Accounting Review. Vol. 21, No. 2, 373 – 393. (2012).

[33] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. *La consolidation des co-entreprises en IFRS: étude de l'impact du changement de méthodes pour les sociétés européennes. Reporting methods for Joint Ventures: which consequences for European listed companies?* 33ème Congrès de l'AFC. (2012).

[34] Richardson, W., Roubi, R., Soonawalla, K. European Accounting Review. Vol. 21, No. 2, 373 – 393. (2012).

[35] The equity method may be defined as a one-line consolidation since an investment is presented in the investor's balance sheet as a single amount initially measured at cost and adjusted thereafter, with the investor's share of the investee's earnings reported as a one line in the investor's income statement. Milburn, J. A., Chant, P. D. (1999).

[36] Under proportionate consolidation, the venturer's pro-rata share of the assets, liabilities, revenues and expenses subject to joint control is combined on a line-by-line basis with the venturer's other assets, liabilities, revenues and expenses. The venturer's portion of the cash transactions is reported in the venturer's cash flow statements as well. Milburn, J. A., Chant, P. D. (1999).

around the appropriateness of whether to apply the former or the latter with no evident solution. The alternative approaches are required or allowed by different standard-setters all over the world[37]. For instance, on the one side, the equity method is required by the American APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock* (APB, 1971), the Australian ASB 131, *Interests in Joint Ventures* (AASB, 2004)[38] and the New Zealand SSAP 25 (Statements of Standard Accounting Practice) *Accounting for Interests in Joint Ventures and Partnerships* (Institute of Chartered Accountants of New Zealand, 1990)[39]. Similarly, from 1998, in the United Kingdom, the FRS 9, *Associates and Joint Ventures* (ASB, 1997), requires venturers to apply the gross equity method, an extension of the equity method[40], which instead was applied before 1998. On the other side, from 1995, the Canadian Institute of Chartered Accountants Handbook, with the revised Section 3055, *Interests in Joint Ventures* (CICA, 1994) mandates the use of proportionate consolidation to account for all interests in joint ventures, with the requirement of additional footnotes disclosing venturer's share of disaggregate revenues, earnings, assets, liabilities and cash flows. This has not always been the case, in fact, prior to 1995, the Canadian GAAP allowed firms to choose either proportionate consolidation or equity method, with the latter being regarded as the normal reporting method. The accounting regime was later changed to have better disclosure following the growth in number and size of joint ventures in Canada (Willet, 1995)[41]. As argued by Richardson et al. (2012), the new view recalled that of the IASB, which until the issuance of the new IFRS 11, recommended the use of proportionate consolidation rather than that of equity method. Likewise, the Italian framework and the Spanish regulation prescribe proportionate consolidation as the *benchmark treatment*, even if the Italian framework requires the application of the equity method if the company chooses not to consolidate the jointly controlled entity, and the Spanish regulation permits the equity method as

[37] Lourenco, I. C., Curto, J. D. *Determinants of the Accounting Choice between Alternative Reporting Methods for Interests in Jointly Controlled Entities.* European Accounting Review. Vol. 19, No. 4, 739 – 773. (2010).

[38] In December 1998, the AASB had already published a revised standard, the AASB 1006, distinguishing joint venture entities from joint venture operations and requiring the use of equity method for the former, while for the latter the reporting of the venturer's share of assets, liabilities, revenues and expenses. Thereafter, the standard AASB 131 (2004) reinforced the AASB preference for the equity method since it had eliminated the option of proportionate consolidation for joint ventures. Stoltzfus, R. L., Epps, R. W. (2005).

[39] SSAP 25 limited the use of proportionate consolidation in cases in which the venturers received shares of the output from the venture, which needed to be an unincorporated business venture. Milburn, J. A., Chant, P. D. (1999).

[40] This method requires equity method recognition in the income statement and balance sheet, with the firm's shares of the gross assets and liabilities underlying the investment shown in aggregate on the face of the balance sheet. The firm's share of joint venture earnings is presented as a separate line item in the income statement, and similarly, joint venture revenues are disclosed as an additional line item in the income statement before equity method revenues. Soonawalla, K. *Accounting for Joint Ventures and Associates in Canada, UK, and US: Do US Rules Hide Information?* Journal of Business Finance and Accounting. 33 (3) & (4), 395-417. (2006).

[41] Richardson, W., Roubi, R., Soonawalla, K. European Accounting Review. Vol. 21, No. 2, 373 – 393. (2012).

the alternative approach when the proportionate consolidation cannot be implemented[42].

As already anticipated, in this controversial scenario, the IASB, before to revise its approach and issue IFRS 11, recommended in the first version of IAS 31 *Joint Ventures* (IASC, 1990) the use of proportionate consolidation as the preferred and benchmark treatment for joint ventures, but admitted the use of the equity method as allowed alternative treatment. Even the last version of IAS 31 (IASB, 2010), while following the IASB policy of not referring to a *preferred method*, explicitly described the equity method as the *alternative* to proportionate consolidation[43]. According to what highlighted by Saccon et al. (2012) the Board's reason in favour of proportionate consolidation was provided in paragraph 32 of IAS 31:

> *When recognizing an interest in a jointly controlled entity, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. This substance and economic reality are reflected in the consolidated financial statements of the venturer when the venturer recognizes its interests in the assets, liabilities, income and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph 34.*

This was the official explanation given by the Board. However, Saccon et al. (2012) remark that the real explanation may be found in what Ernst and Young argued in this regard in 2004:

> *Joint ventures comprise a major part - sometimes all - of the activities of entities in some sectors (particularly extractive industries, property and construction). Over the years, these sectors have developed generally accepted 'industry GAAPs'... Any attempt to standardise the accounting at this stage could have led to industry opposition so strong as to have seriously impeded the harmonisation programme.*

Following these arguments, it seems that the rationale behind the preference of one method over the other was not clear neither in the mind of the international accounting standard-setter. Hence, from the outset, the IASB and previously the IASC did not anchor their accounting requirements on a solid basis made up, for instance, of concrete researches or studies proving that one method was effectively more beneficial for users of financial information.

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[42] Catuogno, S., Allini, A. *Multiple Evaluation Options & Comparability: Equity Investments in Italy and Spain.* Accounting and Management Information Systems. Vol. 10, No. 2, 249-274. (2011).
[43] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).

Indeed, Saccon et al. (2012) comment that the choice of the IASB towards proportionate consolidation was merely a pragmatic issue rather than a conceptual one. Confirming this point of view, Camfferman and Zeff (2007) state that the drafting process of the first version of IAS 31 was quite complicated. Joint ventures were considered a novel phenomenon in the middle of the 80s and a variety of meanings were associated to this concept. Already at that time, the main question was whether jointly controlled entities should be accounted for by adopting the equity method or the proportionate consolidation. Surprisingly, initially the IASC tended towards the equity method, with proportionate consolidation that could be used under limited circumstances. It was after a set of opposing comment letters, that the Board decided to favour the proportionate consolidation, leaving no room for using the equity method. However, once again given the contrast shown by the SEC, by many US and UK firms and by the UK standard-setter of that time called Accounting Standards Committee (ASC), the IASC modified its position by allowing the equity method as the alternative method[44].

These arguments highlight that the international standard-setter was guided primarily by the willingness to meet the preferences of constituents rather than by a certain theoretical research background. Therefore, the debate on which was the more suitable accounting treatment between equity method and proportionate consolidation became very soon an international open question, culminating in the short-term convergence project of IFRS 11.

Practitioners and academics have debated the potential impacts of joint ventures on financial statements of investor firms and alternative accounting treatments since the sixties (Kocan, 1962; Nielsen, 1965; Reklau, 1977; Dieter and Wyatt, 1978)[45]. Even the FASB added in its agenda a project aimed at investigating whether the accounting practices common in the US system met the information need of financial statements users[46]. In this debatable context, an attempt to harmonise what should have been considered a joint venture for accounting purposes and the appropriate method of measurement was made in September 1999, when the FASB in cooperation with the G4 + 1 issued a special publication *Reporting Interests in Joint Ventures and Similar Arrangements* [47] in which it discussed the conceptual arguments for and against each different accounting treatment with the goal to develop a common understanding and an international consensus on this matter. The G4 + 1 consisted of a group of accounting policy makers: the Australian Accounting Standards

[44] Camfferman, K., Zeff, S. A. *Financial Reporting and Global Capital Markets: A History of the International Accounting Standards Committee, 1973 - 2000*. Oxford University Press. (2007).
[45] Kothavala, K. *Proportional Consolidation versus the equity method: A risk measurement perspective on reporting interests in joint ventures*. Journal of Accounting and Public Policy. 22, 517 – 538. (2003).
[46] Stoltzfus, R. L., Epps, R. W. *An empirical study of the value-relevance of using proportionate consolidation accounting for investments in joint ventures*. Accounting Forum. 29 (2), 169 – 190. (2005).
[47] Lim, C. Y., Yeo, G. H., Liu, C-S. *Information asymmetry and accounting disclosures for joint ventures*. The International Journal of Accounting. 28, 23 – 39. (2003).

Board, the Canadian Accounting Standards Board, the New Zealand Financial Reporting Standards Board, the UK Accounting Standards Board, the FASB and the IASC. The G4 + 1 report identifies three methods for reporting investments in joint ventures: the equity method, the proportionate consolidation and the expanded equity method, however recommends as the most appropriate method for presenting an interest in a joint venture the use of the equity method along with the provision of supplementary disclosure, among which the investor's share of current and long-term assets, current and long-term liabilities, revenues and expenses by major components, net income before and after taxation and cash flows from operating, investing and financing activities[48].

Due to the lack of consistency in the G4 + 1 accounting standards and practices, the report proposes a common definition of *joint venture* as well as one of *joint control*. Joint venture is described as an enterprise that is jointly controlled by the reporting enterprise and one or more other parties, while joint control exists when no one party alone has the power to control its strategic operating, investing and financing decision, but two or more parties together can do so, and each of the parties sharing control (joint venturers) must consent. Furthermore, it is stressed that the existence of a joint venture does not depend merely on the existence of a specific legal form. Some years later, this argument has been taken by the IASB to explain one of the major weaknesses of IAS 31[49].

Even the rationale for preferring the equity method exposed in the G4 + 1 report has been mentioned by the IASB to legitimise the elimination of the proportionate consolidation in IFRS 11. Really, Milburn and Chant (1999) conclude that the proportionate consolidation is conceptually inconsistent with the definition of an asset and a liability described in the conceptual frameworks of the G4 +1 members. A venturer alone cannot control its pro rata share of joint venture assets (e.g. venture's cash, plants, etc.) and it is not directly responsible for a portion of joint venture's debt. Conversely, an investor can control its joint venture rights to determine essential venture's decisions and it has a collective return on the joint venture's net assets. These arguments would justify the coherence of reporting only the net equity interest[50].

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[48] Milburn, J. A., Chant, P. D. *Reporting Interests in joint ventures and similar arrangements.* Financial Accounting Series; No. 201 – E. Financial Accounting Standards Board. (1999).
[49] Milburn, J. A., Chant, P. D. Financial Accounting Series; No. 201 – E. Financial Accounting Standards Board. (1999).
[50] Milburn, J. A., Chant, P. D. Financial Accounting Series; No. 201 – E. Financial Accounting Standards Board. (1999).

Soon after the G4 + 1 meeting, in 2001 the IASB (pushed especially by the SEC and the IOSCO) took into account the potential elimination of choices proposed in different standards, among which IAS 31[51]. Accordingly, in its June 2002 meeting[52], the IASB considered the possibility to eliminate the proportionate method and asked the Australian standard-setter to work on this subject and after the Norwalk Agreement, the revision of IAS 31 became integral part of a short-term convergence project aiming at reducing differences between US GAAP and IFRSs[53]. In April 2003[54], the IASB asked the AASB to engage with a broader and long-term research project on joint venture arrangements. Thus, the revision project started with the involvement of national standard-setters from Australia, Hong Kong, Malaysia and New Zealand, which basically run a preliminary research, focusing mainly on the definition of joint venture as well as the differences between a joint venture entity and direct interests in assets and liabilities of a joint arrangement, and finally on methods of accounting applicable by investors in such entities[55]. One of the significant aspects outlined in *the IASB's Research Project on Joint Ventures led by the AASB* was the application of the **substance over form** principle which in turn required the exercise of professional judgement to determine the true nature of an arrangement.

During the IASB meeting in 2003[56], while talking about the potential usefulness of the equity method, several Board members expressed dissent in this regard. For instance, some of them noted that:

> *The expanded equity method and the gross equity method might suffer from the same criticisms often made of proportional consolidation […]*
> *Under equity accounting, the balance sheet and income statement effectively "shrink" due to the netting that occurs in the application of the equity method and information is lost.*

Despite these criticisms and lack of consensus, in December 2005[57] the IASB decided that the existing option of proportionate consolidation should have been removed. Above all, the IASB justified the overall revision of IAS 31 and more precisely the elimination of the proportionate method by pointing out three main benefits achievable with the new IFRS[58]: first, a consistency with the Framework's definitions given the sole recognition in financial statements of controlled

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[51] Camfferman, K., Zeff, S. A. Oxford University Press. (2007).
[52] IASB. *IASB Update June 2002*. www.ifrs.org.
[53] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[54] IASB. *IASB Update April 2003*. www.ifrs.org.
[55] Hamidi – Ravari, A., Australian Accounting Standards Board. *The IASB's Research Project on Joint Ventures led by the AASB*. Financial Reporting, Regulation and Governance. (2005).
[56] IASB. *IASB Update April 2003*. www.ifrs.org.
[57] IASB. *IASB Update December 2005*. www.ifrs.org.
[58] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).

assets and present liabilities, second a major comparability given the elimination of options and last a convergence in principle with US GAAP that generally requires the use of the equity method[59]. Saccon et al. (2012) remark that the IASB regarded the arguments of some constituents, affirming that proportionate method was a practical way to report a venturer's interest in a joint venture, as less important than the conceptual coherence with the Framework[60]. In *the Basis for Conclusions on Exposure Draft* (BC 12), the Board states:

> *Their view is that proportionate consolidation better meets the information needs of users of financial statements by providing a better representation of the performance of an entity's management and an improved basis for predicting cash flows. The Board noted these arguments but concluded that the practical argument does not refute the fundamental inconsistency with the Framework.*

In this way, the IASB seemed to favour a conceptual view rather than the importance of relevance to users. However, referring to the quotation above, Saccon et al. (2012) reveal that this proposition is an unsubstantiated value judgement. In fact, in the *Basis for Conclusions on IFRS 11*, the IASB does not refer directly to the consistency/inconsistency argument anymore, but interestingly it refers to the principle-based approach to accounting for joint ventures established by the new standard IFRS 11 (BC 3 and BC 73), to the better convergence with US GAAP even if not complete (BC 3) and to a better verifiability, comparability und understandability of financial statements (BC 73). Thus, Saccon et al. (2012) express that it seems as if the IASB implicitly admitted that the conceptual consistency argument, for long time debated by participants in the due process, was not defensible anymore, and implicitly recognised that the main argument for the elimination of the proportionate consolidation was a convergence one[61].

After all, a confirmation that the elimination of proportionate consolidation was above all a mere question of convergence with US GAAP was clearly pointed out by the same IASB during its July 2006 meeting[62]. What is more, being conscious of the fact that US GAAP allows in limited cases for certain industries (e.g. oil & gas, extracting, construction industries) the application of the proportionate consolidation, the Board clearly observed that the main goal of the revision project was to *converge with the US accounting literature for jointly controlled entities […] rather than to harmonise with existing US practice generally.* However, this affirmation is questionable since at that time and today as well there is no evidence in literature that clearly shows the superiority of the equity method over

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[59] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements.* (2007).
[60] Assets are defined as resources controlled by an entity from which future economic benefits are expected to inflow and liabilities are described as present obligations which will result in an outflow of resources from the entity. IFRS Foundation. *The Conceptual Framework for financial reporting.* (2010). Chapter 4. www.ifrs.org.
[61] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[62] IASB. *IASB Update July 2006*. www.ifrs.org.

the proportionate consolidation. As observed by Saccon et al. (2012) literature provides mixed and inconclusive results on the relevance for users of each method, thus this is a clear proof confirming that this kind of argumentation cannot be mentioned by the IASB to support its position regarding the elimination of proportionate consolidation.

All things considered, as in the case of IAS 31, the IASB did not support its conclusions, this time in favour of the equity method, with coherent and clear argumentations or with any theoretical research background. It seemed that the main concern for the IASB was to enhance its acceptance towards the US standard-setter and the SEC as well, by reducing remarkable differences between IFRSs and US GAAP[63], even if officially after the issuance of IFRS 11 the IASB has never declared to have eliminated the accounting option primarily to reach convergence[64].

Finally, the inconsistency and ambiguity of standard-setters all over the world on this matter has been proved even by what has affirmed the Canadian standard-setter once the IASB Exposure Draft was published. Albeit from 1995 the CICA required the use of proportionate consolidation to account for joint ventures[65], in January 2008 in its comment letter, the Canadian Accounting Standards Board explicitly affirmed[66]:

> *We support the proposals in ED 9 and agree that they provide a more faithful application of the framework to joint arrangements. In particular, our User Advisory Committee agrees that the equity method is more appropriate for accounting for interests in joint ventures rather than proportionate consolidation.*

After the issuance of IFRS 11 the question of whether the equity method might be really the more suitable method for reporting investments in joint ventures remains still open-ended, leaving room for further discussions[67].

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[63] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[64] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[65] The CICA had affirmed that financial statements prepared under proportionate consolidation gave users more information about the resources, the obligations and the operations run by a venturer using joint ventures, hence proportionate consolidation best reflected the risks to which a venturer was exposed. Richardson et al. (2012).
[66] Richardson, W., Roubi, R., Soonawalla, K. European Accounting Review. Vol. 21, No. 2, 373 – 393. (2012).
[67] Catuogno, S., Allini, A., D'Ambrosio, A. *Information Perspective and Determinants of Proportionate Consolidation in Italy. An ante IFRS 11 Analysis.* Rivista dei Dottori Commercialisti. (2015).

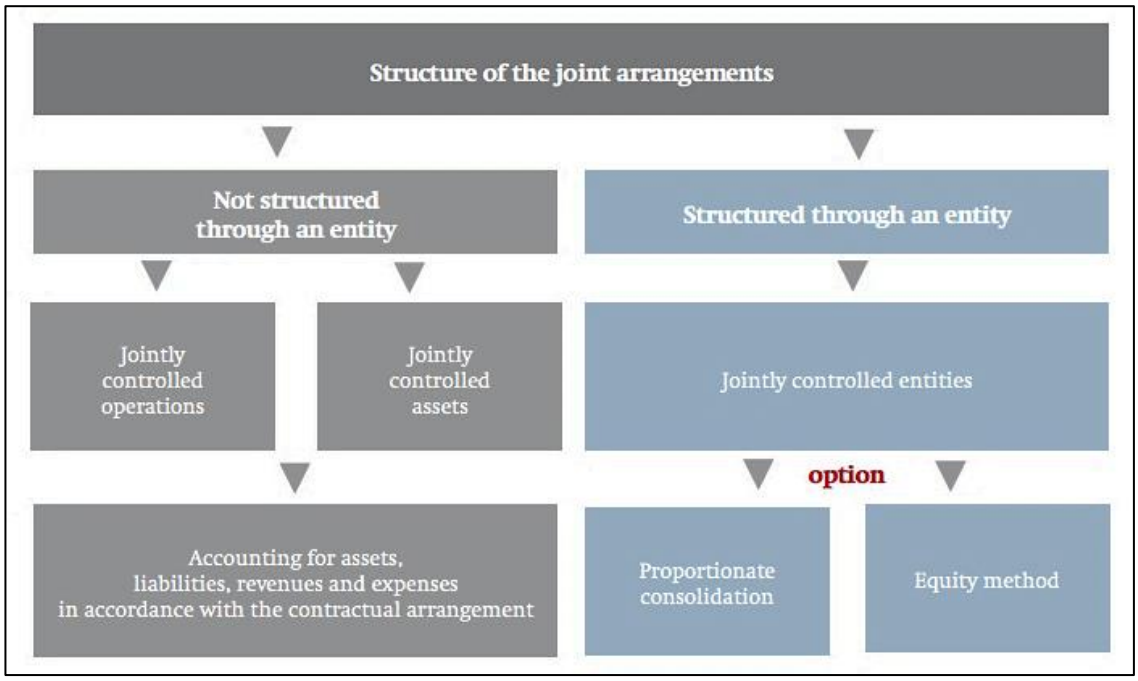
2.3 The Weaknesses of IAS 31 as explained by the IASB

The previous section concluded that the main reason behind the revision project of IAS 31, which saw the involvement of the IASB in the issuance of a new standard to account for joint ventures - IFRS 11, was driven by an issue of convergence with US GAAP.

Nevertheless, in its *Project Summary and Feedback Statement – IFRS 11 Joint Arrangements* (May 2011)[68], the IASB does not explicitly mention the convergence argument as the main aim justifying the changes in the accounting treatment for joint ventures. The Board has just affirmed that, even though the initial goal of the project was to focus on convergence differences, resolvable within a short time period, the primary concern was to improve the accounting for joint arrangements by remedying two aspects of IAS 31 which were regarded as impediments to high quality reporting of joint arrangements. First, in IAS 31 the structure of the arrangement was the only determinant of the accounting and, second, an entity had a choice of accounting treatment for interests in jointly controlled entities (JCEs) between the proportionate consolidation and equity method[69]. In *Why we undertook the project,* one of the section of the *Feedback Statement*, the IASB highlights that indeed its concern was to intervene by introducing important changes aimed at removing the two weaknesses impairing the quality in reporting joint ventures. In the IASB's opinion, these two weaknesses could lead to situations in which: arrangements, entitling parties to similar rights and obligations, were accounted for differently, and conversely, arrangements, giving to participators different rights and obligations, were accounted for similarly[70]. In this way, the IASB used these two arguments defined as relevant inconsistencies to excuse its final decision to issue a new standard, which would have brought significant implications in the classification and accounting method for joint arrangements, despite the great opposition shown after the publication of the Exposure Draft by the accounting profession, audit firms, banks and brokerage companies, as well as financial statements preparers[71].

[68] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[69] IFRS Foundation. *Frequently Asked Questions – IFRS 11 Joint Arrangements*. (2011). www.ifrs.org.
[70] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[71] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

FIGURE 2.3.1 – **THE WEAKNESSES OF IAS 31**



Source: IFRS Foundation. *Project Summary and Feedback Statement*. (2011)

The Board regards IFRS 11 as an improvement on IAS 31 given that it establishes a principle-based approach to guide the accounting for all joint arrangements. Unlike the classification brought about by IAS 31, in IFRS 11 the types of joint arrangements are determined by assessing the rights and obligations of the parties arising from the arrangements[72]. Therefore, the existence of a separate vehicle is not the key factor to determine the classification of joint arrangements anymore. In this way, a joint arrangement is classified as a *joint operation* if the application of the principle leads to parties having rights to individual assets and obligations for the liabilities of the arrangement, while if the application of the principle results in parties owning rights to the net assets or net outcome of the generated activities, that arrangement is a *joint venture*[73].

The concept of *substance over form* had been already introduced in the G4 + 1 Report (1999), where in section 2.41 *Legal structure and substance of a joint arrangement*, it is stated that the existence of a joint venture does not depend merely on the existence of a specific legal entity, therefore one must carefully examine the constructive and contractual provisions of a cooperative arrangement to assess whether an arrangement is a joint venture[74]. Thereafter, the relevance of substance over form was stressed also in *the IASB's Research Project on Joint Ventures led by the AASB* (2005), where

[72] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[73] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[74] Milburn, J. A., Chant, P. D. Financial Accounting Series; No. 201 – E. Financial Accounting Standards Board. (1999).

it is asserted that investors might choose a particular structure to carry on their arrangements to benefit from the advantages given from the selected structure, while minimising relative drawbacks. Consequently, this may result in legal forms not conforming with substance to such an extent that the distinction between entity and non-entity joint arrangements may become not so clear[75].

The application of substance over form and the assessment of parties' rights and obligations are not automated processes. In fact, they require professional judgement by joint arrangements participators. Really, recognising rights and obligations is a crucial phase in applying IFRS 11. Once a joint arrangement is classified as joint venture or joint operation, the relative accounting treatment does not leave room for any option[76]. Hence, a joint operator must account for assets, liabilities, relative revenues and expenses in accordance with applicable IFRSs, whereas a joint venturer must account for its investment using the equity method, as it owns only rights to the net assets of an arrangement[77]. The classification proposed by IFRS 11 with the relative accounting treatment for each type of joint arrangement is similar to what the Australian standard (AASB 1006) required: equity accounting for joint venture entities whereas accounting for the share of assets, liabilities, revenues and expenses for joint venture operations.

In this way, the IASB believes to have solved one of the problems related to IAS 31. In line with what the AASB stated in the research project, the IASB was convinced that the form of the arrangement (establishment of a separate vehicle or not) could not be the sole driver in defining the accounting method for interests in joint arrangements anymore. In the Board's opinion, the inconsistency of the legal form as unique key factor for classification was evident as arrangements, very similar in substance, could be assessed and accounted for differently in financial statements. For instance, jointly controlled operations and jointly controlled assets were arrangements in IAS 31 that did not require the establishment of an entity. Hence, parties were simply asked to recognise assets, liabilities, revenues and expenses arising from the arrangements. Nevertheless, if the same arrangements had been structured through an entity, IAS 31 would have classified them as jointly controlled entities, thus allowing parties to choose either proportionate consolidation or equity method. Furthermore, the Board was conscious that if from the one hand the form might certainly affect the rights and the responsibilities of an entity, from the other hand an owner might reverse the effects of such structure through establishing guarantees or indemnities[78]. Hence, this would prevent legal form from being a valid driver to assess joint arrangements.

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[75] Hamidi – Ravari, A., Australian Accounting Standards Board. Financial Reporting, Regulation and Governance. (2005).
[76] IFRS Foundation. *Frequently Asked Questions – IFRS 11 Joint Arrangements.* (2011). www.ifrs.org.
[77] IFRS Foundation. *Project Summary and Feedback Statement.* (2011). www.ifrs.org.
[78] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements.* (2007). www.ifrs.org.

To understand how organisations, accountants, audit firms etc. reacted with respect to the new principle-based approach officially presented in the Exposure Draft, the study of Tiron-Tudor and Müller *Agreement and Disagreement regarding IASB's proposed changes to accounting for Joint Ventures* (2009) is considered[79]. They analysed the feedback and the opinions sent to the Board during the comment period after the Exposure Draft (ED 9) was published in September 2007[80]. Then, they grouped the organisations, which had submitted comment letters, into six clusters: Accounting and Audit Profession (AAP – 27), Accounting Standards Setters (AAS – 18), Banking and Financial Services (BFS - 13), Construction & Extractive Industry (including Oil & Gas) (CEI - 15), Industry and Services (except Construction and Extractive) (IS - 29) and other (OTH - 6)[81]. Thereafter, they divided *Question 2,* dealing with the principle-based approach into two separate research questions, and finally they run a quantitative and qualitative analysis of the answers, as follows.

Before to present the results, it is worth reminding that in ED 9, as it will be specified later, the Board proposed to classify joint arrangements into three possible types, as required by IAS 31: joint operations, joint assets and joint ventures. However, in the final version of IFRS 11 the two concepts of joint assets and joint operations have been brought together into the sole category of *joint operations* [82]. Anyway, this difference between the exposure draft and the official standard IFRS 11 is not a concern if Question 2 is taken into account, as the central point underlying this question focuses only on the principle-based approach as a new means for classification, instead of structure.

Question 2 (ED 9): *Do you agree that a party to a joint arrangement should recognize its contractual rights and obligations relating to the arrangement? If so, do you think that the proposals in the exposure draft are consistent with and meet this objective? If not, why? What would be more appropriate?*

[79] Tiron – Tudor, A., Müller, V-O. *Agreement and Disagreement regarding IASB's proposed changes to accounting for Joint Ventures.* Accounting and Management Information Systems. Vol. 8, No. 1, 7-26. (2009).
[80] Tiron – Tudor and Müller counted 114 comment letters. (111 were the effective number received, but one of these was a joint response gathering 4 organisations). From the total number of 114 comment letters received, however at that time 2 could not be downloaded from the IASB Website and 4 were sent by private persons on their own behalf. Tiron – Tudor and Müller excluded all of them from the analysis given that they were concerned with finding the opinion of organisations only. In this way, they analysed a total number of 108 comment letters.
[81] The reason why for separating the group CEI was based on the fact that these industries are very sensitive to proportionate consolidation, and that in these industries US GAAP allows the proportionate consolidation.
[82] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

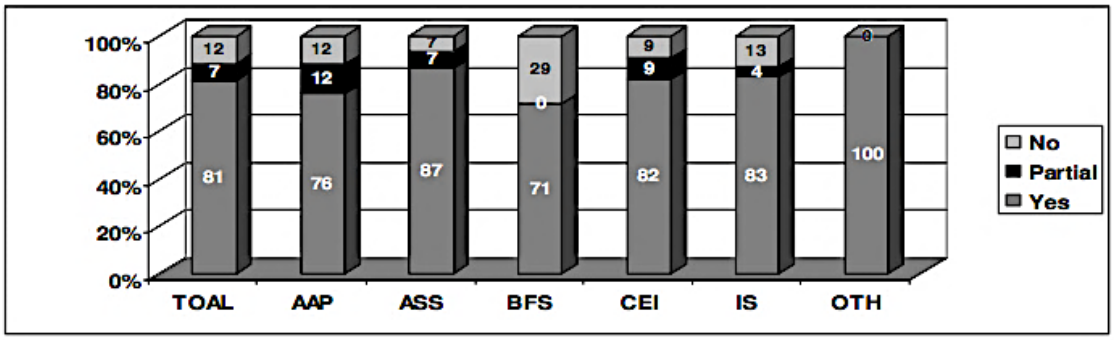
Question 2 as divided by Tiron-Tudor and Müller (2009):

Question 2.1: *Do you agree that a party to a joint arrangement should recognize its contractual rights and obligations relating to the arrangement?*

Question 2.2: *If so, do you think that the proposals in the exposure draft are consistent with and meet this objective? If not, why? What would be more appropriate?*

The results of the quantitative analysis referring to Question 2.1 are visible from Figure 2.3.2. As confirmed by the graph below, responses to Question 2.1 indicated an overall agreement. More precisely, the 88% of the respondents showed a partial or a total agreement to the IASB's proposal. The Banking and Financial Services Group showed, among all, the lowest agreement percentage.

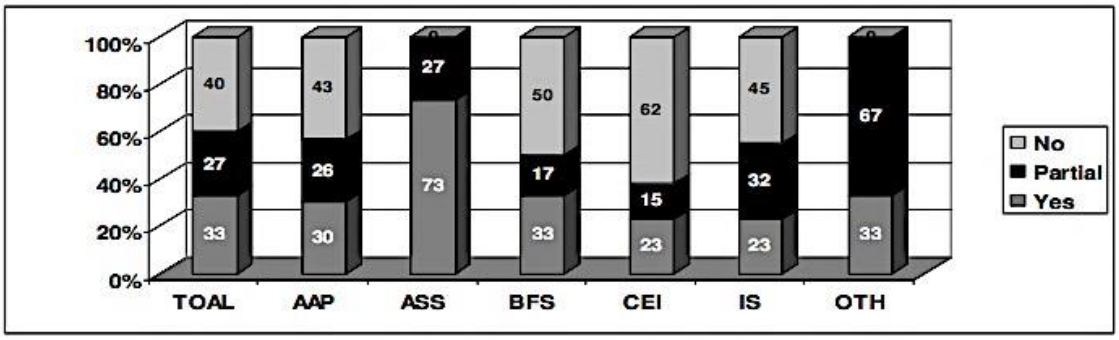
FIGURE 2.3.2 – **ANSWERS RECEIVED FOR QUESTIONS 2.1**



Source: Tiron – Tudor and Müller. (2009)

The answers to Question 2.2 (shown in Figure 2.3.3) exhibited, conversely, relative high differences in the opinions of respondents belonging to different groups. The agreement percentage of the entire sample was of about 60%, and among all, the Accounting Standards Setter group recorded no negative answer: 73% were totally affirmative and 27% partially affirmative, while the CEI group (Construction and Extractive industries) recorded the highest disagreement percentage with 62%.

FIGURE 2.3.3 – **ANSWERS RECEIVED FOR QUESTIONS 2.2**



Source: Tiron – Tudor and Müller. (2009)

Overall, the quantitative analysis shows that many respondents gave a positive feedback to the new core principle approach. Nevertheless, the qualitative analysis of comment letters referring to Question 2 highlights a list of the more frequently encountered arguments against the Board's proposal. First, the principle and its potential implications raised concerns regarding the definition of an asset. In fact, some respondents argued that splitting up assets into their related rights and their separate recognition did not comply with the Framework and this was perceived also as more difficult to apply in practice than the requirements in IAS 31. Other respondents considered that the Exposure Draft seemed internally inconsistent in explaining the application of the rights and obligations model, because recognising a share of a joint asset would have not been consistent with the Framework definition of an asset given that the party does not unilaterally control joint assets. The same reasoning applied for liabilities. Some other respondents argued, instead, that the general principle of recognising contractual rights and obligations would have led to have as main driver in the determination of the accounting treatment still the legal form of the arrangement. Further, not few respondents were convinced that the new approach should have been codified first in the Framework rather than in ED 9, and finally many respondents required more guidance for the application of the principle[83].

Despite the concerns exposed through the comment letters, in its *Project Summary and Feedback Statement* the IASB believes that the principle-based approach of IFRS 11 enhances verifiability and understandability as the accounting would reflect more faithfully the economic phenomena that it represents (i.e. the effective rights and the obligations of the parties), additionally it would improve consistency provided that it leads to the same accounting outcome for each type of arrangement, and last but not least, it would increase comparability among financial statements, as users may be able to identify and understand similarities and differences between similar joint arrangements[84]. Moreover, to assist preparers in the classification of their joint arrangements, the Board decided to publish an additional guidance with practical examples.

Certainly, due to this short-term convergence project, the provisions of IFRS 11 have posed challenges in the accounting for joint arrangements. Companies had to re-evaluate all their existing joint arrangements in accordance with the principle-based approach. For sure, this reclassification might have been a great workload, especially for those firms operating in industries where setting up joint arrangements is a common strategy to share costs, risks and know-how[85].

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[83] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. Vol. 8, No. 1, 7-26. (2009).
[84] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[85] Leitner – Hanetseder, S., Stockinger, M. *How does the elimination of the proportionate consolidation method for joint venture investments influence European companies?* ACRN Journal of Finance and Risk Perspectives. (2014).

2.4 Constituents' reaction to the elimination of Proportionate Consolidation

The most controversial change introduced with the short-term convergence project was the elimination of proportionate consolidation. The inconsistency and lack of consensus behind this decision has already been discussed. The purpose of this section is to learn more about the reaction constituents (the accounting and audit profession, national standard setters, preparers, brokerage firms etc.) had once the Board officially presented its proposal of removing the accounting option for proportionate consolidation.

Given the narrow scope of the convergence project involving the revision of IAS 31, the IASB decided neither to publish a discussion paper nor to set up a working group, it published directly an Exposure Draft, *ED 9 – Joint Arrangements*, in September 2007, leaving a four-month comment period. Eleven of the thirteen Board members at that time approved the Exposure Draft for publication, whereas only two members abstained in view of their recent appointment to the Board. The Exposure Draft received 111 comment letters, almost half of which were against the Board's decisions[86].

According to the IASB's Due Process Handbook[87], after the publication of the Exposure Draft, the comment letters received by interested parties play a very significant role in the decision-making process of the Board[88]. For instance, as already mentioned, negative comment letters made the Board change the preferred accounting treatment in the first version of IAS 31 from the equity method to proportionate consolidation. Catuogno et al. (2015) affirm that the formal debate among standard setting participants took a long time before IFRS 11 was issued in 2011. On one side, not all Board members agreed with the proposed elimination of proportionate method. On the other side, as already talked about, comment letters received by the IASB after the publication of ED 9 revealed a strong opposition of respondents that did not support the IASB's view[89]. Even Saccon et al. (2012) confirm that the joint ventures project had a slow course because of the controversial changes proposed and probably as being part of a larger consolidation project[90].

In its *Project Summary and Feedback Statement*, the Board recognises that numerous respondents reacted against the elimination of proportionate consolidation since the Board was denying what it had affirmed almost twenty years earlier, once IAS 31 was first issued[91]. To understand the nature of respondents and their geographical origin, the content analysis of comment letters of *Question 3*

[86] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[87] IFRS Foundation. *Due process Handbook*. (June 2016). www.ifrs.org.
[88] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[89] Catuogno, S., Allini, A., D'Ambrosio, A. Rivista dei Dottori Commercialisti. (2015).
[90] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[91] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements*. (2007). www.ifrs.org.

presented by Saccon et al. (2012) is examined[92]. This question invited interested parties to express opinions about the elimination of proportionate consolidation. In this connection, 113 constituents replied[93]. Question 3 is quoted below:

Question 3 (ED 9): *Do you agree that proportionate consolidation should be eliminated, bearing in mind that a party would recognize assets, liabilities, income and expenses if it has contractual rights and obligations relating to individual assets and liabilities of a joint arrangement? If not, why*?

Saccon et al. (2012) divided respondents into seven groups: preparers (including individual preparers and professional associations), the accounting profession, investors, national standard setters (including the EFRAG), market regulators (including the IOSCO), government agencies and other interested parties. No "Academics" group was identified since the IASB did not receive any letter from academics in this case. Thereafter, all the arguments used against the elimination of proportionate consolidation were identified[94].

Consistently with previous studies (Yen et al. 2007), two main types of argumentations had been observed: economic arguments and conceptual arguments. The former category refers to the potential consequences of a standard for users of financial statements and even for preparers, such as implementation costs and potential effects on the contracts. By contrast, the latter considers the inconsistency of the standard, such as internal inconsistency, contradiction with other standards or with the conceptual framework and divergence with the goals announced by the standard setter. Accordingly, the concerns of respondents had been classified into economic argumentations and conceptual arguments. The former referred to: (1) the equity method does not provide relevant and transparent information to users, (2) the elimination of the proportionate consolidation would have relevant impacts for preparers, as for instance a decrease in net sales or a restructuration of deals, (3) the elimination of proportionate consolidation would lead to inconsistencies between the internal reporting and the published financial statements. The latter conversely dealt with: (1) the equity is not conceptually justified, (2) the motivation provided by the Board seems not consistent with what previously affirmed about proportionate consolidation in IAS 31, (3) while convergence with US GAAP is one of the goal of the project, the IASB proposals are not fully convergent with what the FASB prescribes. In this way quality of financial reporting is compromised only in favour of an incomplete convergence[95].

[92] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[93] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[94] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[95] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).

Saccon et al. (2012) confirm the results of previous studies concerning the high participation of financial statements preparers compared with users (Jorissen et al., 2012[96]; Georgiou, 2010[97]). 53.1% of respondents were preparers. The table below proves that respondents to Question 3 were mainly disappointed with the proposed accounting change (61.7%). Preparers were the one who showed the highest disagreement percentage. Certainly, it was imaginable given that with the new IFRS they would have changed their reporting practices[98].

TABLE 2.4.1 – **CONSTITUENTS' POSITION ON THE ELIMINATION OF PROPORTIONATE CONSOLIDATION**

Constituents	Agree		Disagree		Neutral		Total	
	N	%	N	%	N	%	**N**	**%**
Preparers	14	23.3	42	70	4	6.7	**60**	**53.1**
The Accounting Profession	8	34.8	14	60.9	1	4.3	**23**	**20.3**
Investors	1	50	1	50	-	-	**2**	**1.7**
National Standard Setters	9	45	10	50	1	5	**20**	**17.7**
Market Regulators	-	-	2	100	-	-	**2**	**1.7**
Government Agencies	2	100	-	-	-	-	**2**	**1.7**
Other interested parties	2	50	-	-	2	50	**4**	**3.5**
Total	**36**	**31.9**	**69**	**61.7**	**8**	**7.1**	**113**	**100.0**

Source: Saccon et al. (2012)

Interestingly, even the accounting profession appeared dissatisfied with the controversial change, for it requested the Board to provide more compelling arguments proving that the equity method was conceptually superior to proportionate consolidation[99].

To confirm that neither the use of the equity method relies on a precise rationale, it is worth recalling *the analysis of the International Development of the Equity Method*, in which Nobes (1992)[100] traces the history of the diffusion of the equity method. As early as 1910s in the US and UK, it became a common practice to consolidate subsidiaries and afterwards a widespread practice to account for associates and joint ventures even abroad (e.g. Australia). However, what emerges from the Nobes' analysis is that the equity method has reached such a wide diffusion because it was primarily used

[96] Jorissen, A., Lybaert, N., Orens, R., Van der Tas, L. *Formal Participation in the IASB's due process of standard setting: a multi-issue/multi-period analysis.* European Accounting Review. Vol. 21, No. 4, 693 – 729. (2012).
[97] Georgiou, G. *The IASB standard-setting process: Participation and perceptions of financial statement users.* The British accounting Review. 42, 103 – 118. (2010).
[98] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[99] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[100] Nobes, C. *An Analysis of the International Development of the Equity Method.* Abacus. Vol. 38, No. 1. (2002).

by the two strongest accounting nations (USA and UK) rather than because it was supported by precise conceptual arguments and clear theoretical justifications[101].

Moving on, the results related to the geographical origin of preparers mainly opposing the elimination of proportionate consolidation are indicated in the table below. Not surprisingly, apart from few exceptions[102], the disagreement was more intense in European countries (e.g. France[103], Germany[104], Spain, Italy)[105] where proportionate consolidation used to be a common method to report an interest in joint ventures under local GAAP.

TABLE 2.4.2 – **GEOGRAPHICAL ORIGIN OF PREPARERS**

Geographical origin	**Agree**		**Disagree**		**Neutral**		**Total**	
	N	%	N	%	N	%	**N**	**%**
Australia	1	33.3	2	66.7	-	-	**3**	**5**
Belgium	-	-	1	100	-	-	**1**	**1.6**
Canada	2	28.6	4	57.1	1	14.3	**7**	**11.7**
Denmark	-	-	1	100	-	-	**1**	**1.6**
Europe	-	-	*3*	*100*	-	-	**3**	**5**
France	1	10	*9*	*90*	-	-	**10**	**16.7**
Germany	1	16.7	*4*	*66.6*	1	16.7	**6**	**10**
Greece	-	-	1	100	-	-	**1**	**1.6**
Italy	-	-	*1*	*100*	-	-	**1**	**1.6**
Luxembourg	-	-	1	100	-	-	**1**	**1.6**
Norway	-	-	-	-	1	100	**1**	**1.6**
South Africa	3	75	1	25	-	-	**4**	**6.7**
Spain	-	-	*3*	*100*	-	-	**3**	**5**
Sweden	-	-	1	100	-	-	**1**	**1.6**
Switzerland	2	33.3	3	50	1	16.7	**6**	**10**
The Netherlands	1	50	1	50	-	-	**2**	**3.3**
UK	3	37.5	5	62.5	-	-	**8**	**13.3**
USA	-	-	1	100	-	-	**1**	**1.6**
Total	**14**	**23.3**	**42**	**70**	**4**	**6.7**	**60**	**100.0**

Source: Saccon et al. (2012)

[101] For instance, the threshold of 20%, commonly used to refer to the concept of significant influence, had arisen pragmatically in the UK and then accepted in the US as a compromise. Thus, this is an arbitrary threshold lacking basis of convincing theory.

[102] UK and Australia registered a relative high disagreement percentage, irrespective of the fact that, prior to the incorporation of IFRS, in these countries the equity method was required for jointly controlled entities. AASB 1006 *Interests in Joint Ventures* (1998) - AASB 131 *Interests in Joint Ventures* (2004). www.aasb.gov.au.

[103] Jones, C., Samar – Fauchon, M. D. *European comparison: UK & France. The main differences between UK and French accounting practice.* Deloitte & Touche. (2001).

[104] PwC. *IFRS versus German GAAP (revised). Summary of similarities and differences.* (2010).

[105] One example per each country respectively is:
EDF (French leader group in the power & utilities industry, founded in 1946),
Volkswagen AG (German automobile producer, founded in 1937),
SEOPAN (Spanish Association of Construction Companies and Concessionaires of Infrastructures founded in 1957),
Unicredit Group (Italian bank, founded in 1998).
Also, Sweden, Belgium and Denmark seemed to oppose the elimination of proportionate consolidation, but the low involvement of preparers from these countries made it difficult to draw conclusions. Saccon et al. (2012).

In line with the negative comments of preparers, there is no wonder that European Accounting Organisations such as the EFRAG, the DRSC (*Accounting Standards Committee of Germany*) and the FEE (*Federation of European Accountants - Accountancy Europe*) replied against the Board's proposal[106], as follows:

- *We believe that proportionate consolidation should not be eliminated until a comprehensive review of the accounting and reporting of joint ventures has been completed and has concluded that proportionate consolidation is the option that should be eliminated.* (EFRAG, comment letter, 2008).
- *In general, we support the objective of convergence of IFRSs and US GAAP. However, we disagree with the way how this is achieved in the context of ED9. This is because convergence does not mean the mere adoption of existing accounting standards by another standard setter. Rather, a critical analysis of accounting alternatives is needed to select the most appropriate one.* (DRSC, comment letter, 2008).
- *we agree with EFRAG that it would be premature to amend IAS 31 as drafted in the proposed ED. A longer-term and separate joint project between FASB-IASB would be more appropriate to deal with this type of amendment.* (FEE, comment letter, 2008).

The OIC, the Italian Standard Setter, believed, as well, that the proportionate consolidation better represented interests in jointly controlled entities, whereas the equity method would bring to the omission of relevant elements from financial statements, such as the financial indebtedness of the venturer[107]. Some of its arguments against the IASB's decision are quoted below[108]:

- *In important industrial sectors, business activity is principally carried on through joint ventures, often these are specially formed in order to undertake important projects in partnership. In these cases, the use of the equity method would lead to the elimination from the venturer's financial statements of the revenues (and costs) that in fact constitute the representation of the business and its outcome [...]. We do not believe that this reporting would give a faithful representation of the business, or that it would be useful in predicting the venturer's future cash flows and the related risks.* (OIC, comment letter, 2008).
- In *support of the goal of reducing accounting options, the OIC believes that the accounting of jointly controlled entities should require measurement using the proportional method rather than the equity method. Alternatively, considering that other projects are underway that could have significant effects on the issue in question, the OIC believes it would be appropriate in the meantime to retain the options provided for in IAS 31.* (OIC, comment letter, 2008).

[106] IFRS Foundation. *Comment Letters.* (2008). www.ifrs.org.
[107] Catuogno, S., Allini, A., D'Ambrosio, A. Rivista dei Dottori Commercialisti. (2015).
[108] IFRS Foundation. *Comment Letters.* (2008). www.ifrs.org.

One of the exception of disagreement by preparers in countries with no tradition in proportionate method was the UK. Not only UK firms showed dissent[109], but even the accounting professionals of the *Institute of Chartered Accountants in England and Wale*s exposed their concerns with respect to the elimination of proportionate consolidation. The Institute agreed ideally with the reduction of accounting options, but it did not believe that the IASB had developed an appropriate argument to justify the removal. For this reason, it thought that it was premature to prohibit proportionate consolidation given that also the Framework was under review. Moreover, even the Institute saw potential concerns with the equity method due to the exclusion in the balance sheet of net liabilities that necessarily would need disclosure. Finally, it did not trust in the achievable convergence with US GAAP, which conversely allows for certain industries the use of the proportionate method[110].

Saccon et al. (2012) find that a large majority of the 42 companies[111], belonging to the group of preparers, supported proportionate consolidation because it was the accounting treatment they used[112].

TABLE 2.4.3 – **CORRELATION BETWEEN POSITION EXPRESSED AND CONSOLIDATION METHOD USED**

Consolidation method used for joint ventures	**Agree**		**Disagree**		**Neutral**		**Total**	
	N	%	N	%	N	%	**N**	**%**
Proportionate consolidation	3	11.1	23	85.2	1	3.7	**27**	**64.3**
Equity method	8	61.5	3	23.1	2	15.4	**13**	**31**
Not mentioned	-	-	1	50	1	50	**2**	**4.7**
Total	**11**	**26.2**	**27**	**64.3**	**4**	**9.5**	**42**	**100.0**

Source: Saccon et al. (2012)

In its *Feedback Statement*, the IASB recognises that many respondents held up proportionate consolidation as it provided a better reflection of the economic substance of a venturer's interest in a joint venture, especially when the activities of the joint arrangement were strongly connected with the operations carried out by the venturer on its own[113]. In its *Basis for Conclusions on Exposure Draft*, the Board exposed that respondents believed also that the proportionate consolidation better depicted the performance of a venture's management and gave a more detailed basis for predicting

[109] One example of UK opposing firm was Serco Group plc, a multinational provider of public services founded in 1929. www.serco.com. IFRS Foundation. *Serco Group Comment Letter*. (2008). www.ifrs.org.
[110] IFRS Foundation. *Institute of Chartered Accountants in England and Wales Comment Letter*. (2008). www.ifrs.org.
[111] The group of preparers includes 42 firms and 18 professional associations.
[112] To run this sort of analysis the information disclosed in the 2010 financial statements had been used.
[113] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

future cash flows[114]. In accordance with this matter, another great concern referred to the reduction in the amount of information given to third users if only the equity method was required[115]. Finally, some respondents remarked that requiring equity method would result in treating equally from an accounting point of view joint control[116] and significant influence[117], which are indeed different concepts, as joint control entails more management involvement on business decisions[118]. Saccon et al. (2012) stress that while the Board seemed to give greater emphasis to economic arguments, opponents referred more frequently to conceptual arguments in their comment letters. Among all, preparers were the one to have used more frequently (42.1%) economic arguments (e.g. the equity method provides less relevant information for users and brings deep consequences in the preparers' financial statements). By contrast, significant percentages in favour of conceptual arguments were recorded in the accounting - audit profession and market regulators. Respectively 45.2% and 66.7% supported the idea that the equity method had not a conceptual justification and the explanation given by the IASB was not consistent and logical with what it had affirmed in IAS 31 in support of proportionate consolidation. For instance, it is remarkable that all Big 4 audit firms as well as the IOSCO (*International Organisation of Securities Commissions*) acknowledged the IASB's efforts to remove options and reduce differences with US GAAP, however doubted that the proposals of the Board would have met the objectives of the project and they suggested the IASB to undertake a broader project on accounting for joint ventures together with the FASB. Some of their relevant argumentations on this matter are put forward[119]:

- *We generally support the objective of the IASB's convergence efforts and are in favour of eliminating alternative treatments in IFRSs. However, we do not support the proposed removal of the option of proportionate consolidation at this time. In our view, the removal of the option of proportionate consolidation does not meet the objectives of convergence; nor do we believe that there is a sound conceptual basis for eliminating the option of proportionate consolidation without at the same time reconsidering the application of the equity method. […] We believe that the elimination of proportionate consolidation will not achieve*

[114] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements.* (2007). www.ifrs.org.
[115] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements.* (2007). www.ifrs.org.
[116] Joint Control: the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. (IFRS 11). An investor controls an investee when the investor is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. (IFRS 10).
[117] Significant Influence: a holding of 20% or more of the voting power (directly or through subsidiaries) will indicate significant influence and it implies the participation in the policy making process, the representation in the Board of Directors and material transactions between the investee and the investor. (IAS 28).
[118] IFRS Foundation. *Project Summary and Feedback Statement.* (2011). www.ifrs.org.
[119] IFRS Foundation. *Comment Letters.* (2008). www.ifrs.org.

convergence with US GAAP and may even create more divergence in certain industries, e.g., mining and oil and gas. (KPMG, comment letter, 2008).

- *Ernst & Young generally supports the elimination of options in standards. […] However, these decisions should be made after a thorough consideration of all available options. We are concerned that the equity method has not been subject to a thorough analysis – a method which we believe also has major shortcomings and inconsistencies with the Framework. […] BC 14 states that because "… the equity method has been used to account for joint ventures in jurisdictions around the world for many years, it is appropriate to be used." In our experience, the proportionate consolidation method has also been used in jurisdictions around the world for many years, and therefore this does not justify the selection of the equity method.* (Ernst & Young, comment letter, 2008).
- *The existing requirements of IAS 31 Interests in Joint Ventures are considered by many to be a pragmatic solution to the difficult question of accounting for interests in entities where the investor is not a passive insignificant investor but is also neither a controlling shareholder.*

  The argument that proportionate consolidation is inconsistent with the Framework, without a true and thorough analysis of accounting for joint arrangements, in our view, leaves the IASB open to criticism that it has proposed a solution only for the sake of US GAAP convergence. […] The IASB's argument that proportionate consolidation is inconsistent with the Framework appears to have predominantly focused on the balance sheet treatment of joint ventures, rather than also considering whether the equity method presents the most relevant and reliable outcome in both the income statement and cash flow statement. […] We would therefore prefer for the IASB and FASB to run a full joint convergence project on the accounting for joint arrangements to determine the highest-quality solution. (Deloitte, comment letter, 2008).
- *We acknowledge the Board's intention for this to be a limited scope project to achieve convergence in principle with US GAAP. However, this limitation in scope has prevented the Board from achieving improvements in faithful representation that are needed and could be achieved with a broader project. The potential benefits of these proposals do not outweigh the cost and potential disruption for many entities as they re-assess and perhaps change their accounting for joint arrangements. Further, we do not believe that further convergence will be achieved in practice. This concern is more significant because we observe that joint arrangements are increasingly being used by companies to expand their operations in emerging markets. […] equity accounting cannot be assessed as superior. Equity accounting introduces practical application difficulties, such as the prohibition from equity accounting for net liabilities and accounting for investee to investor or upstream transactions.* (PwC, comment letter, 2008).
- *Considering that proportionate consolidation is widely used, and, as a consequence, a change in accounting method could result in a significant financial statement impact for many issuers, we believe the IASB needs to further develop its basis for a such change.* (IOSCO, comment letter, 2008).

In the qualitative analysis of Tiron – Tudor and Müller (2012) similar argumentations have been listed: (1) many respondents considered that *proportionate consolidation better met the information needs of third users* by providing through disaggregated information a better representation of the performance of an entity's management. With the equity method, all the key operating information on the joint venture activities like assets and liabilities would not be present in the primary financial statements. Thus, the primary financial statements would be less relevant for users, and companies would be obliged to compensate the missing information in the footnotes. This could lead to undue costs and efforts for entities that were applying proportionate consolidation: these entities would have needed to develop specific information for primary financial statements users while keeping proportionate consolidation procedures for internal reporting[120]. (2) Most respondents argued that *proportional consolidation reflected the substance and the economic reality of a joint arrangement* and believed in the argument in favour of proportionate consolidation provided in IAS 31[121]. (3) Another common argument was that *joint ventures and associates represented different degrees of ability to exercise influence* and thus it would have been questionable to account for them by using the same method. Accordingly, numerous respondents underlined the difference between joint control and significant influence and suggested that such a difference would have deserved different accounting treatments[122]. (4) Numerous opponents deemed that *the differences between equity accounting and proportionate consolidation had not been fully explored*. Accordingly, some respondents argued that in their view equity accounting was effectively a one-line consolidation that in substance adopted a proportionate consolidation approach, however presented the outcome as a single amount in the balance sheet as well as income statement[123]. (5) Interestingly, not few respondents believed that by eliminating the proportionate method, *full convergence between IFRS and US GAAP would have not been achieved* as for some companies (e.g. oil & gas, exploring and construction industries) according to AIN 2, APB 18 and EITF 00-1 proportionate consolidation is still allowed within US GAAP. Therefore, the elimination of pro-rata consolidation within IFRS would have not contributed to bring a further convergence with US GAAP. Instead, under IAS 31 entities could achieve convergence on a voluntary basis[124].

For a comprehensive view, the arguments used by respondents in favour of the elimination of the option are put forward: (1) *proportionate consolidation led to assets and liabilities being recognised that did not meet the definitions of assets and liabilities* in the IASB's Framework. Some respondents considered that it should have been removed as it inappropriately implied that the reporting entity had direct

[120] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. Vol. 8, No. 1, 7-26. (2009).
[121] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[122] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[123] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[124] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).

control over its proportionate share of individual assets or a direct share in the revenue of the joint venture[125]. (2) Many respondents believed that continuing to allow *proportionate consolidation on a line by line basis might have reduced comparability* between companies in the same industry because of the effects that these two different methods have on the margins and ratios of joint venturers[126]. (3) Some respondents also argued that the *use of the equity method was more supportable, and it would have reflected the substance of the situation rather than its legal form*. By contrast, proportionate consolidation would just have reflected the legal structure[127]. (4) A few respondents believed that proportionate consolidation should have been removed for interests in joint ventures merely *for the sake of the IFRS – US GAAP (short-term) convergence*, as US GAAP (APB 18) generally requires the equity method[128]. (5) Finally, some organisations were confident that this elimination would have been *consistent with the IASB's policy of removing choices of accounting options* within IFRS[129].

2.5 A recap of the IASB's responses to opponents

A brief summary of the IASB's responses to opponents is provided. In response of whom argued that the equity method would treat equally joint control and significant influence, the IASB stressed that using the equity method would not support the idea that two different concepts would be represented as involving the same type of investment. Moreover, given the absence of an evident conceptual argument against proportionate consolidation, the IASB simply justified its stance by pointing out that equity accounting had been used to account for joint ventures around the world for many years, despite the advice to prefer the use of proportionate consolidation present in IAS 31[130]. In this regard, the IASB believed that disclosure requirements in IFRS 12 - *Disclosure of Interests in Other Entities* would play an important role in reflecting differences between investing in joint arrangements (IFRS 11) and associates (IAS 28)[131].

In addition, the IASB was convinced that IFRS 12 would compensate the lack of information in financial statements following the removal of the proportionate consolidation with disclosures in the footnotes for each material joint venture of the net debt position, profitability and operating cash flows. To whom arguing that proportionate consolidation provided more useful information about the involvement in joint ventures, the IASB replied that such a reasoning was misleading, as proportionate consolidation would have mixed revenues, expenses, assets and liabilities that were

[125] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[126] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[127] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[128] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[129] Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
[130] IFRS Foundation. *Basis for Conclusions on Exposure Draft. ED 9 Joint Arrangements.* (2007). www.ifrs.org.
[131] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

controlled by an investor with those that could not be managed without the consent of other joint venturers[132].

Finally, the IASB remarked that the requirement to apply the equity method did not prevent a party from recognising in its financial statements individual assets as well as a share of liabilities, revenues and expenses of the joint arrangement. If rights and obligations to a jointly controlled entity existed, this arrangement would be classified as a joint operation and the joint operator would account for the portion of its assets, liabilities, revenues and expenses under its interest as indicated in the contractual arrangement[133].

Responses given by the Board to whom were arguing that IFRS 11 would not contribute to reach a real convergence with US GAAP will be addressed specifically in Chapter 6.

2.6 The Due Process: from the Exposure Draft ED 9 to IFRS 11 – the Outreach Activity

The due-process entails all the set of consultative procedures established by the Trustees[134] and the IASB to ensure that, the Board, in the exercise of its independent decision-making process, conducts its standard-setting activities in a clear and transparent manner, considering a wide range of views from interested parties[135]. The Board affirmed that a wide outreach activity was undertaken between April 2008 and May 2009 including discussions with the IFRS Advisory Council. Formal public meetings were not held, however the IASB said to have met more than 40 respondents to ED 9 who agreed to share actual examples and contractual documentation to test the application of the proposals. Additionally, the Board met other interested parties, including preparers from a variety of industries and geographical locations, user groups and national-standard setters. Further quarterly public meetings with the oil & gas industry had been organised. Indeed, this was one of the industries more concerned with the proposed changes[136]. Interestingly, among the different consultation activities, the Board affirmed that the openness of respondents and constituents to share their joint arrangement contracts as examples to be analysed was an important stage, as the IASB had the chance to understand deeply joint arrangements in a wide range of industries, such as the construction, oil & gas, mining, real estate, environmental services, aerospace and defence, telecoms, banking and energy industries. At these meetings, the Board discussed the contractual terms with respondents and assessed the classification of their arrangements and the impact that

[132] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[133] IFRS Foundation. *Frequently Asked Questions – IFRS 11 Joint Arrangements*. (2011). www.ifrs.org.
[134] The Trustees are responsible for the governance and oversight of the IASB. They are accountable to the Monitoring Board, a body of publicly accountable market authorities. www.ifrs.org.
[135] IFRS Foundation. *Due Process Handbook*. (2016). www.ifrs.org.
[136] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

the new requirements would have caused upon their accounting processes[137]. The Board said that these discussion moments had been significant, since they provided additional inputs in order to finalise the application guidance and the illustrative examples accompanying the new IFRS 11.

Afterwards, a draft of the application guidance and requirements was circulated to a selection of preparers from a variety of industries and geographical locations for receiving their feedback before balloting the documentation[138]. Feedback received during the outreach activities along with comment letters were brought to the Board public discussions for the final development of IFRS 11[139], although the IASB affirmed that it would have based its conclusions on the merits of the argumentations brought for and against each alternative and not on the mere number of responses supporting each specific alternative[140].

Consequently, some aspects of the Exposure Draft were modified. First, the Exposure Draft presented three types of arrangements (joint operations, joint assets and joint ventures). Since for some respondents was not straightforward the difference existing between a joint asset and an asset of a joint operation, the IASB simplified the number of possible types of joint arrangements. It merged *jointly controlled operations* and *jointly controlled assets* into a single arrangement category called *joint operations*, narrowing the possible cases from three to two[141]. Second, the Board provided an enhanced application guidance for supporting entities in classifying arrangements and make them understand how to assess their rights and obligations by considering different sources, such as the structure of the arrangements and in the case of separate vehicles, the legal form of the vehicles, the terms of the contractual arrangements and when relevant other facts and circumstances[142]. Last, disclosure requirements were improved, in IFRS 12 the IASB increased the amount of summarised financial information to be reported. Unlike the Exposure Draft, IFRS 11 was finally supported by all Board members in May 2011[143]. Interestingly, the FASB did not participate directly in the project activities and it did not approve the final version of IFRS 11[144].

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137 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
138 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
139 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
140 Tiron – Tudor, A., Müller, V-O. Accounting and Management Information Systems. (2009).
141 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
142 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
143 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
144 IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.

CHAPTER 3.

IFRS 11 VERSUS IAS 31: A PRACTICAL GUIDE FOR IMPLEMENTING THE NEW APPROACH

3.1 Overview - Key changes between IAS 31 and IFRS 11

The short-term convergence project concluded with IFRS 11 – *Joint Arrangements*, which was issued on 12 May 2011. It superseded IAS 31 – *Interests in Joint Ventures* and the related interpretation SIC 13 – *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*[1] dealing with a venturer's accounting for non-monetary contributions to a jointly controlled entity in exchange for an equity interest in the same jointly controlled entity being accounted for using either the equity method or proportionate consolidation[2].

Originally IAS 31 – *Financial Reporting of Interests in Joint Ventures* was issued by the IASC in 1990, afterwards the IASB adopted it in April 2001 and in December 2003 the Board amended and renamed the standard with a new title – *Interests in Joint Ventures*. The little amendment was done in conjunction with a revision to IAS 27 – *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* and IAS 28 *Accounting for Investments in Associates*. Certainly, the major revision project to IAS 31 was made with the issuance of IFRS 11 that, as already mentioned, replaced IAS 31 and incorporated the guidance contained in the related Interpretation SIC 13[3].

Indeed, IFRS 11 was part of a consolidation package of five new/amended standards which established new requirements for consolidation, joint arrangements and disclosure of interests in other entities. Alongside IFRS 11, the new standards issued in May 2011 were IFRS 10 – *Consolidated Financial Statements* and IFRS 12 – *Disclosure of Interests in Other Entities*, while IAS 27 – *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* were amended and renamed[4]. Thus, the consolidation requirements in IAS 27 were replaced by IFRS 10 as well as the definition of control had been revised[5]. Specifically, IFRS 12 replaced the disclosure requirements of IAS 31. Moreover, in June 2012, IFRS 11, IFRS 10 and IFRS 12 were amended by the *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance*. It limited the necessity to provide adjusted comparative information only to the annual period immediately

[1] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[2] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[3] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[4] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[5] IFRS Foundation. *Basis for Conclusions on IFRS 11 Joint Arrangements*. (2011). www.ifrs.org.

preceding the first annual period of application. Finally, in May 2014 the Board amended IFRS 11 to provide additional guidance on the accounting for acquisitions of interests in joint operations in which the activity constitutes a business, as defined by IFRS 3[6].

The key changes brought with IFRS 11 are summarised in the table below.

TABLE 3.1.1 – **KEY CHANGES BETWEEN IAS 31 AND IFRS 11**

Key Change	IAS 31	IFRS 11
Number and name of classification Under IFRS 11: ➢ Classifications reduced from three to two; ➢ Jointly controlled entities are now termed joint ventures; ➢ Jointly controlled operations and jointly controlled assets are now termed joint operations.	1. Jointly controlled entity 2. Jointly controlled operation 3. Jointly controlled asset	1. Joint venture 2. Joint operation
Classification determination No longer determined solely by structure or legal form.	In all instances where a separate entity is established, these joint arrangements are classified as *jointly controlled entities*.	The establishment of a separate entity does not on its own determine the classification of a joint arrangement.
Subsequent accounting Equity accounting is now the only accounting method for entities classified as *joint ventures*. Proportionate consolidation is prohibited for entities that meet the definition of a joint venture.	*Jointly controlled entities* can subsequently be accounted for by either: - Equity method; - Proportionate consolidation.	The equity method is the only method for the subsequent accounting for *joint ventures*.
Definition of joint control There is a new definition of control introduced under IFRS 10, which directly impacts the definition of joint control under IFRS 11. It is essential that the relevant activity (or activities) of the joint arrangement is (are) identified so that it can be determined who controls the relevant activity.	Control is the power to govern the financial and operating policies of an economic activity to obtain benefits from it.	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Source: BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013)

[6] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements.* (2011).

In IFRS 11, the Board decided to use the term *Joint Arrangement* rather than *Joint Venture* to describe in general arrangements that are subject to joint control. However, what does not change are the two essential features required in IAS 31 for arrangements to be identified as joint ventures: the **existence of a contractual arrangement** binding the parties to the arrangement as well as the **establishment of joint control** by the contractual arrangement[7].

3.2 Joint Arrangements and the Unit of Account

IFRS 11.4 defines a joint arrangement as *an arrangement of which two or more parties have joint control*[8]. All joint arrangements have a contractual arrangement that binds the parties and provides two or more of those parties with joint control over the arrangement. The new definition of a joint arrangement is generally consistent with the IAS 31 definition of a joint venture. In fact, in IAS 31 a joint venture is defined as *a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control*[9]. Therefore, an arrangement does not qualify as a joint arrangement if one party can unilaterally control the arrangement, having the power to make the key decisions by itself[10].

Specifically, IFRS 11 remarks that an enforceable contractual arrangement is often, but not always, in writing, usually in the form of a contract or documented discussions between the parties, although less usual[11]. Joint control can also be established through local legislation, other statutory mechanisms or as part of the governing rules of the entity, either individually or in conjunction with other contractual agreements between the parties[12]. More precisely, when joint arrangements are structured through a *separate vehicle*, the contractual arrangement or some aspects of it may be incorporated in the articles, charter or by-laws of the separate vehicle. Contractual arrangements generally specify the terms upon which the parties participate in the arrangement, as for instance:

- The purpose, the specific activity and the duration of the joint arrangement;
- The appointment of the members of the board of directors (or equivalent governing body);
- The decision – making process (e.g. the matters requiring decisions from the parties, voting rights of the parties, required level of agreement for those matters);
- The capital or other contributions requirements;
- The sharing of assets, liabilities, revenues, expenses, profit or loss of the joint arrangement

[7] IFRS Foundation. *Basis for Conclusions on IFRS 11 – Joint Arrangements.* (2011). www.ifrs.org.
[8] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements.* (2011).
[9] IFRS Foundation. *IAS 31 – Interests in Joint Ventures.* (2010).
[10] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[11] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[12] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).

between the parties[13].

As affirmed by Ernst & Young (2011), understanding the terms of the contractual arrangement is essential for evaluating whether joint control exists, and if so, the type of joint arrangement. The following example taken from PwC's *Practical guide to IFRS* is considered to understand this point:

EXAMPLE 3.2.1 – **Joint arrangements established through articles of association**

Shareholders A and B form a new arrangement (entity J). Entity J's articles of association include a clause that states all shareholders must unanimously agree on the relevant activities of the entity. No other agreements are entered into by the shareholders to manage the activities of entity J.

Even if no separate joint venture agreement is established, in this specific case, entity J meets the definition in IFRS 11 of a joint arrangement. In fact, the clause included in the entity J's articles of association (all shareholders must unanimously agree on the relevant activities) is sufficient for this matter, provided that the entity J's articles of association are legally binding[14].

Ernst & Young (2011) notes that IFRS 11 does not explicitly specify the unit of account for determining whether a joint arrangement exists. However, it recognises that the Board seemed to intend for the unit of account for a joint arrangement to be the activity that two or more parties agree to undertake and jointly control. Indeed, in BC 35 the IASB affirms:

> *Many respondents to ED 9 were concerned that joint ventures could be merely 'residuals'. This is because these respondents interpreted joint ventures to mean that after parties had identified rights to individual assets or obligations for expenses or financing, joint ventures would be merely any remaining assets and liabilities of the arrangement. As a result of these concerns, the Board clarified that the unit of account of a joint arrangement is the activity that two or more parties have agreed to control jointly, and that a party should assess its rights to the assets, and obligations for the liabilities, relating to that activity. Consequently, the term 'joint venture' refers to a jointly controlled activity in which the parties have an investment* [15].

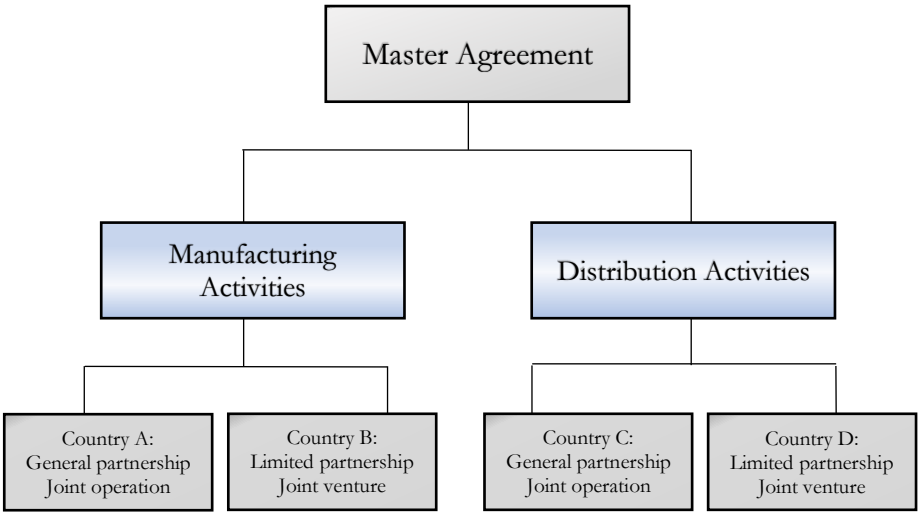
Even if frequently each contractual agreement sets up a single joint arrangement, the approach outlined in the *Basis for Conclusions on IFRS 11* would result in some cases in which there are multiple arrangements related to the same activity. Likewise, within a single entity or a separate vehicle more than one activity may be undertaken. Generally, in such cases there might be some sort of division or segmentation between different activities within the same entity or vehicle. Following the same

[13] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[14] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[15] IFRS Foundation. *Basis for Conclusions on IFRS 11 – Joint Arrangements.* (2011). www.ifrs.org.

reasoning, one master agreement may include more than one unit of account, namely more than one activity that is jointly controlled[16]. Under IFRS 11 a master agreement is defined as a framework agreement that sets up the general contractual terms for undertaking one or more activities. Hence, the framework agreement may determine that the parties establish different joint arrangements to deal with specific activities. The type of these joint arrangements might differ if the parties' rights and obligations diverge when undertaking the different activities. For this reason, joint operations and joint ventures can coexist when the parties undertake different activities being part of the same framework agreement[17]. The following example taken by Ernst and Young (2011) illustrates a case in which a master agreement might establish distinct joint arrangements, each of which might be classified as either a joint operation or a joint venture.

EXAMPLE 3.2.2 – **Master agreement for manufacturing and distribution**

A single contract between two parties specifies the terms and conditions related to manufacturing and distribution activities and dictates how these activities will be carried out in different jurisdictions through several entities.



The parties may determine that this agreement contains several joint arrangements (one for each activity in each jurisdiction, corresponding to an entity). In this case, an entity would be classified as a joint venture or a joint operation if terms and conditions relating to each activity were distinct for every single entity. Nonetheless, if one party had the ability to direct the relevant activities in certain entities (e.g. the entity in country A), and the other party could direct the relevant activities of other entities (e.g. the entity in country B), there would not be joint control as each party would control its respective entities[18].

[16] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[17] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[18] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

In other cases, there may be a single master agreement covering different activities, some of which may be controlled solely by one of the parties, while other may be jointly controlled by the parties. In such circumstances, it is necessary to pay attention in determining the unit of account and which arrangements are jointly controlled. Example 3.2.3 explains such a case.

EXAMPLE 3.2.3 – **Agreement with control and joint control**

A and B enter into a contractual arrangement to buy a building that has 12 floors, which they will lease to other parties. A and B are responsible for leasing five floors each, and each can make all decisions related to their respective floors and keep all of the income with respect to their floors. The remaining two floors will be jointly managed. All decisions with respect to those two floors must be unanimously agreed between A and B, and they will share all profits equally.

In this example, there are three types of arrangements set up by a single agreement: five floors that A controls (accounted for under other IFRS), five floors that B controls (accounted for under other IFRS) and finally two floors that A and B jointly control - a joint arrangement (within the scope of IFRS 11). Once again, the agreement confers joint control by stating that the management of the two floors requires the unanimous agreement between the parties[19].

All in all, it is worth stressing the importance of considering the substance of the dealings between the parties to assess whether a contractual arrangement exists or not. Specifically, investors have not simply to rely on the existence of a written contract, they should also evaluate the presence of particular statutory mechanisms or the existence of specific terms incorporated in the investee's articles of association[20].

3.3 Joint Control

IFRS 11 relies upon the control principle defined in IFRS 10 – *Consolidated Financial Statements*. The definition of control provided by the IASB has changed with the introduction of IFRS 10. If under IAS 27 (2008) control was *the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it* [21], under IFRS 10, instead, *an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee* [22]. Consequently, the new control model requires three key elements to be present: **power**, **exposure to variable returns** and **linkage between power & variable returns**[23],

[19] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[20] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[21] IFRS Foundation. *IAS 27 – Consolidated and Separate Financial Statements*. (2008).
[22] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[23] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

where *power* is determined by the presence of *existing rights that give the current ability to direct the relevant activities (i.e. the activities that significantly affect the investee's returns)*[24]. Since IFRS 11 and IFRS 10 interact with each other, when dealing with the requirements for joint arrangements, it is significant having in mind the concepts introduced with IFRS 10[25].

Under IFRS 11 *joint control* is *the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control* [26]. Therefore, the key aspects for having joint control are: **contractually agreed sharing of control**, **relevant activities** and **unanimous consent**. According to IFRS 10 (B 11), relevant activities are those activities of an arrangement that *significantly affect the investee's returns*. Judgement is required while assessing relevant activities, and depending on the circumstances, they may include: (a) selling or purchasing of goods or services, (b) managing financial assets during their life (including upon default), (c) selecting, acquiring or disposing of assets, (d) researching and developing new products or processes; and (e) determining a funding structure or obtaining funding[27]. Unanimous consent, instead, as affirmed in IFRS 11, means that any party (with joint control) can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about relevant activities) without its consent, that is all parties with joint control must agree and act together before taking decisions relating to the relevant activities. Consequently, an arrangement can meet the definition of a joint arrangement when not all of its investors have joint control of the arrangement. In this regard, IFRS 11 distinguishes between parties that have joint control of a joint arrangement (i.e. joint operators and joint venturers) and parties that simply participate in, but do not share control of a joint arrangement. In the last case, these parties hold a simple investment, which should not be accounted for under IFRS 11[28].

To evaluate if joint control exists, an investor should adopt a **two-step approach**:

Step 1: First, an entity assesses whether all the parties, or a subset of them, control the arrangement (based on the definition of control in IFRS 10). If all the parties, or a group of them collectively are able to direct the activities that significantly affect the returns of the arrangement (i.e. relevant activities), they control the arrangement collectively.

Step 2: Secondly, an entity must assess whether it has joint control of the arrangement. Indeed, joint control exists only when decisions about the relevant activities require the unanimous consent of the parties collectively controlling the arrangement[29].

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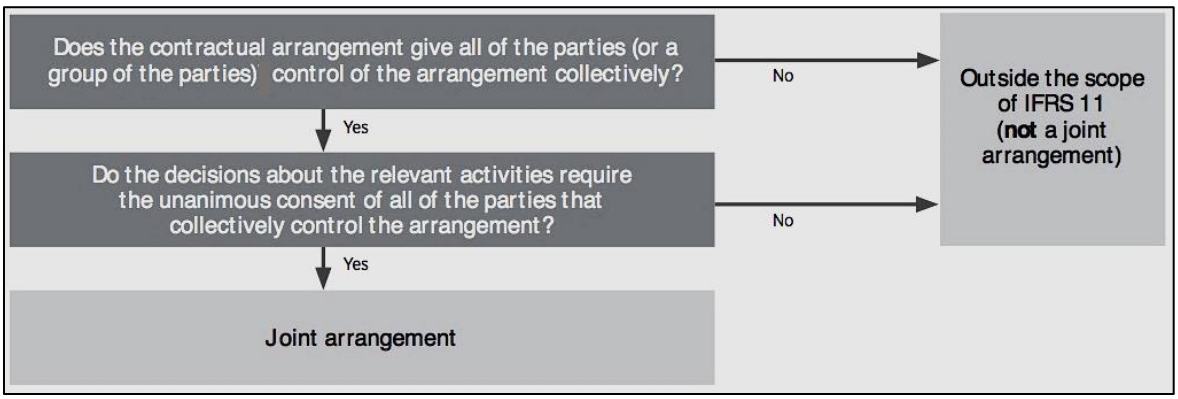
[24] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[25] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[26] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[27] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[28] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[29] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

FIGURE 3.3.1 – **ASSESSING JOINT CONTROL**



Source: Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011)

If after having applied the approach outlined in Figure 3.3.1, an arrangement results outside the scope of IFRS 11, an entity accounts for its interest in that arrangement in accordance with other IFRSs, such as IFRS 10 – *Consolidated Financial Statements*, IAS 28 – *Investments in Associates and Joint Ventures* or IFRS 9 – *Financial Instruments* [30].

In its *Practical guide to IFRS*, PwC comments that the definition of joint control introduced with IFRS 11 is similar in substance to what IAS 31 defined as joint control, that was *the contractually agreed sharing of control over an economic activity*, existing *only when the strategic financial and operating decisions relating to the activity* required *the unanimous consent of the parties sharing control* (the venturers). Therefore, financial and operational decisions may be aligned to the new concept of relevant activities, as they both refer to the major decision activities involving a joint arrangement[31].

[30] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[31] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).

3.3.1 Joint Control – Relevant Activities

The first necessary step to determine if joint control over a joint arrangement exists is to identify the relevant activities of the arrangement, namely the activities that significantly affect the returns of the arrangement. Therefore, it is relevant to understand well the goal of the arrangement and the risks arising from it. In most cases, guiding the strategic operating and financial policies of the arrangement is the activity that mostly affects the returns. Usually, an arrangement requires the parties to agree on both policies. However, sometimes it might happen that unanimous consent is required only for directing one specific type of strategic policy, financial or operating. In such cases, the parties should assess which of those two activities (operating or financing) most significantly affects returns and whether joint control over that activity exists[32]. Example 3.3.1.1 illustrates this point.

EXAMPLE 3.3.1.1. – **More than one activity affects returns of an arrangement**

Two parties create an agreement for the production and sale of a pharmaceutical product. Three activities significantly affect the returns of this arrangement: (1) production of the pharmaceutical product (only one party is responsible for it), (2) marketing and selling activities (in charge of the other party), (3) both parties must approve all financial policies regarding production, marketing and selling activities (e.g. approval of budgets and any specific deviation from the budget require unanimous consent).

Considering the first two activities, the agreement gives each party freedom in performing their operating decisions, as long as within the constraints of the budgets. In this specific example, the parties have to determine which activity most significantly affects the returns of the arrangement. The facts and circumstances might entail that either of the first two activities could be the activity that most significantly affects the returns of the arrangement. If that were the case, then the party responsible for that activity would have power (and possibly control) over the arrangement, as it can direct that activity without the other party. Nevertheless, facts and circumstances might reveal that the relevant activity refers to the direction of the financial policies. In such a case, as unanimous agreement is required to direct those strategic decisions, joint control would exist and consequently both parties would have an exposure to variable returns from the arrangement and thus would fall within the scope of IFRS 11[33].

An arrangement may involve different or sequential activities, occurring in different stages. In general, there may be some situations in which parties have rights to direct different activities and other circumstances in which instead parties may collectively direct all the activities. In the first

[32] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[33] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

case, unless facts and circumstances change, joint control does not occur. Hence, each party must assess if it has rights to direct the activities that most significantly affect returns, and afterwards if it has power over the arrangement. Example 3.3.1.2, taken from IFRS 10 and mentioned by Ernst & Young (2011), helps clarify this concept.

EXAMPLE 3.3.1.2. – **Directing sequential activities separately**

Two investors set up an investee to develop and market a medical product. The first investor is responsible for developing and obtaining regulatory approval for the medical product. This implies having the unilateral ability to make all decisions relating to the development of the product and to obtain regulatory approval. Once the regulator has approved the product, the second investor will produce and sell it. In this case, it is the second party to have the unilateral ability to direct the manufacturing and the marketing of the project.

Each investor needs to understand whether developing and obtaining regulatory approval or the manufacturing and marketing of the product is the activity that most significantly affects the returns of the arrangement and evaluate if it can direct that activity. In determining which investor has the power, some elements should be considered, such as: the purpose of the investee, the factors that determine the profit margin, the revenue and value of the investee, the effect on the investee's returns resulting from each investor's decision-making authority, the investors' exposure to variable returns, as well as, the uncertainty in gaining regulatory approval and which investor controls the product once the development phase has been successful. In this precise example, it is evident that joint control does not occur. In fact, the involved parties do not collectively direct the activities of the arrangement, rather one party directs each activity. Only if the two investors changed their decision-making process and agreed to collectively take decisions on both phases, the two parties would have joint control[34].

3.3.2 Joint Control – Rights to joint control

After having identified relevant activities, it is fundamental to determine what rights give a party the power to direct those relevant activities. Usually, relevant activities are directed by voting rights that are held in proportion to ownership interests[35]. However, as already introduced, to determine whether joint control exists, it is not sufficient to evaluate if all the parties, or a group of them, are able to collectively control those activities that significantly affect the returns of the arrangement. Consequently, each party must assess whether the unanimous consent of the parties collectively controlling the arrangement is required to take all the decisions concerning the relevant

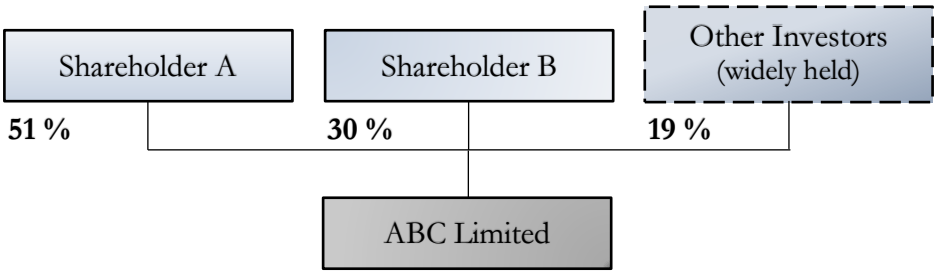
[34] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[35] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

activities[36].

As noted in IFRS 11 B 6, assessing whether the arrangement is jointly controlled can require judgement. In fact, the contractual terms of an arrangement do not need to explicitly affirm that decisions regarding relevant activities must be made unanimously between parties. Sometimes the specific contractual terms or the structure of the arrangement may lead to **implicit joint control**, which indeed originates from the contractual arrangement[37]. For instance, supposing two parties have 50% ownership (50% of the voting rights) of an arrangement, joint control may exist even if the contractual arrangement between them only specifies that at least 51% of voting rights are required to make decisions about the relevant activities. In this case, in fact, it is like the parties have implicitly agreed to unanimously take all significant decisions together[38]. The example below, taken from the PwC's *Practical guide to IFRS* (2011), illustrates better this aspect.

EXAMPLE 3.3.2.1. – **Implicit joint control**

ABC Limited's articles of association require a 75% majority to approve decisions concerning the relevant activities of the entity. They state also that each shareholder is entitled to vote in proportion to its respective ownership interest.



ABC Limited is implicitly jointly controlled by shareholders A and B, as based on their ownership interests (collectively 81%). Shareholder A cannot unilaterally make decisions about the relevant activities, as a 75% majority is required leading A and B to act unanimously[39]. Anyway, as affirmed by Ernst and Young (2011) careful evaluation of the contractual terms is needed whenever parties to an arrangement assess implicit joint control. This is because it may happen that two parties have equal ownership interests but only one of them, in accordance with their agreement, has actually the power to direct relevant activities[40].

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36 IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
37 Articles, charter or by-laws of a separate vehicle (when one exists) are also part of the contractual arrangement. Statutory requirements might be analysed as well.
38 IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
39 PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
40 Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

In determining if unanimous consent is required, it is important to remember that to have joint control IFRS 11 does not force every party to the arrangement to agree unanimously in all decisions regarding relevant activities. To have unanimous consent, instead, only those parties that collectively control the arrangement must agree. A contractual arrangement might often require a minimum proportion of the voting rights to make relevant decisions, as in the previous example. However, when that minimum threshold may be reached by more than one single combination of the parties agreeing, the arrangement is not a joint arrangement unless the contractual agreement contains a clause, specifying which parties (or combination of parties) must unanimously agree to decisions about relevant activities[41]. The following example illustrates this point.

EXAMPLE 3.3.2.2. **Joint Control by a single combination of parties**

Three parties establish a separate legal entity (entity X) in which the three entities have different shares of voting rights. Entity X activities constitute a business[42]. A contractual arrangement entered into by the three parties specifies that at least 75% of the voting rights are required to make decisions about the relevant activities.

Entity A holds 50% of voting rights, entity B 25% and entity C 25%.

In this case, even if entity A can block any decision, it does not control the arrangement alone since it needs the agreement of either B or C. Indeed, entities A, B and C collectively control entity X, however the 75% minimum proportion may be achieved by more than one combination of parties (A + B or A + C = 75%). Consequently, because more than one combination can control entity X, joint control does not exist. Therefore, the contractual arrangement does not constitute a joint arrangement and it falls outside the scope of IFRS 11. Accordingly, each of the three parties needs to assess whether it has significant influence over entity X. If it were the case, each entity would account for its investment as an associate in accordance with IAS 28 (2011) or if not, each of them would account for a financial asset following IFRS 9 *Financial Instruments*. By contrast, if there were a contractual arrangement specifying a single combination of parties to take decisions about entity X relevant activities, there would be joint control[43]. All concepts introduced so far are summarised in the following table.

[41] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

[42] In IFRS 3 – *Business Combinations* (2008), a business is defined as: An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

[43] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

TABLE 3.3.2.1 – **JOINT CONTROL**

Requirement	**Scenario 1** 75% vote to direct relevant activities	**Scenario 2** 75% vote to direct relevant activities
Party A	50%	50%
Party B	30%	25%
Party C	20%	25%
Conclusion	**Joint control** A and B collectively control the arrangement (only their votes meet the requirement) Because they are the only combination of parties that collectively control the arrangement, A and B must unanimously agree.	**No Joint control** Multiple combinations of parties could collectively control the arrangement (i.e. A and B or A and C could vote together to meet the requirement). Since the contractual agreement does not specify which parties must agree, there is no unanimous consent.

Source: BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013)

To conclude these considerations, it is worth recalling what PwC observes in its *Practical guide to IFRS* (2011): an entity is not automatically a joint arrangement because two or more parties hold equal shares in it. Hence, it is important to distinguish between joint control and collective control. Joint control only exists when there is a contractual agreement requiring two or more parties to unanimously agree on decisions about the arrangement's relevant activities and the parties together control the arrangement. Instead, joint control does not exist if decisions only require the consent of a majority of owners. In this case, control would be contractually shared, but the same group of investors does not need to agree to all relevant activities[44].

The party that participates in a joint arrangement but does not have joint control (i.e. Party C of Scenario 1) in IAS 31 was called *investor in a joint venture*, in IFRS 11 this term is no longer used and the accounting treatment for this kind of *passive investor* varies depending on the classification of the joint arrangement into a joint operation or a joint venture[45].

[44] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[45] Ernst & Young. *Challenges in adopting and applying IFRS 11.* (2011).

3.3.3 Joint De –Facto Control

Unlike IAS 27 (2008) *Consolidated and Separate Financial Statements*, IFRS 10 explicitly addresses the principle of **de-facto control**, which arises when an investor with less than a majority of voting rights in another entity has control over that entity. This might happen when the investor has the practical ability to direct the entity's relevant activities unilaterally (IFRS 10 B 41). In determining whether an investor has de-facto control, the investor considers the size of its own voting rights relative to the size and dispersion of holdings of the other voting parties[46]. IFRS 10 B 42 lists some key factors that should be looked at:

- The more voting rights an investor owns, the more likely the investor has existing rights giving him the current ability to direct relevant activities;
- The more voting rights an investor holds relative to other parties, the more possible for the investor is to exercise power to direct relevant activities;
- The more other vote holders would need to act together to outvote the investor, the more probably the investor can control the entity alone[47].

Since joint control may arise implicitly from a contractual arrangement, it is worth discussing the difference between *de-facto joint control* and *joint de-facto control*. The former refers to situations in which two or more parties collectively control an arrangement, but there is no requirement for unanimous consent between them. The latter, instead, concerns parties collectively controlling an arrangement with a specific requirement for unanimous consent[48]. More precisely, in de-facto joint control there are past precedents of the parties voting together over the relevant activities, even if there is no contractual agreement to do so. Usually, these parties drive the final decisions because remaining investors are numerous and widespread. Nevertheless, such situations do not fall under IFRS 11, given that the standard requires a contractual or implicit agreement to be in place to set unanimous consent between parties. By contrast, joint de-facto control may occur when there is a large block of voting power held by a certain number of investors that have a contractual agreement to always vote together in relation to relevant activities. In such a case, due to the requirement of unanimous consent, joint de-facto control falls within the scope of IFRS 11[49].

The example that follows illustrates more clearly all the above considerations.

[46] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[47] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[48] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[49] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

EXAMPLE 3.3.3.1 – **De-facto joint control vs Joint de-facto control**

Entities A and B hold interests in a separate legal entity, together with other investors (dispersed in scenarios 1 and 2, and entity C in scenario 3). The contractual arrangement for each scenario specifies that at least a majority (i.e. more than 50%) of the voting rights is required to make decisions about the relevant activities.

Scenario 1: Entity A 35%, Entity B 35%, Dispersed 30%. (There is no contractual agreement that imposes A and B to vote together);

Scenario 2: Entity A 24%, Entity B 24%, Dispersed 52%. (There is a contractual agreement between A and B to vote together);

Scenario 3: Entity A 24%, Entity B 24%, Entity C 52%. (There is a contractual agreement between A and B to vote together). Entity A and B also have a substantive option to each acquire 10% of C's shares[50].

In the first scenario, there is no joint control, because there is no explicit or implicit contractual arrangement setting how to achieve control and consequently unanimous consent.

In the second scenario, A and B are deemed to have the practical ability to direct relevant activities together. Therefore, the 48% significant minority block of shares results in joint-de facto control. In practice, the decisions jointly taken by A and B would ultimately affect final decisions especially having in mind that probably at least more than 4% of dispersed investors does not vote as well as more than 2% of dispersed investors decides to vote in the same way as A and B. In this respect, in analysing IFRS 11, BDO comments that IFRS 11 and IFRS 10 do not give a precise indication concerning potential minority block thresholds to be reached (e.g. 45%, 40%, 35%) by two or more parties in order to have joint de-facto control. Therefore, the assessment of joint de-facto control requires an accurate judgement by investors.

Finally, even in the third scenario joint de-facto control occurs, as a contractual agreement requiring unanimous consent between A and B exists. Furthermore, the substantive option for A and B to buy additional C's shares, if exercised, would result in block voting rights exceeding the required 50% hurdle[51].

3.3.4 Substantive and Protective rights in joint arrangements

In the previous section, scenario 3 introduces the important concept of **substantive rights** while judging joint control. IFRS 10 – *Consolidated Financial Statements* explains that *a right is substantive if the holder has the practical ability to exercise the right.* Assessing whether rights are substantive requires judgement. Thus, IFRS 10 lists potential facts and circumstances to be considered in the assessment

[50] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[51] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).

phase, for instance the existence of potential barriers to exercise the right (e.g. financial penalties or conversion price), whether the agreement of other parties is required and whether the exercise of the rights would benefit the holder[52]. Furthermore, to fulfil the substantive criteria, rights need to be exercisable when decisions relating to relevant activities are made. This is different to what was previously required by IAS 27 (2008) that the rights were exercisable at the holder's reporting date. In addition, in accordance with IFRS 10, a right may also be substantive if it is not currently exercisable but exercisable when decisions about the relevant activities are taken[53].

If substantive rights might give the owner of those rights control over the arrangement and prevent other parties from having joint control, this is not the case for protective rights, which are defined in IFRS 10 as rights designated to *protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate*[54]. In accordance with IFRS 10 B 26, **protective rights** *relate to fundamental changes to the activities of an investee or they apply in exceptional circumstances*. Some examples of protective rights may include: a lender's right to restrict a borrower from undertaking activities that could change its credit risk, the right of a party holding a non-controlling interest to approve the issuance of new debt instruments or equity, or to approve a capital expenditure greater than the one required in the ordinary course of business, the right of a lender to seize the assets of a borrower if it fails to meet the loan repayment[55].

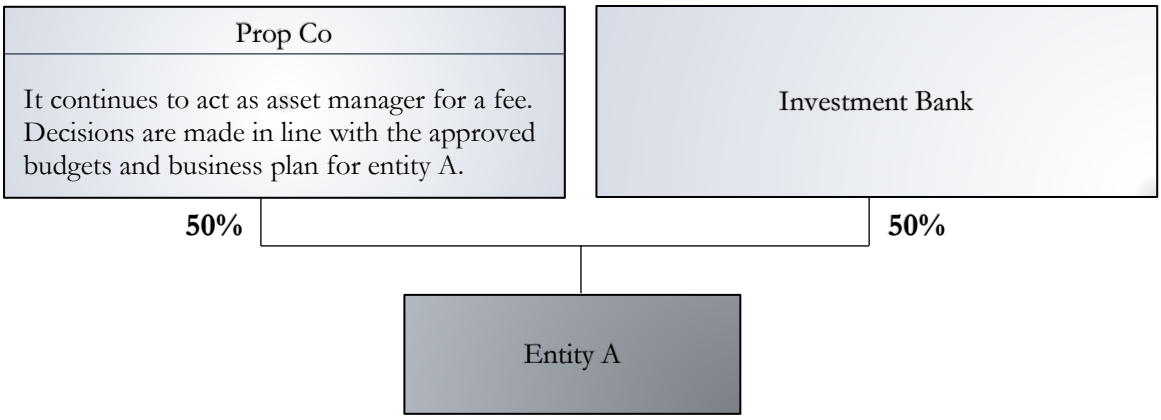
Determining whether substantive or protective rights exist becomes fundamental mainly in situations in which one of the parties to the arrangement is appointed as the operator or **manager of the arrangement**. Since it is unlikely that two or more parties operationally undertake relevant activities together, this practice is common mainly in certain industries (e.g. the extractive industry) regardless of whether the arrangement is structured through an incorporated entity or a contractual arrangement[56]. Managers are often appointed for undertaking a variety of roles (e.g. developer in a real estate project, head contractor in a construction project, manager of a portfolio of investment properties, researcher and developer of pharmaceuticals, and operator of a mine or oil & gas field). Frequently the manager is one of the investor of the joint arrangement and given its role it manages the day-to-day operations of the arrangement's activities. Precisely for this reason, it is essential to assess whether that investor is simply acting as an agent or a principal. Under IAS 31 it was generally concluded that the manager simply acted as agent carrying out the decisions of the parties sharing control of the arrangement. Conversely, IFRS 10 along with IFRS 11 highlight the importance to

[52] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[53] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[54] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[55] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[56] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

understand if the manager can indeed control the arrangement. Accordingly, when decision-making rights have been delegated, IFRS 10 describes how to determine if the decision-maker is acting as a principal or as an agent (on behalf of the principal) and to evaluate which party (if any) has power to exercise control[57]. In this respect, IFRS 10 lists some factors to be assessed: *the scope of the manager's decision-making authority*, eventual *rights held by other parties (e.g. protective, substantive or removal rights)*, *the remuneration to which it is entitled* and *the decision maker's exposure to variable returns from other interests held in the investee (i.e. direct investment of the manager in the arrangement)*[58]. Indeed, if the manager cannot be easily replaced, if it is paid at a non-market rate of return for its services and if it is largely exposed to variable returns, that manager is probably acting as principal. In such a case, of course there is no joint control[59]. The following example taken from PwC's *Practical guide to IFRS* helps clarify how to assess if an arrangement is a joint arrangement, when a manager is appointed.

EXAMPLE 3.3.4.1 – **Impact of managing an arrangement**

Property Company Limited (Prop Co) has a wholly owned subsidiary, entity A, which holds a portfolio of buildings. To reduce its exposure to this market, Prop Co sells 50% of its investment in entity A to the Investment Bank. The contractual agreement between the parties establishes that decisions regarding entity A's relevant activities are made jointly.



Entity A is jointly controlled, because Prop Co and the Investment Bank must unanimously agree on the relevant activities, and Prop Co, being the operator, is required to manage the entity's day-to-day operations in respect of the agreed decisions. Instead, this would not be a joint arrangement if Prop Co could unilaterally make decisions regarding the arrangement's relevant activities[60].

[57] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[58] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[59] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[60] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).

When assessing joint control, consideration must be given in cases where one party acts as a **de facto agent** of another party. According to IFRS 10, *a party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf*[61]. Since such a relationship needs not to involve a contractual arrangement, identifying de facto agents may be complex and require a careful analysis of all relevant facts and circumstances. For example, a contractual arrangement involves three parties: A, B and C respectively with 50%, 25% and 25% of the voting rights. If the contractual agreement specifies that at least 75% of the voting rights is required to make decisions about the relevant activities, the situation entails neither control nor joint control, as more than one combination of parties can reach 75% and direct the arrangement. However, if facts and circumstances proved that C was deemed to be a de facto agent of B, then A and B would jointly control the arrangement because B could really control 50% of the voting rights (in combination with C's 25%)[62].

Other situations in which assessment is required while determining if joint control exists are those where the **government is a party** to the arrangement. For example, a government may own a land containing oil reserves and it may establish a contractual arrangement with an oil company to drill the oil and sell it through a separate vehicle. In this case, the oil company needs to evaluate all the contractual terms and clauses to determine whether it has joint control or other types of interest in the arrangement. In the case in which all the final decision-making authority over the development activities were held by the government, the government would control the separate vehicle. However, if unanimous consent between the two parties was required, joint control would exist, and the arrangement would fall within the scope of IFRS 11[63].

3.3.5 Dispute resolution clauses: Ultimate voting authority and arbitration

Sometimes contractual arrangements involving two or more parties may provide a specific party with the casting vote in case of disagreement or deadlock among the parties. Indeed, dispute resolution clauses must be well assessed because they may confer upon a single party the ultimate voting authority and thus the ability to unilaterally direct the decisions on the relevant activities of the arrangement. In such a scenario, of course joint control would not occur. However, as pointed out by Ernst & Young (2011), a party does not necessarily have control because it holds a deciding vote. This is true if other parties can act without the agreement of that party. For example, there may be three parties to an arrangement in which the contractual agreement gives ultimate decision-making authority to one of them but recognises the possibility for the other parties to reach two

[61] IFRS Foundation. *IFRS Standard 10 – Consolidated Financial Statements*. (2011).
[62] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[63] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

votes to carry out a motion, consequently preventing the party with the casting vote to control the activities[64].

Among dispute resolution clauses, a contractual arrangement may include also an arbitration provision. Arbitration occurs when in the case of a dispute, the issue is solved by a third party that binds with its decision all the parties sharing control. Unlike ultimate voting authority, arbitration does not prevent an arrangement to be a joint arrangement[65], as it provides only a mechanism with which resolving deadlock[66].

3.4 Types of joint arrangements

Joint arrangements are set up to attain multiple goals (e.g. sharing costs, risks, accessing new markets or new technologies) and they may be established using different structures. Some of them might entail the establishment of a separate vehicle and some of them not[67]. Unlike IAS 31 where the existence of a separate vehicle drove the classification of joint arrangements (jointly controlled assets, jointly controlled operations or jointly controlled entities), under IFRS 11 the classification of a joint arrangement depends upon the **rights and obligations** of the parties to the arrangement. Accordingly, a joint arrangement may be classified as either a joint operation or a joint venture[68]. Under IFRS 11, the classification of joint arrangements is a key point as it drives the accounting[69].

It is a common business practice to use the term *joint venture* to identify joint arrangements in general. For instance, under IAS 31, joint ventures included not only jointly controlled entities, but jointly controlled operations and jointly controlled assets as well. However, IFRS 11 narrows the scope of the term. Thus, joint ventures refer just to a subset of the overall population which is now called *joint arrangements*. Consequently, simply because an arrangement is called joint venture in its contractual agreement, indeed, does not imply that it will be accounted for as a joint venture within IFRS 11[70].

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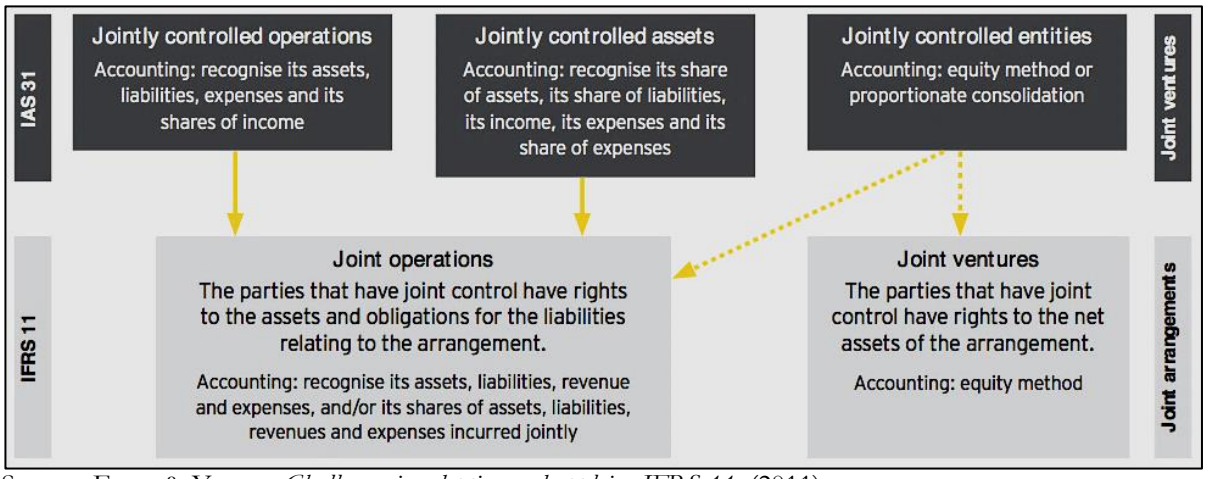
[64] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[65] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[66] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[67] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[68] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[69] Deloitte. *Clearly IFRS. Moving ahead in an IFRS world. A practical guide to implementing IFRS 11 – Joint Arrangements.* (2013).
[70] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

FIGURE 3.4.1 – **SIMILAR CONCEPTS, DIFFERENT TERMS**



Source: Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011)

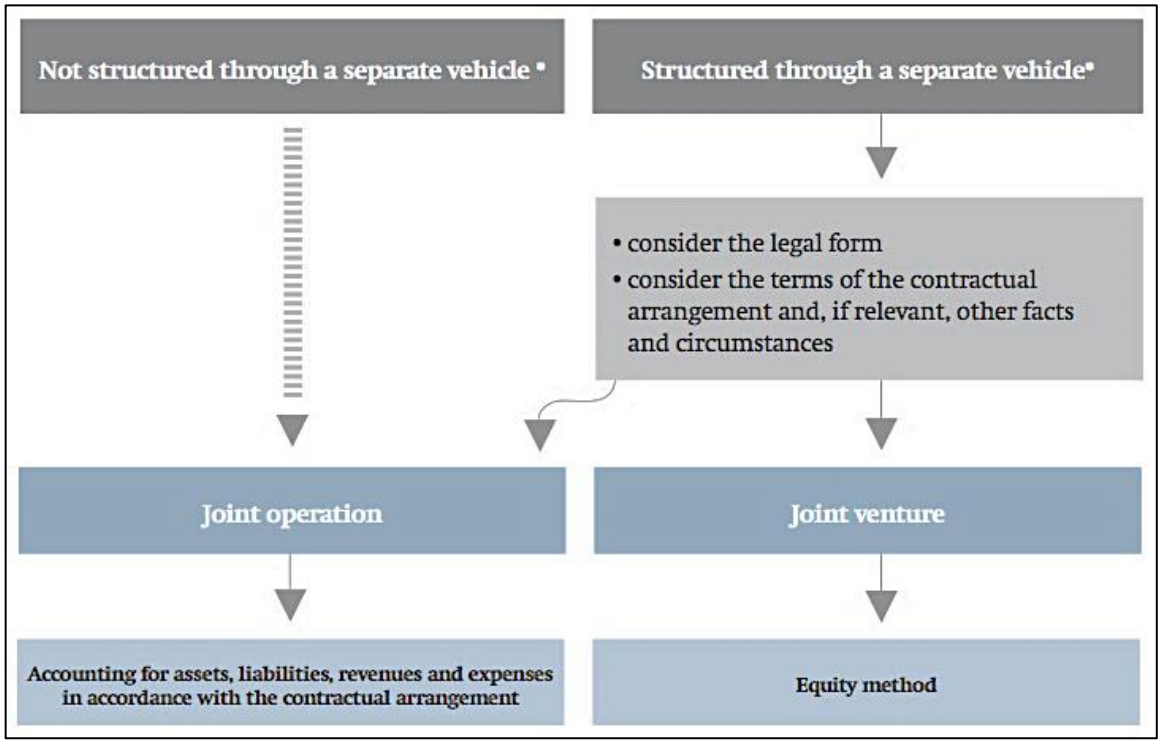
As visible from Figure 3.4.1, jointly controlled assets and jointly controlled operations (as defined under IAS 31) are called joint operations within IFRS 11. Despite the different definitions, the accounting treatment for this type of arrangements continues to be the same (i.e. recognising the relative share of assets, liabilities, revenues and expenses arising from the arrangement)[71]. The new standard, IFRS 11, describes a **joint operation** as *a joint arrangement whereby the parties that have joint control* (joint operators) *of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement.* Conversely, according to IAS 31 a **jointly controlled operation**[72] entailed *the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that* was *separate from the venturers themselves. Each venturer* used *its own property, plant and equipment and* carried *its own inventories. It also* incurred *its own expenses and liabilities and* raised *its own finance, which* represented *its own obligations.* Similarly, a **jointly controlled asset**[73] involved *the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of the joint venture and dedicated to the purposes of the joint venture. The assets* were *used to obtain benefits for the venturers. Each venturer* might have taken *a share of the output from the assets and each* bore *an agreed share of the expenses incurred. These joint ventures* did *not involve the establishment of a corporation, partnership or other entity, or a financial structure that* was *separate from the venturers themselves*[74].

[71] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[72] An example of jointly controlled operation was the combination of operations, resources and expertise to manufacture, market and distribute jointly a particular product, such as an aircraft. IAS 31 (2010).
[73] An example of jointly controlled asset was the joint control and use of an oil pipeline. IAS 31 (2010).
[74] IFRS Foundation. *IAS 31 – Interests in Joint Ventures*. (2010).

Whenever a separate entity was established, IAS 31 classified that arrangement as a **jointly controlled entity**. In fact, a jointly controlled entity was a j*oint venture involving the establishment of a corporation, partnership, or other entity in which each venturer* had *an interest. A jointly controlled entity controlled the assets of the joint venture, incurred liabilities, and expenses and earned income. Each venturer* was *entitled to a share of the profits*[75]. Following the principle-based approach in IFRS 11, a jointly controlled entity might be classified either as a joint operation or a joint venture. In this case, the assessment of the rights and obligations of the parties sharing control is the key factor to identify the type of joint arrangement[76]. Accordingly, a joint arrangement is a **joint venture** *whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement* [77].

Consequently, under IFRS 11 if a joint arrangement is not structured through a separate legal entity, it is always accounted for as a joint operation, whereas if a joint arrangement is structured through a separate legal entity, then depending on the rights and obligations of the parties, each of them will account for its interest either by using the equity method (joint venture) or by recognising its share of assets, liabilities, income and expenses (joint operation)[78].

FIGURE 3.4.2 – **CLASSIFICATION OF A JOINT ARRANGEMENT**



Source: IFRS Foundation. *Project Summary and Feedback Statement*. (2011)

[75] IFRS Foundation. *IAS 31 – Interests in Joint Ventures*. (2010).
[76] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[77] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[78] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

IFRS 11 states that to assess the rights and obligations arising from an arrangement, the first (but not unique) factor parties should consider is the *structure of the arrangement*. If the arrangement is not structured through a separate vehicle[79], that arrangement is classified as a joint operation (see Figure 3.4.2). Thus, in such cases, the contractual arrangement establishes the parties' rights to the assets and obligations for the liabilities along with the connected revenues and expenses[80].

For instance, two parties may agree to produce a product together, with each of them being responsible for a specific production phase and each of them using its own assets and incurring its own liabilities. Furthermore, the contractual arrangement may determine how the revenues and the expenses incurred should be divided upon the parties sharing control. Besides, there may be other situations in which two or more parties might agree to share and use an asset together. Hence, in these cases the contractual agreement sets the parties' rights to that asset and how the output, the related costs and revenues incurred should be shared between parties[81].

If a separate vehicle exists, then a joint arrangement may be either a joint operation or a joint venture. Accordingly, to determine the correct classification (and the right accounting treatment) a party needs to assess its rights and its obligations arising from the arrangement in the normal course of business. Therefore, parties must perform a careful assessment of the *legal form* of the separate vehicle, the terms of the *contractual arrangement* and, when relevant, *other facts and circumstances*[82]. Ernst & Young (2011) affirms that when classifying a joint arrangement, the Board generally expects all parties to the same joint arrangement to reach the same conclusion about the classification of that arrangement. However, if it were not the case, it would mean that within the same separate vehicle the parties have different rights to the assets and different obligations for the liabilities[83]. The term *separate vehicle* introduced with IFRS 11 is broader in meaning than the concept of an *entity* which IAS 31 referred to. Ernst & Young (2011) remarks that such a change was made primarily because in some jurisdictions separate vehicles were established to set up joint arrangements, but in those jurisdictions, those separate vehicles did not meet the definition of a legal entity, thus they were automatically excluded from being accounted for as a jointly controlled entity in IAS 31[84].

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[79] A separate vehicle includes separate legal entities or those entities recognised by statute. Separate vehicles might or might not have a legal personality. These separate vehicles might also be incorporated (separate entities from business owners) or unincorporated (the business owners and the business itself are the same. Hence, the owner personally bears all results of the business). Anyway, separate vehicles have a separate financial structure. PwC. (2011).
[80] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[81] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements.* (2011).
[82] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[83] Ernst & Young. *Challenges in adopting and applying IFRS 11.* (2011).
[84] Ernst & Young. *Challenges in adopting and applying IFRS 11.* (2011).

Unlike IAS 31 where the accounting solely depended upon whether a separate entity existed, under IFRS 11 the legal form of the separate vehicle should be analysed as well to evaluate whether it confers a separation between the parties and the separate vehicle on its own (i.e. the assets and the liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties)[85]. If a separation of rights and obligations between the parties and the separate vehicle exists, the joint arrangement is probably a joint venture. Anyway, a further assessment of the contractual terms and, when relevant, other facts and circumstances should be considered since sometimes they can override the effects of the legal form. For instance, this may occur when the contractual clauses force parties to purchase part or all of the output of the joint arrangement[86].

Ernst & Young and PwC (2011) remark the importance of carefully assessing the impact or effects of local laws on the form of the separate vehicle. Indeed, in many countries, a corporation (or a limited liability company) confers separation between the parties and the separate vehicle and provides parties with rights only to the net assets (i.e. creditors do not have recourse to the investors for the liabilities of the corporation). However, this may not be the case in all countries. Likewise, usually a partnership with unlimited liability (and no legal personality)[87] does not confer separation between the parties' assets and liabilities and those of the separate vehicle. Therefore, the individual parties (and not the partnership on its own) are those to have the benefits and obligations for all assets and liabilities of the partnership. In such a case, under IFRS 11, that joint arrangement would be classified as a joint operation. Even so, if that partnership limited the liability of its partners to their investment, it would be a joint venture, as the parties would have only an interest to the net outcome generated by the economic activity[88]. Such a consideration is meaningful provided that under IAS 31, given the establishment of a separate entity, both types of partnership would have been accounted for as jointly controlled entities, despite being different in substance[89]. All in all, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle is sufficient to conclude that the arrangement is a joint operation only if the legal form results in the separate vehicle not being able to be considered separately from the parties (i.e. the assets and liabilities of the separate vehicle are the parties' assets and liabilities)[90].

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[85] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[86] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[87] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).
[88] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[89] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[90] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).

Where a separation between the vehicle and the parties exists, the terms of the contractual arrangement should be critically evaluated to determine whether they confirm or modify the effects of the legal form upon the parties' rights and obligations. IFRS 11 lists some of the common terms agreed in both join operation and joint venture's contractual agreements. They are reported in table 3.4.1 that follows.

TABLE 3.4.1 – **COMPARISON OF COMMON FEATURES IN CONTRACTUAL ARRANGEMENTS**

	JOINT OPERATION	**JOINT VENTURE**
Terms of the contractual arrangement	The parties have rights to the assets and obligations for the liabilities relating to the arrangement.	The parties have rights to the net assets relating to the arrangement.
Rights to assets	The parties share all interests in the assets in a specified proportion.	The assets belong to the arrangement. The parties to the arrangement do not have direct rights, title or ownership of the assets.
Obligations for liabilities	The parties share all liabilities, obligations, costs and expenses in a specified proportion. The parties are liable for claims on the arrangement raised by third parties of the arrangement.	The joint arrangement is liable for the debts and obligations of the arrangement. The parties are liable to the arrangement only to the extent of their respective investments in the arrangement or their respective obligations to contribute any unpaid or additional capital to the arrangement or both. Creditors of the arrangement do not have any right of recourse against the parties in respect of debts or obligations of the arrangement.
Revenues and expenses Profits or losses	The arrangement establishes an allocation of revenues and expenses based on relative performance of each party (for example, basis of capacity used by each party). This could differ from their ownership interest in the arrangement.	The arrangement establishes each party's share in the profit or loss of the arrangement.
Guarantees	The provision of guarantees by parties to a joint arrangement (or a commitment to provide them) does not by itself result in the classification of an arrangement as a joint operation.	

Source: PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011)

Furthermore, IFRS 11 includes an example of how contractual terms can modify the form of the separate vehicle: assuming two parties set up a joint arrangement in an incorporated entity, each of which has 50% ownership interest. The incorporation provides a separation of the entity from the owners. Hence, taking into consideration only the legal form, parties have rights only to the net assets of the arrangement. However, through the contractual terms they state that each party has an interest in the assets of the entity and each is liable for the liabilities in a specified proportion. Such modifications lead the joint arrangement to be classified as a joint operation[91].

Sometimes parties to a joint arrangement may provide guarantees to third parties (e.g. parties will support the joint arrangement in case of distress or losses, parties may assure quality in the services delivered from the joint arrangement and other form of guarantees for the repayment of financing received from third parties). Although it might appear counter-intuitive, the presence of some guarantees by the parties does not imply that the joint arrangement is automatically a joint operation. The rationale behind is that the guarantee does not lead the guarantor (i.e. the parties) to have a present obligation for the underlying liabilities of the joint arrangement[92].

Sometimes, contractual agreements may include other terms upon liquidation or dissolution of joint arrangements. More precisely, parties may contribute assets to the joint arrangement for being used to run the business. Nevertheless, if the joint arrangement is liquidated or dissolved, the contributed assets may revert to the contributing parties. As for guarantees, this provision does not imply that the joint arrangement is a joint operation. As remarked by Ernst and Young (2011) parties do not expect to receive the contributed assets in the normal course of business[93], but only in case of liquidation.

Similarly, as pointed out by Mazars (2012), if parties agree to share profits or loss relating to the arrangement on a specific proportion (i.e. the parties' ownership interest), this provision does not directly classify the arrangement in a joint venture. Indeed, IFRS 11 stipulates that such a clause does not prevent an arrangement from being identified as a joint operation provided that the parties have also rights to the assets and obligations for the liabilities of the arrangement[94].

Summing up, in most cases, the terms of the contractual arrangement are consistent with the legal form of the joint arrangement. Nevertheless, as widely discussed, parties may choose a specific legal form for tax or other regulatory reasons and may modify the connected effects with the terms included in the contractual arrangement[95].

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[91] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[92] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[93] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[94] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).
[95] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).

In practice parties should carefully reflect upon the following questions: (a) Do the terms of the contractual arrangement provide the parties with rights to the assets and obligations for the liabilities or rights to the net assets of the joint arrangement? (b) Do the terms fix that the parties share all interests of the assets of the arrangement in a specified proportion (i.e. in proportion to the parties' ownership interest in the arrangement or in proportion to the activity carried out and directly attributed to them) or do the parties have no interest in the arrangement's assets? (c) Do the terms settle that parties having joint control share all liabilities, obligations, costs and expenses in a specified proportion? To this purpose, it is worth considering if parties are liable for claims raised by third parties. (d) Does the contract state that all revenues and expenses should be allocated to the parties based on their relative performance (i.e. based on the capacity that each party uses in a plant jointly operated)? In this case, any clause for the allocation of profit or loss must be carefully analysed. Depending on the responses, the analysis ends at this stage if it is confirmed that the joint arrangement is a joint operation[96].

Conversely, if neither the analysis of the contractual terms of the arrangement indicates that parties have rights to the assets and obligations for the liabilities (e.g. joint operation), it is necessary to look at all the relevant facts and circumstances to determine the appropriate classification. At this point of the analysis, the purpose and the design of the joint arrangement should be carefully examined. For instance, when the activities of a joint arrangement are primarily designed to provide the parties with an output, this indicates that the parties have rights to substantially all the economic benefits of the assets of the arrangement. Frequently in these circumstances the parties prevent the arrangement from selling its output to third parties, unless their approval. Besides, parties set the price of the output sold at a level designed to cover only the costs of production and administrative expenses. In this way, the arrangement is intended to operate just at a break-even level. With such a purpose, the separate entity depends exclusively on the parties for the generation of cash flows. Therefore, all liabilities incurred by the joint arrangement are primarily satisfied by the cash flows of the parties purchasing the output. Indeed, if the parties are substantially the unique source of cash flows that guarantees the continuity of the business, according to IFRS 11 they have in practice a present obligation for the joint arrangement's liabilities and they are joint operators[97]. However, if the parties changed the contractual terms so that the arrangement could sell its output to third parties, this would result in a joint venture taking its own demand, inventory and credit risks[98].

[96] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[97] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[98] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements.* (2011).

BDO (2013) expands these considerations to such cases in which each party has the option to purchase the output from the joint arrangement and if the option is not exercised, the entity is able anyway to sell the output to the market. Irrespective of how likely the parties are to exercise the option, according to BDO the presence of the option does not create a contractual obligation for the parties to fund the liabilities of the joint arrangement and thus the joint arrangement would be a joint venture[99].

Ernst & Young (2011) observes that in some cases only one party to the arrangement may receive or purchase all the output. For example, this may happen when one of the parties does not operate in the same industry of the joint arrangement (e.g. a local government with a foreign entity) and it is compensated in some other manners relative to its interest in the joint arrangement (e.g. cash). It may even occur that the party receiving all the output is acting as an agent on the behalf of other parties. In such a case, Ernst & Young (2011) believes that the first step is to confirm the existence of joint control, given that the party receiving the output may in practice have the power to unilaterally control the arrangement. If joint control exists, the joint arrangement would likely be a joint operation. This is because despite the different nature of the assets to which parties hold rights (e.g. one party receives a tangible output, whereas the other receives a financial asset), both have rights to the assets and obligations for the liabilities of the arrangement rather than rights to the net assets[100].

Finally, Ernst & Young (2011) reasons about those cases where parties provide cash flows at inception of a joint arrangement with no one else expecting to provide cash until the end of an activity. This particular situation does not imply that the joint arrangement is a joint operation. In fact, parties are not providing cash on a continuous basis and are not expected to fund the activities in the normal course of business. For instance, parties need to intervene if the contributed equity is not sufficient to run the business. In such a case, the parties would be joint venturers[101].

Table 3.4.2 which is reported as follows summarises all the relevant facts and circumstances that should be carefully evaluated by parties to understand whether a certain joint arrangement is a joint operation or a joint venture.

[99] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[100] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[101] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

TABLE 3.4.2 – **OTHER FACTS AND CIRCUMSTANCES**

	JOINT OPERATION	JOINT VENTURE
Restrictions on selling output	Restricted from selling output to third parties.	Able to sell output to other parties.
Requirements to purchase output	Parties (individually or collectively) must purchase substantially all of output produced.	Other parties might purchase the output.
Source of cash flows to pay liabilities	The parties to the joint arrangement.	Third parties, through their purchase of output.
Expected financial performance	Designed to operate at break-even or to generate losses that will be funded by the parties.	Designed to generate a profit.

Source: Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011)

If a framework agreement has been concluded between two or more parties for establishing all the general terms to undertake multiple activities together, the features of each joint arrangement must be assessed separately from the others, despite being part of the same framework agreement. Thus, under these circumstances joint operations and joint ventures may coexist[102].

The three following examples have been chosen to portray all the considerations concerning the classification of joint arrangements made so far. They are taken from the illustrative examples accompanying IFRS 11 with two of them being mentioned by Mazars (2012)[103]. Really their analysis is useful to fix the new classification procedure.

EXAMPLE 3.4.1 – **Construction Services**

A and B are two companies whose core business consists in the provision of many types of public and private construction services. They obtain a government contract for the construction of a road and the contractual arrangement determines the participation shares of each entity and establishes joint control. A separate vehicle, entity Z, is set up through which they run the business. Entity Z, on behalf of A and B, enters into the contract with the government. The assets and liabilities required to construct the road are held by entity Z. Entity Z legal form gives the parties (A and B) rights to the assets and obligations for the liabilities of Z. Moreover, the contractual arrangement establishes that: (a) A and B have the rights to all assets needed to build the road based on their participation shares in Z. (b) A and B have several joint responsibilities for all operating and financial obligations relating to the activities of Z based on their ownership interest. (c) The profit or loss is shared by A and B on the basis of their interest in Z. For overseeing the construction phase, A and B appoint an operator (an employee of one of the parties alternating between A and B). Finally, entity Z invoices the government on behalf of A and B [104].

[102] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[103] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[104] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).

The joint arrangement is carried out through a separate vehicle whose legal form does not confer separation between the separate vehicle Z and its investors (i.e. the assets and liabilities held in Z are the parties' assets and liabilities). This is confirmed by the terms agreed by the parties in their contractual arrangement. Consequently, the joint arrangement is a joint operation[105].

EXAMPLE 3.4.2 – **Shopping centre operated jointly**

Two real estate companies (entities A and B) set up a separate vehicle (entity X) for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the real estate companies A and B establishes the joint control over entity X. The main feature of entity X legal form is that X has rights to its assets and obligations for its liabilities relating to the management of the shopping centre. The activities of X imply the rental of the retail units, maintaining the centre and its equipment and managing the car park.

The terms of the contractual arrangement state that: (a) X owns the shopping centre. The agreement does not specify that the parties have rights to the assets to the shopping centre. (b) The parties are not liable in respect of the debts, liabilities or obligations of entity X. Their liability is limited to the unpaid capital contribution. (c) The parties have the right to sell or pledge their interests in entity X. (d) Each party receives a share of the income from operating the shopping centre (rental income net of operating costs) in accordance with each party's interest in entity X.

The joint arrangement is structured through a separate vehicle whose legal form attributes to the arrangement its own rights and obligations. Neither the contractual agreement nor other relevant facts and circumstances question the conclusion of the analysis of the legal form. Consequently, A and B recognise their rights to the net assets of X as an investment using the equity method[106].

EXAMPLE 3.4.3 – **Liquefied natural gas arrangement**

Company A enters into a joint arrangement with company B to develop and operate a gas field (owned by A) and the LNG facility to liquefy the gas. The parties agree to contribute respectively the gas field and cash to a new separate vehicle, entity C. Each party takes 50% ownership interest in C, whose legal form causes a separation between the entity and the parties. Moreover, the contractual arrangement specifies that: (a) Each firm must appoint unanimously two members to the board of C (the board must unanimously agree the strategy and the investments made by C). (b) The day-to-day management of the gas field and LNG facility, including development and construction activities are undertaken by company B in accordance with the directions jointly agreed by the parties. Entity C will reimburse B for the costs incurred. (c) Entity C is liable for taxes and royalties on the production and sale of LNG gas as well as for other liabilities incurred in the course of the ordinary business (e.g. account payables). (d) A and B have equal shares in the profit of entity C.

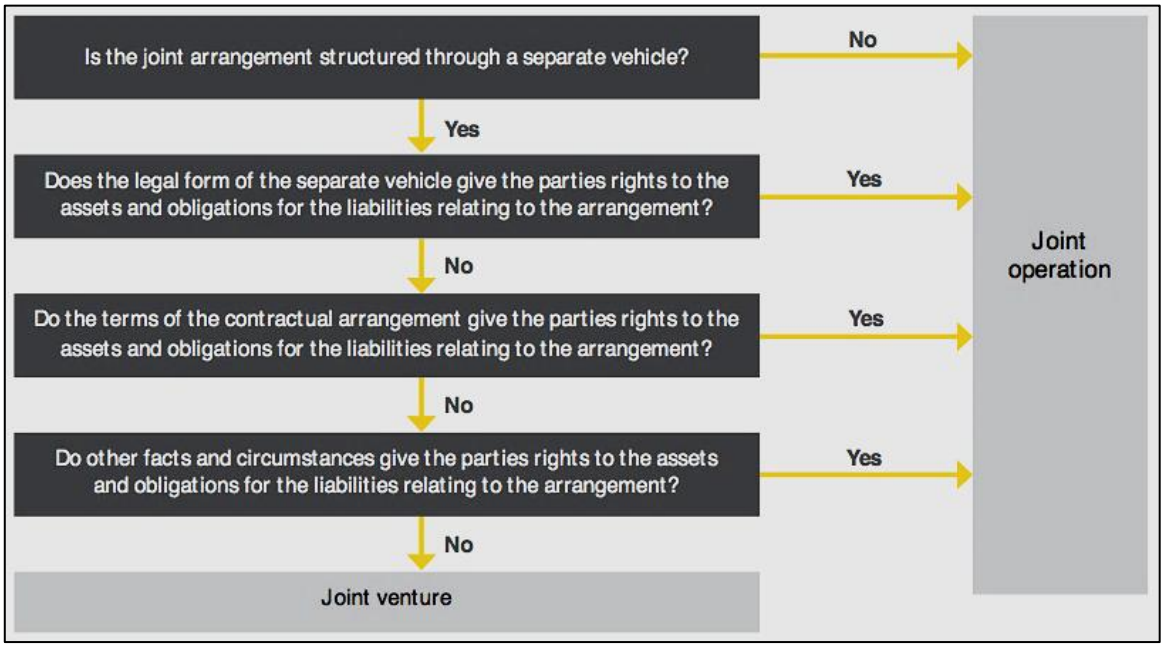
The contractual agreement does not specify that the parties have rights to the assets or obligations for the liabilities of C. However, the board decides to enter into a financing arrangement with a syndicate of lenders to help fund the

[105] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[106] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).

development of the gas field. The arrangement specifies that the syndicate has recourse to companies A and B only if C defaults during the development of the field. Conversely, the lending syndicate will not have recourse once the facility is in production since the cash inflows generated from the LNG gas sales should be sufficient to repay the loan.
The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the two companies A and B and the joint arrangement C. The terms of the contract state that the parties have rights to the net outcome of the generated activity. The right of recourse held by the lenders does not impose to the parties an obligation to the liabilities of C, they only guarantee the repayment of the loan in case of default of the facility during the development and construction phase[107].

To conclude the section, Flowchart 3.4.3 put forward illustrates all the steps examined so far to identify where a joint arrangement is a joint operation or a joint venture. As remarked by Deloitte (2013) a positive answer to every single question would result in a joint arrangement classified as a joint operation. In fact, the ***Yes*** answer indicates that rights to the assets and obligations for the liabilities exist and there is no requirement to continue the analysis with the consideration of other questions. Instead, a ***No*** answer does not result in a classification conclusion but requires going on with the assessment questions[108].

FIGURE 3.4.3 – **STEPS FOR THE DISTINCTION BETWEEN A JOINT OPERATION AND A JOINT VENTURE**



Source: Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011)

[107] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[108] Deloitte. *Clearly IFRS. Moving ahead in an IFRS world. A practical guide to implementing IFRS 11 – Joint Arrangements*. (2013).

Finally, IFRS 11 incorporates the concept of continuous assessment. Therefore, each time there is a change in the legal form, in the contractual terms or other facts and circumstances as well as how activities are directed, each party to an arrangement should assess whether it still has joint control on the arrangement and whether the type of joint arrangement has changed[109].

3.5 The Accounting Treatment for Joint Operations

The new standard IFRS 11 requires a joint operator to recognise in its consolidated[110] as well as individual[111] and separate[112] financial statements its share of assets, liabilities, revenues and costs on a line-by-line basis. More precisely IFRS 11 states that *a joint operator shall recognise in relation to its share of interest in a joint operation: (a) its assets, including its share of any assets held jointly; (b) its liabilities, including its share of any liabilities incurred jointly; (c) its revenue from the sale of its share of the output arising from the joint operation; (d) its share of the revenue from the sale of the output by the joint operation; (e) its expenses, including its share of any expenses incurred jointly*[113]. Furthermore, IFRS 11 specifies that the accounting and measurement for each of the listed items is in accordance with the applicable IFRSs (e.g. IAS 2 for recognising inventories)[114]. The accounting treatment for joint operations is consistent with the accounting requirement under IAS 31 for jointly controlled operations and assets[115].

Ernst and Young (2011) remarks that careful attention should be given to the nature of the rights to the assets and obligations for the liabilities when determining the suitable accounting. For example, a joint operator may have a direct liability for the entire balance of certain joint operations' liabilities, with the right of reimbursement by the other parties for their share of such liabilities. In such a case, the joint operator would recognise 100% for such liability and a receivable for the reimbursement (IFRSs prohibit the offsetting of the two items). Sometimes, there may be instances where the other parties are unable to pay. Hence in this circumstance, the joint operator would not recognise the entire amount due as a receivable because part of it will be impaired. Anyway, the liability for the joint operator would be accounted for following IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*. Similarly, if one joint operator acts as the manager of the arrangement

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[109] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[110] Consolidated Financial Statements are prepared by an entity that is a parent, which at least has a subsidiary. BDO. (2013).
[111] When an investor has no subsidiaries (it is not a parent), it is required to prepare individual financial statements in which its interests in associates or joint ventures are equity accounted. BDO. (2013).
[112] Separate Financial Statements are prepared by a parent or an investor in a joint venture or associate, where the investments are accounted for either at cost or in accordance with IFRS 9 – *Financial Instruments*. IFRS standards do not request the preparation of Separate Financial Statements, although they are often prepared due to an entity's local legal requirements. BDO. (2013).
[113] IFRS Foundation. *IFRS Standard 11 – Joint Arrangements*. (2011).
[114] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[115] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).

and receives fees for its services from the other joint operators, the party receiving the fees would account for them according to IFRS 15 – *Revenue from Contracts with Customers* (it superseded IAS 18 – *Revenue* starting from 2018). Conversely, if a joint operator needs to recognise its share of assets, it would probably account for them by applying IAS 16 – *Plant, Property and Equipment* or IAS 38 – *Intangible Assets*[116].

Even BDO (2013) affirms that in practice each party to a joint operation needs to assess with attention all the terms stated in the contractual agreement because the share of the assets, liabilities, income and expenses relies on the conditions agreed upon the parties. For example, if a contractual arrangement establishes that each party is committed with a specific role and each of them uses its own assets and incurs its own liabilities, in the consolidated financial statements each joint operator would recognise its own assets and liabilities, whereas each of them would account for its share of the income and expenses in accordance with the terms of the agreement[117].

It is worth mentioning that there is a difference between the application of the proportionate consolidation as required by IAS 31 and the method of accounting for joint operations as set out by IFRS 11. If at first glance the two methods appear similar, indeed they bring different results in the consolidated financial statements. In fact, IFRS 11 requires an entity with an interest in a joint operation to recognise its assets, liabilities, revenues and expenses in accordance with the terms of the contractual agreement, rather than basing the recognition on the ownership interest in the joint operation[118]. Ernst and Young (2011) points out that when a joint operator has rights to a specific percentage of the assets and obligations for the same percentage of liabilities, there would likely not be a difference between the accounting for a joint operation and proportionate consolidation. Nevertheless, when the joint operator has different rights (and percentages) to various assets and different obligations for liabilities, the consolidated financial statements would look dissimilar when accounting for individual rights and obligations towards proportionately consolidating a fixed share of all the assets and liabilities[119]. The following example from Ernst & Young (2011) illustrates the accounting for joint operations.

EXAMPLE 3.5.1 – **Accounting for rights to assets and obligations for liabilities**

D and E establish a joint arrangement (F) using a separate vehicle. The legal form does not confer separation between the parties and the separate vehicle itself. Neither the contractual terms nor relevant facts and circumstances indicate otherwise. Consequently, D and E account for their rights to the assets and their obligations for the liabilities of F in accordance with the applicable IFRSs. Each single party owns 50% of the equity in F. Nevertheless, the terms of

[116] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[117] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[118] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).
[119] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

the contractual agreement establish that D has the rights to all of Building No. 1 and the obligation to pay all the debt in F. D and E have rights to all other assets in F and obligations for all other liabilities in F in proportion to their ownership interest (50%).

F's balance sheet is as follows (in CUs):

Assets		**Liabilities & Equity**	
Cash	20	Debt	120
Building No. 1	120	Employee benefit plan obligation	50
Building No. 2	100	Equity	70
Total Assets	**240**	**Total Liabilities & Equity**	**240**

Under IFRS 11 the consolidated financial statement of D would appear as follows:

Assets		**Liabilities & Equity**	
Cash	10	Debt	**120**
Building No. 1	**120**	Employee benefit plan obligation	25
Building No. 2	50	Equity	35
Total Assets	**180**	**Total Liabilities & Equity**	**180**

Since D has rights to all Building No. 1 and an obligation to all the joint operation's debt, it records the entire amount of both. This confirms how differences may exist between the measurement of assets and liabilities calculated under proportionate consolidation as compared to recognising the share of a joint operator's rights to individual assets and obligations for the liabilities[120].

As already introduced above, there may be some cases in which a party is involved in a joint operation but does not share joint control. According to IFRS 11, if that party has rights to assets and obligations for liabilities of the joint operation, that party should follow the general accounting treatment required for joint operators[121]. Conversely, if a party owns neither rights to the assets nor obligations for the liabilities it should account for its interest in its consolidated/individual financial statements in accordance with IAS 28 - an interest in a separate vehicle over which it has significant influence, IFRS 9 (or IAS 39 as applicable) - an interest in a separate vehicle over which it does not have significant influence, therefore in this case the interest is treated like a financial asset and other applicable IFRSs - an interest in an arrangement without a separate vehicle[122].

[120] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[121] Consolidated/Individual and Separate Financial Statements. BDO (2013).
[122] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
Regarding the accounting measurement in the Separate Financial Statements, if the non-joint controlling party has significant influence, it should account for its interest at cost or in accordance with IFRS 9 (or IAS 39). If it were not the case, only IFRS 9 (or IAS 39 as applicable) should be applied. BDO (2013).

If a joint operation is structured through a separate vehicle and a passive investor exists, the joint operator does not recognise the rights to assets and obligations for liabilities attributable to the non-controlling interest (i.e. passive investor). Rather, a joint operator recognises only its share of any assets held jointly and its obligations for its share of liabilities incurred jointly. The example that follows taken from Ernst & Young (2011) illustrates better this point.

EXAMPLE 3.5.2 – **Joint operation with a non-controlling interest - passive investor**

A and B establish a joint operation Z, which is conducted through a separate vehicle. Each of them owns 40% of the shares of the separate vehicle. The remaining 20% of Z is owned by C, which is considered a passive investor since it does not share joint control. A, B and C account for their assets, including their share of any assets held jointly, and their liabilities, including their share of any liabilities incurred jointly, in accordance with applicable IFRSs. Consequently, A and B would simply recognise in their financial statements the 40% of Z assets, liabilities, revenues and expenses, without considering the non-controlling interest held by C[123]. This approach differs from what happens with full consolidation (Modified Parent Company Theory or Entity Theory), which includes the recognition of non-controlling interest[124].

When a joint operator enters into a transaction with the joint operation in which it holds an interest, such as a **sale** or a **contribution of assets**, it is like the joint operator has transactions with the other parties of the joint operation[125]. Thus, the joint operator should recognise gains only to the extent of the other parties' interest in the joint operation. By contrast, when transactions provide evidence of a reduction in the value of the assets to be transferred to the joint operation, those losses should be recognised fully by the joint operator transferring the assets. Furthermore, as already introduced, a joint operator may also **purchase assets** from the joint operation, in such cases the joint operator should not recognise its share of gains and losses until it resells those assets to third parties. Even in this case, when this type of transactions provides evidence of impairment losses with respect to the assets purchased, the joint operator should recognise its share of those losses[126]. As remarked by Ernst & Young (2011) IAS 31 required the transfer of risks and rewards of ownership to the joint venture, before to permit the recognition of the portion of the gains and losses attributable to the other joint venturers. Instead, IFRS 11 does not embody such requirement since the IASB is moving away from the *risks and rewards model* and is approaching the *control model.* Additionally, E & Y (2011) believes that even though these requirements do not explicitly address parties to a joint operation which do not share joint control, it would be appropriate to follow the

[123] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[124] Gallimberti, C., Marra, A., Prencipe, A. *Consolidation. Preparing and understanding consolidated financial statements under IFRS*. Mac Graw Hill Education. (2013).
[125] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[126] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A*. (2012).

same accounting procedures in such circumstances[127]. The example put forward taken from BDO (2013) clarifies the considerations stated above.

EXAMPLE 3.5.3 – **Elimination of intercompany transactions**

Entities A and B (the parties) establish a joint arrangement structured through a separate vehicle X in which each party has 60% and 40% share of the voting rights over the relevant activities. Entity X is required to sell its entire output to only the two joint operators. During the period, total revenues of X from sales to the parties A and B are CU 18,000 and CU 12,000 respectively with a cost of sales equal to CU 16,000. At the reporting date, entity A has sold the inventory acquired by the arrangement to a third party for CU 21,600, X assets equal to cash CU 30,000 while liabilities are nil and no outstanding trade payable/receivable balances between X and the parties exist.

Entity A's income statement before to eliminate transactions with the joint operation is as follows:

Entity A		Share in X results	Total
Revenue	21,600	18,000	39,600
Cost of sales	18,000	9,600	27,600
Gross Profit	**3,600**	**8,400**	**12,000**

In accordance with IFRS 11, A should account for its share of the revenues and expenses in relation to its interest in the joint operation X. Thus, the A's share of revenue in X is equal to CU 18,000, while A's share of cost of sales is equal to CU 9,600 (16,000*60%). However, since these revenues are generated with itself through an intercompany transaction, A must eliminate these revenues in full as part of its consolidation procedures, otherwise they would be counted twice. Therefore, the results are eliminated as follows:

(Debit) Revenue	18,000	
(Credit) Cost of sales		18,000

Accordingly, in its financial statements A would recognise only the revenues with third parties CU 21,600 and cost of sales 9,600.

Entity A		Share in X results	Total	Elimination of intercompany transactions	Consolidated Financial Statements
Revenue	21,600	18,000	39,600	(18,000)	21,600
Cost of sale	(18,000)	(9,600)	(27,600)	18,000	(9,600)
Gross Profit	**3,600**	**8,400**	**12,000**	**-**	**12,000**

[127] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

If A had not sold the inventory purchased from X to third parties by reporting date, A would have an inventory item in its statement of financial position of CU 18,000 (a "cost" representing the amount paid for the purchase of the output from X). From a group perspective, this would result in inventory overstated, as the inventory recorded at CU 9,600 in X accounts are accounted at CU 18,000 in A's accounts. The elimination occurs as follows:

(Debit) Revenue	18,000	
(Credit) Cost of sales		9,600
(Credit) Inventory		8,400

Accordingly, this results in a full elimination of all intercompany revenues and expenses as well as the elimination of the overstatement of inventory, the inventory shall be carried at CU 9,600 (CU 18,000 – CU 8,400)[128].

3.6 Accounting for Joint Ventures: Proportionate Method vs Equity Method

Under IFRS 11, a joint venturer must account for its investment in a joint venture only by using the equity method. It has been widely discussed in the second chapter that this was the most controversial change brought by the new standard. What are the main features of both accounting methods?

According to IAS 31, *the application of proportionate consolidation means that the statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible.* Instead, *the statement of comprehensive income of the venturer includes its share of the income and expenses of the jointly controlled entity*[129]. IAS 31 allowed two reporting formats when using the PC method. The first format combined the proportionate interests in the assets, liabilities, income and expenses of the joint venture with the corresponding items in the venturer's financial statements (line-by-line reporting), whereas the second reporting format showed those proportionate interests in the venturer's financial statements as separate line items[130]. For example, if the first format was chosen, a venturer might have combined its share of the jointly controlled entity's inventory with its own inventory and its share of the jointly controlled entity's property, plant and equipment with

[128] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[129] IFRS Foundation. *IAS 31 – Interests in Joint Ventures.* (2010).
[130] Leitner – Hanetseder, S., Stockinger, M., *How does the elimination of the proportionate consolidation method for joint venture investments influence European companies?* ACRN Journal of Finance and Risk Perspectives. (2014).

its own property, plant and equipment[131]. Conversely, if the choice had been the second format, the line 'creditors' would have contained a sub-heading 'share of creditors of joint ventures'[132].

Coming to the technical issues connected with proportionate consolidation, when applying this method, the value of the investment participation (recorded in the individual balance sheet of the venturer) should be replaced during the consolidation process by the venturer's corresponding percentage of any assets and liabilities of the joint venture. In addition, as for the accounting of a joint operator, non-controlling interest should not be accounted for. By the way, this is the main difference between PC and full consolidation. Furthermore, the intercompany transactions should be eliminated proportionally to the venturer's percentage of ownership interest. Last but not least, the reporting party cannot offset assets with liabilities or revenues with costs, unless legal rights to do this exist[133].

By contrast, as explained by IAS 28 (2011), under the equity method the investment is initially recognised at acquisition cost, as all other assets. (i.e. Acquisition cost for 50% of JV = €200 million: (Debit) **Investment in JV + €200 million** | (Credit) **Cash - €200 million**). After the acquisition, at each reporting date, the value of the investment is increased (or decreased) in proportion to the profit (or loss) realised by the investee (or joint venture). The joint venturer's share of the venture's profit or loss is recorded in the venturer's Profit and Loss Statement. (i.e. Total JV profits = €80 million: (Debit) **Investment JV + €40 million** | (Credit) **Investment Income JV + €40 million**). Profits or losses are not the only events affecting the owner's equity of the investee. Indeed, IAS 28 indicates that any distribution from the venture to the joint venturer (e.g. dividends) reduces the carrying amount of the investment recorded in the investor's financial statements. Thus, whenever dividends are paid out, the owners' equity of the venture decreases. Accordingly, the value of the investment in the venturer's financial statements is reduced in proportion to its ownership interest (i.e. Dividends to be distributed = €50 million; 50% venturer's ownership interest in JV: (Debit) **Cash + €25 million** | (Credit) **Investment in JV - €25 million**).

Furthermore, another adjustment to the carrying amount of the venturer's investment under the equity method might arise from changes in the venture's owners' equity following the revaluation of property, plant and equipment in accordance with IAS 16 – *Property, Plant and Equipment*. IAS 16 establishes the accounting treatment for property, plant and equipment to be used for more than one accounting period, for carrying out for instance the production or supply of goods and services

[131] IFRS Foundation. *IAS 31 – Interests in Joint Ventures*. (2010).
[132] The Chartered Institute of Management Accountants (CIMA), Topazio, N. *Group Accounting for Joint Ventures*. Topic Gateway Series No. 29. (2008).
[133] Andrei, P., Azzali, S., Gavana, G., Lai, A., Rinaldi, L., Saccon, C., Viganò, R. *Bilancio Consolidato*. Gruppo 24 Ore. (2011).

or for administration purposes. An organisation may choose to measure its property either at cost net any accumulated depreciation and impairment or at a revalued amount less any subsequent accumulated depreciation and impairment. If the investee opts for the revaluation model, upward revaluations are recorded as a revaluation surplus in its owners' equity. Therefore, such an increase in the investee's owners' equity shall be mirrored in the value of the investment recorded in the financial statements of the investor. As contra entry, such an increase shall be recorded in the equity of the venturer rather than in its income statement. (i.e. Revaluation Surplus = €3 million: (Debit) **Investment in JV + €1.5 million** | (Credit) **Revaluation Surplus + €1.5 million**)[134].

All in all, when the venture obtains a profit (or a loss) the value of the investment recorded by the venturer will increase (decrease) proportionally to its interest in the joint venture and as a contra entry, an income statement item will be recorded. Dividends distributed reduce the value of the investment and the contra entry is cash or dividends receivables. Other changes in the equity of the venture such as those due to the application of the revaluation method or to the translation of foreign currency financial statements shall be mirrored proportionately in the carrying amount of the investment. Such changes will affect the owners' equity of the investor and will be reported within its other comprehensive income[135].

It is common in practice that the acquisition cost of an investment exceeds the proportionate share of the book value of the investee. For example, book values of individual assets and liabilities might be different from the respective fair values (i.e. undervalued plants) or the investee may have unrecognised intangible assets (i.e. patents) or the investor may be willing to pay for a goodwill (i.e. the expectation of future earnings [or losses]. It is calculated as the difference between the purchase price and the proportionate interest in the fair value of the investee's net assets). Similarly to full consolidation, under the equity method it is important to allocate the acquisition cost to its different components. Even the share of profit (loss) realised by the investee needs to be adjusted before to increase the value of the investment in the venturer's consolidated balance sheet and the amount of investment income in the venturer's income statement. Accordingly, the share of net income is adjusted for amortisation/depreciation of eventual unrecognised and undervalued assets (goodwill is not amortised)[136]. The example below illustrates this significant issue.

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[134] Gallimberti, C., Marra, A., Prencipe, A. *Consolidation. Preparing and understanding consolidated financial statements under IFRS*. Mac Graw Hill Education. (2013).
[135] Gallimberti, C., Marra, A., Prencipe, A. Mac Graw Hill Education. (2013).
[136] Gallimberti, C., Marra, A., Prencipe, A. Mac Graw Hill Education. (2013).

EXAMPLE 3.6.1 – **Equity method with allocation of acquisition cost**

On 1st January X, company A pays €220 million for having 40% ownership interest in the investee JV. On the date of acquisition, the net book value of JV is €400 million. The difference between the cost and the net book value depends on the existence of unrecorded patents, whose fair value is estimated to be €50 million (remaining useful life 20 years) and to some property undervalued by €70 million (remaining useful life 7 years). The remaining difference is allocated to goodwill and the tax effect is calculated at a rate of 50%. At 31st December X, JV reports a profit of €25 million.

ALLOCATION OF THE ACQUISITION COST:

- **Net Book value of JV** 40% * 400 = 160
- **Unrecorded Patents** 40% * 50 * (1 – 0.50) = 10
- **Undervalued Property** 40% * 70 * (1 – 0.50) = 14
- **Goodwill** 220 – (160 + 10 + 14) = 36

TOTAL COST **€220**

CALCULATION OF THE ADJUSTED INCOME:

- **Net Income** 40% * 25 =10
- **Amortisation of Patents** 10/20 = (0.5)
- **Depreciation of Property** 14/7 = (2)

ADJUSTED INCOME **7.5**

The corresponding entries will be:

(Debit) **Investment in JV + 220**	(Credit) **Cash – 220**
+ 7.5	(Credit) **Investment Income + 7.5**

When transactions between the investor (venturer) and the investee (venture) occur, IAS 28 states that all gains and losses resulting from *upstream* and *downstream* transactions, involving assets which do not constitute a business, between an entity and its joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the joint venture. Upstream transactions are, for example, sales of assets from an associate or a joint venture to the investor. Downstream transactions entail, for instance, sales or contributions of assets from the investor to its associate or its joint venture. In both cases, the entity's share in the joint venture's gains or losses resulting from these transactions is eliminated. Thus, under the equity method all transactions involving the sale/purchase of assets (e.g. inventory, fixed assets etc.) with unrealised gains and losses should be considered and what is eliminated is only the proportionate share of the

unrealised gains or losses that typically arise in connection to such sales[137]. However, unrealised losses are not eliminated to the extent that transactions provide evidence of an impairment of the assets transferred. Gallimberti et al. (2013) explain that a common way to eliminate such unrealised gains or losses implies to adjust the income from the investment, similarly to what happens for amortisation adjustments. The example 3.6.2 put forward will help clarify this procedure.

EXAMPLE 3.6.2 – **Unrealised gains on inventory (continuation of example 3.6.1)**

At the end of period X+1, JV reports a profit of €30 million. During the period X+1, A sold merchandise to JV realising revenues for €20 million. The cost of goods sold was €12 million. At the end of the period, 80% of that merchandise is still unsold in JV's inventory. (Using the data of the previous example, at the end of the period X the value of the investment in JV is equal to €227.5 million. Before to compute the unrealised profit, the first step is to adjust the JV income in X+1, as follows).

CALCULATION OF ADJUSTED INCOME X+1

➢ **Net Income**	40% * 30 = 12
➢ **Amortisation of patents**	10/20 = (0.5)
➢ **Depreciation of Property**	14/7 = (2)
➢ **Elimination of unrealised intra-group profit**	(1.28)
ADJUSTED INCOME	**8.22**

CALCULATION OF THE UNREALISED INTRA-GROUP PROFIT

➢ **Total Gross Profit**	20 – 12 = 8
➢ **Total Net of Tax Profit**	8 * (1 - 0.5) = 4
➢ **Total Unrealised Profit**	80% * 4 = 3.2
SHARE OF UNREALISED PROFIT	**40% * 3.2 = 1.28**

At the end of the period X+1, A will make the following journal entry:

(Debit) **Investment in JV + 8.22** | (Credit) **Investment Income + 8.22**

Thus, the value of the investment at 31st December X+1 is equal to €235.72 million[138].

[137] Gallimberti, C., Marra, A., Prencipe, A. Mac Graw Hill Education. (2013).
[138] Gallimberti, C., Marra, A., Prencipe, A. Mac Graw Hill Education. (2013).

In the case of contributions involving non-monetary assets by a joint venturer in exchange for an equity interest, the resulting profit or loss is recognised in the investor's financial statements only to the extent of unrelated investors' interests in the joint venture. However, if the transaction lacks commercial substance (in accordance with IAS 16), the gain or loss is regarded as unrealised and should be eliminated against the equity accounted investment[139]. If in addition to receive an equity interest, the venturer receives monetary or non-monetary assets, the investor recognises in full in profit or loss the portion of the gain or loss on the non-monetary contribution related to the assets received[140].

Finally, it is worth recalling that if the acquisition cost is lower than the proportionate share of the net fair value of the investee's identifiable assets and liabilities, IAS 28 requires the amount in excess to be included as income in the determination of the investor's share of the associate or joint venture's profit or loss for the period in which the investment is acquired. In addition, if the investor needs to account for losses, these losses will reduce the carrying amount of its investment. It may happen that through the recognition of losses; the value of the investment may be reduced to zero. In such cases, the investor must discontinue recognising its share of further losses. As a matter of fact, under the equity method, if the investment is reduced to zero, a liability is recognised only to the extent in which the investor has a commitment towards the investee. Afterwards, if the associate or joint venture returns to be profitable, the investor will resume recognising its share of profits only after those profits equal the shares of losses not recorded[141].

What are the main differences between the equity method and proportionate consolidation? There are some technical differences between the two methods that should be taken into account. As remarked by Mazars (2013), in the event of losses recorded by the joint venture, proportionate consolidation requires the investor to recognise its share of those losses without limit, whereas as already mentioned, under the equity method the investor ceases to account for the losses in its financial statements if the amount of those losses is equal or greater than the value of its investment. Moreover, regarding the elimination of intragroup balances, the proportionate method requires the elimination of all transactions between the investor and the joint venture based on the investor's ownership interest in the joint venture, whereas under the equity method only unrealised internal profits or losses should be eliminated. Furthermore, also the impairment testing differs depending on whether equity method or proportionate consolidation is applied. In fact, in the case of assets and liabilities proportionately consolidated (including goodwill), IAS 36 – *Impairment of assets* should be used for non-financial assets, while IFRS 9 – *Financial Instruments* should be applied for financial

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139 IFRS Foundation. IAS 28 - *Investments in Asociates and Joint Ventures*. (2011).
140 BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
141 Gallimberti, C., Marra, A., Prencipe, A. Mac Graw Hill Education. (2013).

assets. Particularly, goodwill must be tested at least once a year and any impairment loss should not be reversed in subsequent periods. If an investment is recorded using the equity method, IAS 28 requires applying in a first step IFRS 9 (or IAS 39 – *Financial Instruments: Recognition and Measurement* as applicable) to identify whether an impairment loss should be recognised. Accordingly, in such a case, the recoverable amount of the investment is calculated by applying IAS 36. The entire carrying amount of the investment is tested for impairment as a single asset, therefore goodwill is not tested separately and finally, if a subsequent reversal of an impairment loss must be recognised, this will impact profit or loss of the investor[142].

The next simplified illustration shows the potential impact on consolidated results caused by the application of the equity method compared with the proportionate consolidation[143].

EXAMPLE 3.6.3 – **Group Accounting for Joint Ventures**

The investor V Co owns 50% of JV Co, a joint venture. Exhibit A shows individual company financial statements for the investor V Co and the joint venture JV Co, while Exhibit B illustrates the equity method and proportionate consolidation impact on the V Co's consolidated balance sheet and income statement.

Exhibit A: Individual Company Financial Statements
Balance Sheets at 31th December 2013

	V Co	**JV Co**
Non-Current Assets	100	16
Investment in JV Co at cost	6	-
Current Assets	34	12
TOTAL ASSETS	140	28
Current Liabilities	(5)	(2)
Non-current Liabilities	(25)	(6)
NET ASSETS	**110**	**20**
Shareholder's Equity	70	12
Net income for the year	40	8
Total	**110**	**20**

[142] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[143] The example has been adjusted. The Chartered Institute of Management Accountants (CIMA), Topazio, N. *Group Accounting for Joint Ventures*. Topic Gateway Series No. 29. (2008).

Income Statements for the year ended at 31th December 2013

	V Co	JV Co
Revenue	120	30
Cost of Sales	(60)	(16)
Other expenses	(20)	(6)
Net Income	**40**	**8**

Exhibit B: Equity Method and Proportionate Consolidation[144]
V Co
Consolidated Balance Sheet at 31th December 2013

	Equity	Proportionate
Non-Current Assets	100	108 [+16 * 50%]
Investment in JV Co at cost	10 (+ 4)	-
Current Assets	34	40 [+12 * 50%]
TOTAL ASSETS	**144**	**148**
Current Liabilities	(5)	(6) [+2 * 50%]
Non-current Liabilities	(25)	(28) [+6 *50%]
NET ASSETS	**114**	**114**
Shareholder's Equity	70	70
Net income for the year	44 (+ 4)	44 [+8 *50%]
Total	**114**	**114**

Income Statement for the year ended at 31th December 2013

	V Co	JV Co
Revenue	120	135 [+30* 50%]
Cost of Sales	(60)	(68) [+16 * 50%]
Share of profit of JV	4 [50% * 8]	-
Other expenses	(20)	(23) [+6 * 50%]
Net income	**44**	**44**

[144] The example has been adjusted. The Chartered Institute of Management Accountants (CIMA), Topazio, N. *Group Accounting for Joint Ventures*. Topic Gateway Series No. 29. (2008).

The simple illustration of Example 3.6.3 allows to envisage the substantial effects that moving from the proportionate consolidation to the equity method may lead to investors' consolidated financial statements. Despite having a line-by-line reporting, under the equity method the involvement of a venturer in a joint venture, where it shares control, is merely depicted by a single line item on the balance sheet (representing the value of the investment in the joint venture) and a single line item (portraying the venturer's proportion of the net income of the joint venture) in the statement of comprehensive income[145].

BDO (2013) lists all the potential effects that moving from one method of consolidation to another one brings in the venturers' consolidated financial statements. They are pointed out in the two tables that follow[146].

TABLE 3.6.1 – **EFFECTS ON THE STATEMENT OF FINANCIAL POSITION**

Line Item	Potential Impact	Reason
Current Assets **Current Liabilities** **Non-current Liabilities**	Decrease	The joint ventures financial position is no longer recorded on a line-by-line basis.
Non-current assets	Increase or Decrease	The line item investment in joint ventures is included within non-current assets, therefore the impact will be: **Increase:** if the venturer's share of non-current assets in the joint ventures is less than the value of the investment in the joint ventures. **Decrease:** if the venturer's share of non-current assets in the joint ventures is more than the value of the investment in the joint ventures.
Equity	Potential increase (if the joint venture has net liabilities)	Under the equity method, there are only certain conditions where losses in the joint venture that result in it recording net liabilities are (continued to be) recognised. (i.e. a share of losses is not recorded after a joint venturer's investment carrying amount is reduced to zero, unless the joint venturer has an obligation to fund those losses).

Source: BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013)

[145] Leitner – Hanetseder, S., Stockinger, M. ACRN Journal of Finance and Risk Perspectives. (2014).
[146] The tables have been adjusted. BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

TABLE 3.6.2 – **EFFECTS ON THE STATEMENT OF COMPREHENSIVE INCOME**

Line Item	Potential Impact	Reason
Revenues **Operating Expenses**	Decrease	The joint ventures financial performance is no longer recorded on a line-by-line basis.
Operating results **Operating margin** **(Operating Income/Revenues)**	Increase or Decrease	The impact depends on the results/profitability of the joint ventures and if the share of the profit or loss of the investee is presented within the operating income.
Profit Margin **(Net Income/Revenues)**	Increase	Revenues are supposed to decrease to the extent of the venturer's ownership interest in the joint ventures.
Finance income **Finance expenses**	Decrease	The joint ventures financial performance is no longer recorded on a line-by-line basis.
Share of profit from equity-accounted investees **(An entity that previously held neither associates nor jointly controlled entities accounted for in accordance with the equity method, would not have such a line item in its previous consolidated/individual financial statements)**	Increase or Decrease	The impact depends on the results/profitability of joint ventures.
Profit before tax	Increase or Decrease	Decrease/(increase) if the joint venture has a tax expense/(revenue). This is because the share of post-tax profit or loss is included within the venturer's pre-tax results.
Profit or Loss	Potential increase (if the joint venture has net liabilities)	Under the equity method, there are only certain conditions where losses in the joint venture that result in it recording net liabilities are (continued to be) recognised. (i.e. a share of losses is not recorded after a joint venturer's investment carrying amount is reduced to zero, unless the joint venturer has an obligation to fund those losses).

Source: BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013)

Before to conclude this section, it is worth recalling that IFRS 11 prescribes the use of the equity method for both venturers' consolidated and individual financial statements, while as far as separate financial statements, parties may choose to account for their investment either at cost (less any subsequent impairment) or as a financial asset in accordance with IFRS 9 – *Financial Instruments* (or IAS 39 – *Financial Instruments: Recognition and Measurement*)[147]. Besides, in accordance with IAS 28 – *Investments in Associates and Joint Ventures*, a joint venturer is not required to apply the equity method to its investment in an associate or joint venture if it is either a parent exempted from preparing the consolidated financial statements as prescribed by IFRS 10 – *Consolidated Financial Statements* (e.g. it is a wholly-owned or partially owned subsidiary, its debt or equity instruments are not traded in a public market, it is not in the process of issuing any class of instruments in a public market) or if all the following four conditions apply: (a) the venturer is a wholly-owned or a partially-owned subsidiary of another entity whose owners (including non-controlling interest holders) have agreed to allow the venturer not to apply the equity method; (b) the venturer's debt or equity instruments are not traded in a public market (a domestic or a foreign stock exchange or an over-the-counter market, including local and regional markets); (c) the joint venturer is not in the process of filing its financial statements with a securities commission or other regulatory organisations, with the aim of issuing any class of instruments in a public market; (d) any intermediate or ultimate parent of the joint venturer prepares consolidated financial statements in compliance with IFRS available for the public[148].

In addition, under IFRS 11 the Board decided to keep allowing venture capital organisations, mutual funds, unit trusts as well as similar entities, including investment-linked insurance funds, that conclude to be a party to a joint venture (as specified in IFRS 11), to measure their interest at fair value through profit or loss in accordance with IFRS 9 – *Financial Instruments*. In so doing, the IASB reconsidered the scope exemption outlined in IAS 31 regarding venture capital organisations and stated that it was better to refer to such cases as *measurement exemption* rather than *scope exemption*, since the scope exemption was not referred to the fact that those arrangements did not meet the characteristics of joint arrangements, but to the fact that for investments held by venture capital organisations fair value measurement provides more useful information for financial statements users than would do equity method. Thus, all in all, venture capital organisations[149] may still choose under IAS 28 to measure their investment in a joint venture at fair value[150].

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[147] IFRS Foundation. IAS 28 – *Investments in Associates and Joint Ventures*. (2011).
[148] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).
[149] A venture capital organisation (or unit trust, mutual fund, or similar entity) is described as an entity whose business is investing in financial assets with a view of profiting from their total return in the form of interest or dividends and changes in fair value. IFRS 9. BDO (2013).
[150] BDO. *Need to know – IFRS 11 Joint Arrangements*. (2013).

Finally, a party to a joint venture that does not share joint control should assess whether it has significant influence[151]. If it is the case, it should account for its interest in its consolidated and individual financial statements by using the equity method (IAS 28), otherwise it should account for a financial instrument following IFRS 9 (or IAS 39 as applicable). Conversely, where separate financial statements are drawn up, the non-joint controlling party may report its investment in a joint venture either at cost (less impairment) or as a financial asset in accordance with IFRS 9 (or IAS 39 as applicable) if significant influence exists. On the opposite case, the measurement choice is not allowed and only IFRS 9 (or IAS 39 as applicable) may be applied[152]. Moreover, if a party holds an investment in a joint venture that is classified as held-for-sale (the sale is highly probable within twelve months) the investment must be accounted for in accordance with IFRS 5 – *Non-current Assets Held-for-Sale and Discontinued Operations*[153]. Any remaining portion, which has not been classified as held-for-sale, must be accounted for under the equity method until the disposal of the portion classified as held-for-sale. After disposal, a joint venturer assesses any retained investment to determine whether it continues to meet the definition of a joint venture. If it is the case, the venturer accounts for its interest in accordance with IFRS 11 and IAS 28. On the opposite case, an investor accounts for its retained interest as a financial instrument in accordance with IFRS 9 (or IAS 39 as applicable)[154].

3.7 Transition requirements – From IAS 31 To IFRS 11

IFRS 11 started to be effective for annual periods beginning on or after 1 January 2013, while the EU officially endorsed the new standard for annual periods starting from 2014. Early adoption was allowed, provided that the entity applied also IFRS 10, IFRS 12, IAS 27 and IAS 28. All these standards were part of the consolidation package issued in 2011 and dealt with the assessment and measurement of an entity's relationship with other entities (i.e. control, joint control and significant influence over another entity). This Board's requirement was reasonable given that IFRS 11 bases its definition of joint control on what is stated by IFRS 10 and the equity method for joint ventures on the requirements in IAS 28 (2011)[155].

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[151] In IAS 28 (2011) *significant influence* is defined as: the power to participate in the financial and operating policy decisions of the investee but it is not control or joint control of those policies.
If an entity holds, directly or indirectly (e.g. through subsidiaries) 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g. through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.
[152] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[153] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[154] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[155] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).

Generally, IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to retrospectively restate all the prior comparative periods presented. However, *Appendix C* of IFRS 11 simplifies the transition requirements by providing the option to limit retrospective restatement as well as the disclosure of the effects caused by the change in accounting policy only for the annual period immediately preceding the first annual period of application. Accordingly, a party with a reporting date at 31 December that adopted the new standard in 2013 presented the comparative financial results of 2012 by including the effects of IFRS 11. In this way, an entity must still apply IFRS 11 to any joint arrangement that was disposed during the period immediately preceding the year of adoption. Thus, the recalculation must be carried out even if the joint arrangement does not exist anymore in the year of adoption. For instance, on 30th June 2012 entity A disposes X, a jointly controlled entity accounted for using the proportionate consolidation. In year 2013, A must assess which type of joint arrangement X belongs to. If X is qualified to be a joint venture, it must be accounted for using the equity method. Therefore, entity A must transition from measuring its investment in A as at 1st January 2012 using proportionate consolidation to apply equity method. Thereafter, the equity method should be applied until the period of disposal (30th June 2012) and the obtained gain or loss on disposal should be recalculated based on the carrying value calculated in accordance with the equity method[156].

As remarked by BDO, there are two scenarios giving rise to significant changes while moving from IAS 31 to IFRS 11: (1) transition from proportionate consolidation to equity accounting; (2) transition from equity accounting to accounting for the share of underlying assets/liabilities. In the first event, Mazars (2012) points out that the carrying amount of the assets and liabilities resulting from the application of the proportionate consolidation (including goodwill) should be aggregated on the *equity method investment line* at the beginning of the earliest comparative period. Accordingly, the venturer should disclose a breakdown of all the assets and liabilities that have been aggregated into the single line investment item at the start of the immediately preceding period. Furthermore, an impairment test should be performed according to IAS 28. Thus, in the case of any impairment, it should be recorded directly in subtraction of retained earnings and precisely at the beginning of the earliest period presented. Moreover, the initial recognition exemption of deferred tax liabilities and assets under IAS 12 (paragraphs 15-24) does not apply to the recognition of an investment in a joint venture previously proportionately consolidated. Consequently, any deferred taxes should be recognised for any movements in temporary differences. The Example 3.7.1 taken from Mazars (2012) will help illustrate the transition requirements[157].

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[156] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).
[157] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).

EXAMPLE 3.7.1 – **From Proportionate Consolidation to Equity Method**

The data reported in the table below have been extracted from the consolidation reporting on the date of transition to IFRS 11 and refer to a joint venture recognised using proportionate method.

Goodwill	20
Assets	150
Liabilities	(110)
Share of net assets	**60**

The accounting entries at the date of transition to move from proportionate consolidation to the equity method are as follows:

	Debit	Credit
Equity method investments	**60**	
Liabilities	110	
Goodwill		20
Assets		150

The opening balance of the equity-accounted investment is regarded as a deemed acquisition cost for the investment[158]. Afterwards, the positive value of the investment in the joint venture (i.e. 60) must be tested in accordance with IFRS 9 – *Financial Instruments* (or IAS 39 as applicable) and any impairment calculated following IAS 36 – *Impairment of Assets*[159]. In this connection, PwC (2011) remarks that when there are no impairment issues, the transition adjustments should have a nil net effect on the investor's balance sheet.

Instead, in the event of a negative share of net assets in the joint venture, the carrying value of the investment is set to zero and the negative difference should be allocated to retained earnings at the beginning of the earliest period presented and the investor discloses the unrecognised share of losses. In place of recording an entry in retained earnings, a liability must be recognised only if the venturer has a legal obligation related to the negative net assets recognised[160]. This significant aspect is illustrated below.

Goodwill	20
Assets	120
Liabilities	(150)
Share of net assets	**(10)**

[158] PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
[159] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[160] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).

	Debit	Credit
Equity method investments	**0**	
Liabilities	150	
Goodwill		20
Assets		120
Retained Earnings		**10**

If a venturer accounted for a jointly controlled entity using the equity method under IAS 31 and determines that the joint arrangement is a joint operation, it should account for its individual rights to the assets and obligations for the liabilities of the joint operation. Accordingly, under IFRS 11 the joint operator should derecognise its equity accounted investment and on the basis of the contractual arrangement, it should recognise its share of assets and liabilities, including any goodwill that might have been part of the carrying amount of the investment. If any impairment loss was previously computed under the equity method, this must first be recorded in reduction of goodwill at the beginning of the earliest period presented[161]. Furthermore, any positive difference between the value of the equity accounted investment and that of the net assets resulting from the transition, should be recognised in retained earnings. Instead, in case of negative differences, they are offset against any goodwill with any residual difference adjusted to opening retained earnings. Finally, the initial recognition exemption of IAS 12 – *Income Taxes* does not apply for an investment previously equity-accounted[162]. Consequently, any deferred taxes should be recognised for any movements in temporary differences following the assets and liabilities recognised under IFRS 11. Moreover, the parties to the arrangement transitioning from the equity method to accounting for the rights and obligations must disclose a reconciliation between the investment derecognised and the assets and liabilities accounted for in accordance with relevant IFRSs. Disclosure should be given also to any amount recognised in retained earnings[163]. Example 3.7.2 taken from Mazars (2012) illustrates the transition requirements explained above.

[161] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[162] On transition, the effect of such deferred taxes should be recognised directly in equity. BDO. (2013).
[163] BDO. *Need to know – IFRS 11 Joint Arrangements.* (2013).

EXAMPLE 3.7.2 – **From Equity Method to Line-by-line recognition of assets and liabilities**

The data reported in the table below have been extracted from the consolidation reporting on the date of transition to IFRS 11 and refer to a joint operation recognised using the equity method in accordance with IAS 31.

Equity method investments		**120**
Including:	Goodwill	10
	Assets (share)	150
	Liabilities (share)	(40)

The accounting entries for moving to the line-by-line recognition are reported in the table below:

	Debit	Credit
Goodwill	10	
Assets	150	
Liabilities		40
Equity method investments		**120**

In Example 3.7.2, it has been assumed that the joint operator's share in the assets and liabilities of the joint operation corresponds to its percentage of ownership interest in the joint arrangement. However, in case of any difference between the value of the equity-accounted investment and the joint operator's relative share in the assets and liabilities of the joint operation, the investor should account for it first against goodwill and then in retained earnings[164]. This is shown as follows.

Equity method investments		100
Including:	Goodwill	10
	Assets (share)	150
	Liabilities (share)	(40)
	Depreciation	**(20)**

	Debit	Credit
Goodwill	**0**	
Assets	150	
Liabilities		40
Equity method investments		100
Retained Earnings		**10**

[164] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).

PwC (2011) observes that in the case of a joint operator, previously accounted for using the equity method, generally the most visible effect of the transition is the grossing-up of assets and liabilities on the face of the balance sheet. For example, the assets and liabilities may be higher if the equity investment had been previously impaired[165]. In fact, if there is an impairment the carrying amount of an investment might be lower in value than the net amounts of the shares of assets and liabilities recognised for a joint operation in aggregation. On the contrary, there may be cases in which assets and liabilities may be lower if rights to individual assets are different from the share used for equity accounting (i.e. a joint operator might own 50% of a vehicle but only have rights to 40% of the underlying assets)[166].

As regards transitioning from proportionate consolidation to accounting for individual assets and obligations for liabilities, there is no explicit transition guidance in IFRS 11, hence as indicated by Deloitte (2013) it would be assumed that the standard requirements of retrospective application would apply even in this case with any differences on initial adoption being recognised in retained earnings. Of course, an explanation of the changes occurred should be provided in the disclosure notes[167].

Finally, another important aspect that should be recalled while transition from proportionate consolidation to equity accounting takes place is that, in applying proportionate method, borrowing costs incurred to finance the construction of a qualified asset, should be capitalised in accordance with IAS 23 – *Borrowing Costs*[168]. However, this would not be possible when using the equity method since the net asset is not considered to be a qualified asset. According to IAS 23, a qualifying asset *necessarily takes a substantial period of time to get ready for its intended use or sale*. The standard includes no precise definition of what should be meant with *substantial period of time*, thus management should exercise judgement in assessing which assets are subject to capitalisation of borrowing costs. For example, an asset that normally takes one year or even more to be ready for use would usually be a qualifying asset[169].

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165 PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
166 PwC. *Practical guide to IFRS. Joint arrangements: a new approach to an age-old business issue.* (2011).
167 Deloitte. *Clearly IFRS. Moving ahead in an IFRS world. A practical guide to implementing IFRS 11 – Joint Arrangements.* (2013).
168 Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
169 PwC. *A practical guide to capitalisation of borrowing costs.* (2008).

3.8 The Disclosure Requirements of IFRS 12

In its *Project Summary and Feedback Statement – IFRS 11 Joint Arrangements* (May 2011) the IASB regards IFRS 12 – *Disclosure of Interests in Other Entities* as an opportunity to integrate the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities and to present those requirements in a single IFRS. In face of the criticisms against the elimination of proportionate consolidation, the Board argues that IFRS 12 improves the quality of information provided to users. Indeed, according to the IASB, the new disclosure requirements will help users have a *better understanding of the magnitude and relevance of the activities* that entities undertake through their joint ventures[170]. As expressed in the comment letters to the Exposure Draft (ED 9) some respondents perceived the increase in the disclosure for joint ventures as a mere result of having eliminated proportionate consolidation, which in their opinion provided more relevant operating information directly in the investor's consolidated financial statements. Thus, from their point of view relegating meaningful information only to the notes would render financial statements less relevant and useful for users[171].

In response to this, the IASB argues that it is not true that proportionate consolidation gives more information about investments in joint ventures as it would mix shares of revenues, costs, assets and liabilities that cannot be managed without the consent of the other joint venturers with those individually controlled by the same investor. Since the Board in its *Feedback Statement* (2011) claims that the disclosure requirements would enable users to acquire notions about the net debt position, the profitability and estimation of the operating cash flows of all the venturer's material joint ventures[172], this section will analyse the approach adopted by the IASB to achieve this goal through IFRS 12.

IFRS 12 starts by pointing out its objective, that is for an entity to disclose information which helps users of financial statements to assess: (a) *the nature of, and the risks associated with, its interests in other entities*; (b) *the effects of those interests on its financial position, financial performance and cash-flows*[173]. Ernst & Young (2011) remarks that management should use judgement in meeting the objective of IFRS 12 provided that the IASB leaves parties free to fix the right level of detail to disclose information so that useful information is not obscured by either the inclusion of too many insignificant details or the aggregation of items with different features. Another relevant issue is that the Board requires an entity to disclose any additional information necessary to attain the goal if the requirements by

[170] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[171] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[172] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[173] IFRS Foundation. IFRS Standard 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.

IFRS 12 along with the disclosure of other relevant IFRSs are not sufficient to get the objective[174].

First, IFRS 12 states that an entity should disclose information about significant **judgements** and **assumptions** made to determine whether it has joint control or significant influence over an arrangement and if joint control exists, the type of joint arrangement into which an arrangement structured through a separate legal vehicle is classified to (joint operation or joint venture)[175]. Some examples of significant judgements for which disclosure may be required are: (1) whether a right is merely a protective right (which does not give joint control) or a substantive right giving an entity joint control; (2) whether a manager of an arrangement is acting as principal or as agent. In the first case, it would have control of the arrangement; (3) whether a joint arrangement is a joint operation or a joint venture, provided that its classification does not depend exclusively on the existence of a legal structure as it was under IAS 31[176].

Furthermore, IFRS 12 lists the disclosure to be reported in the case of an interest in a joint arrangement or associate. Specifically, the standard states that an entity should provide information that allows users of its financial statements to assess:

- the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and the effects of its contractual relationship with all other investors having joint control or significant influence;
- the nature of, and changes in, the risks associated with its interests in joint ventures and associates[177].

As far as **the nature of an entity's interest in a joint arrangement** is concerned, for each material joint arrangement (joint venture or joint operation) a party must disclose the following qualitative information:

- Name of the joint arrangement;
- Nature of the entity's relationship with the joint arrangement (i.e. the entity may describe the nature of the activities undertaken by the arrangement and whether they are strategic to the entity's activities);
- Place of business of the joint arrangement (and country of incorporation, if different from the place of business);
- Proportion of ownership interest or participating share held by the entity and, if different, the proportion of voting rights held[178].

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[174] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[175] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[176] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[177] IFRS Foundation. IFRS 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.
[178] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).

Ernst and Young (2011) provides an example of disclosure about the nature of a joint arrangement.

EXAMPLE 3.8.1 – **Nature of joint arrangement**

The Group has a 50% ownership interest in F Limited, a joint arrangement, which is held by its subsidiary, K Limited. Due to the terms of the joint arrangement, and the existence of non-voting investors, the Group has a 60% voting interest in F Limited. F Limited's principal place of operations is Eurasia, but it is incorporated in Delaware in the US. The Group is one of the two partners in this joint arrangement, the purpose of which is to extract gas reserves from fields in Eurasia. F Limited is a supplier of gas in Eurasia and it is strategic to the Group's business, given the similarity in business lines to the Group's operations[179].

With regard to **the extent and financial effects of an entity's interests in joint arrangements classified as joint ventures**, an investor must disclose for each **material** joint venture:

- whether the investment in the joint venture is measured at fair value or in accordance with the equity method (for example in the case of a venture capital organisation);
- summarised financial information, which should report the amounts included in the IFRS financial statements of the joint venture and not the entity's share of those amounts. (An entity may present the summarised financial information required on the basis of the joint venture's financial statements if the entity measures its interest in the joint venture at fair value and if the joint venture does not prepare IFRS financial statements and the eventual preparation would be impracticable and would cause excessive costs). If the joint venturer applies equity method, the amounts included in the IFRS financial statements of the joint venture should be adjusted to reflect the adjustments made by the entity when using equity method (i.e. fair value adjustments at the time of acquisition or adjustments for differences in accounting policies). Furthermore, the joint venturer should provide a reconciliation of the summarised financial information presented with the carrying amount of its interest in the joint venture[180]. In this regard, IFRS 12 does not specify which components should be included in the reconciliation, therefore a joint venturer should disclose components that are meaningful to users of financial statements (e.g. any goodwill or fair value adjustments to the notional purchase price). Accordingly, Ernst and Young (2011) adds that accuracy is necessary in explaining well the elements of the reconciliation, among which any goodwill recognised[181]. In B 12 and B 13, IFRS 12 lists the summarised financial information[182] that should be disclosed for each material joint venture[183]:

[179] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[180] IFRS Foundation. IFRS Standard 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.
[181] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[182] Summarised Financial Information is not required when a joint venture is held for sale in accordance with IFRS 5. Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[183] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).

- **dividends** received from the joint venture;
- **current assets** (including cash and cash equivalents);
- **non-current assets**;
- **current liabilities** (including **current financial liabilities**, excluding trade and other payables and provisions);
- **non-current liabilities** (including **non-current financial liabilities**, but excluding trade and other payables and provisions);
- **revenue**;
- **depreciation and amortisation**;
- **interest income and interest expense**;
- **income tax expense or income**;
- **profit or loss from continuing operations**;
- **post-tax profit or loss from discontinued operations**;
- **other comprehensive income**;
- **total comprehensive income**.

➢ If the joint venture is accounted for using the equity method, the fair value of its investment in the joint venture (if there is a quoted market price for the investment)[184].

As pointed out by Ernst & Young (2011), for entities that used proportionate consolidation under IAS 31, providing summarised financial information may help users to fill the gap about the assets and liabilities held by the venturer in the joint venture. Since, IFRS 12 requires a party to provide this financial information **only on a gross basis** and not with the proportionate share of the joint venturer, there may be instances in which a joint venturer voluntarily discloses such information. Anyway, Ernst & Young (2011) highlights that for supporting users, such information should be clearly disclosed as supplementary to the financial statements along with the relative explanation. Moreover, the same audit firm encourages venturers to provide disclosure of their share of profits and comprehensive income for all individually material joint ventures, although IFRS 12 does not explicitly require it[185].

[184] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[185] Ernst & Young. *Challenges in adopting and applying IFRS 11.* (2011).

Regarding entity's investments in joint ventures that are deemed individually **immaterial**, IFRS 12 requires only the provision of summarised financial information to be presented in aggregate. More precisely, a venturer should disclose:

- the **carrying amount of its interests** in all individually immaterial joint ventures accounted for using the equity method;
- the aggregate amount of its share of those joint ventures':
  - **profit or loss from continuing operations**;
  - **post-tax profit or loss from discontinued operations**;
  - **other comprehensive income**;
  - **total comprehensive income**.

Anyway, an entity must provide these disclosures separately for joint ventures and associates[186].

Consistently with what required under IAS 31, in the notes, an entity should also indicate:

- the nature as well as extent of **any significant restrictions** (e.g. resulting from borrowing arrangements, regulatory requirements or contractual arrangements between investors with joint control) on the ability of joint ventures to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity;
- when the financial statements of a joint venture used in applying the equity method are as of a date or for a period that is different from that of the entity:
  - the date of the end of the reporting period of that joint venture's financial statements;
  - the reason for using a different date or period;
- the share of a joint venture's unrecognised losses for the reporting period and cumulatively, if the entity has stopped recognising its share of losses of the joint venture when applying the equity method[187].

Finally, an entity should disclose all the risks associated with its interests in joint arrangements, and precisely:

- the total commitments not yet recognised at the reporting date that the venturer has relating to its joint ventures, separately from the amount of other commitments (including its share of commitments made jointly with other investors having joint control). Commitments are those that may give rise to a future outflow of cash or other resources, and they include:

- unrecognised commitments to contribute funding or resources following for example[188]:

- the constitution or the acquisition agreements of a joint venture (for example requiring an

[186] IFRS Foundation. IFRS Standard 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.
[187] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[188] IFRS Foundation. IFRS Standard 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.

entity to contribute funds over a specific period);

- capital-intensive projects undertaken by a joint venture;
- unconditional purchase obligations, comprising procurement of equipment, inventory or services which an investor is committed to purchase from a joint venture or on behalf of it;
- unrecognised commitments to provide loans or financial support to a joint venture;
- unrecognised commitments to contribute resources to a joint venture, such as assets or services;
- other non-cancellable unrecognised commitments relating to a joint venture.

- unrecognised commitments to acquire another party's ownership interest (or a portion of it) in a joint venture if a specific event occurs or does not occur in the future[189].

Furthermore, given the importance of knowing the venturer's liabilities relating to its involvement in any joint venture, IFRS 12 requires disclosing any contingent liability regarding interests in joint ventures, separately from the amount of other contingent liabilities. Precisely, information should be provided in accordance with IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*, which requests an estimate of the contingent liability, an indication of the uncertainties about the amount or timing of any outflow and the possibility of any reimbursement[190].

All in all, disclosing information requires judgement by parties to a joint arrangement. In the light of their circumstances, parties should identify the level of detail to meet the information needs of users, how much emphasis to give on different aspects of the requirements and how to aggregate information. Indeed, IFRS 12 highlights the need to find a balance between burdening financial statements with excessive details and hiding relevant issues. Accordingly, IFRS 12 states that an entity might aggregate the disclosures required in the case of interests held in similar entities. For instance, an entity might aggregate all pieces of information relating to joint operations separately from those of joint ventures and associates. Moreover, IFRS 12 lists three examples of aggregation levels within classes of entities: the nature of the activities, the industry classification and geography (e.g. country or region). Despite the degree of discretion given by the Board to entities concerning whether to aggregate information or not, parties to a joint arrangement shall always keep in mind the ultimate objective of providing disclosure: clearly explaining to financial statements users the nature and the extent of their interests in other entities[191].

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[189] Mazars. *IFRS 11, Joint Arrangements – Key points of the new standard in 30 Q&A.* (2012).
[190] Ernst & Young. *Challenges in adopting and applying IFRS 11*. (2011).
[191] IFRS Foundation. IFRS Standard 12 – *Disclosure of Interests in Other Entities.* (2011). www.ifrs.org.

The following table helps summarise the disclosure requirements mentioned so far for joint operations and joint ventures.

TABLE 3.8.1 – **DISCLOSURE REQUIREMENTS**

Nature of disclosure	**Disclosures for joint operations AND joint ventures**	**Additional disclosures required for joint ventures only**
Nature, extent and financial effects of an entity's interests in joint arrangements	• Name. • Nature of relationship with the joint arrangement (how the activities of the joint arrangement relate to those of the reporting entity). • Principal place of business and country of incorporation. • Percentage ownership interest (or participating share rights) and percentage of voting rights held.	• Measurement basis: equity method or fair value. If equity method is applied, the fair value must also be disclosed if a quoted market price exists. • Summarised financial information.
Risks associated with an entity's interests in joint ventures	• No additional disclosures for joint operations (since the entity accounts for its share of the assets and liabilities in accordance with the applicable IFRSs, information of this nature would already be addressed).	• Separate disclosure of commitments related to joint ventures. • Separate disclosure of contingent liabilities related to joint ventures.

Source: Deloitte. *A practical guide to implementing IFRS 11 – Joint Arrangements.* (2013)

CHAPTER 4.

POTENTIAL EFFECTS AND IMPLICATIONS FOLLOWING THE INTRODUCTION OF IFRS 11: FROM PROPORTIONATE CONSOLIDATION TO EQUITY METHOD

4.1 The Effect Analysis of the IASB and the related criticisms

In July 2011, two months after the release of IFRS 11, the IASB published its *Effect Analysis*. As described in the IFRS Foundation's *Due Process Handbook*, the effect analysis is a mandatory step in the IASB's due process, with which the Board assesses the potential effects and costs financial statements preparers and users would face following the introduction of a revised standard[1]. To establish the boundaries of the possible consequences, the IASB examined the joint venture activity across the period 1990-2010 using data from a research paper of Sviatoslav Moskalev and Bruce Swensen[2] and from the Thomson Financial SDC Platinum Alliances/Joint Ventures database[3]. In this regard, Saccon et al. (2012) argue that the perimeter chosen by the Board to perform its analysis is quite questionable given that in a footnote to the joint venture activity overview, the Board warns readers that the population of joint ventures referred to in the joint venture overview section may not necessarily refer to arrangements falling within the scope of IFRS 11. Accordingly, it remarks that *as a result, the reader needs to consider that the population that IFRS 11 will potentially affect is likely to be smaller than the population referred to in this section*[4]. The total number of joint venture transactions over the period 1990-2010 having been reported is 86,135, of which 37.10% in the US, 7.05% in China and the remaining 55.85% spread worldwide. Once again, Saccon et al. (2012) highlight that in this case, it would have been interesting to know even the size of the joint ventures with their relative assets and liabilities and not just the mere number[5].

[1] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. *An ex-ante analysis of change in reporting methods: the example of Joint Ventures.* Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).
[2] Sviatoslav, A. Moskalev, Swensen, R. Bruce, *Joint Ventures around the globe from 1990-2000: forms, types, industries, countries and ownership patterns.* Review of Financial Economics 16. (2007).
[3] The database scope consists of all worldwide joint ventures transactions from filings with the SEC and its counterparts in other jurisdictions. IFRS Foundation. *Effect Analysis.* (2011).
[4] IFRS Foundation. *Effect Analysis.* (2011).
[5] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. *La consolidation des co-entreprises en IFRS: étude de l'impact du changement de méthodes pour les sociétés européennes. Reporting methods for Joint Ventures: which consequences for European listed companies?* 33ème Congrès de l'AFC. (2012).

Business Services, Software and Wholesale trade are shown as the industries with the highest concentration of joint ventures, respectively 20.45%, 7.80% and 6.78%, while Mining, Oil & Gas and Real Estate represent respectively 2.67%, 2.51% and 2.07%. To conclude the brief summary of the data upon which the IASB based its Effect Analysis, 63.4% of the joint ventures identified are strategic alliances, not entailing the creation of an independent business entity, while 36.6% are independent firms, resulting to be more frequent only in countries such as China, India, Malaysia and Russian Federation and in the Real Estate and Oil & Gas industries[6].

Demerens et al. (2014) along with Saccon et al. (2012) judge the IASB's analysis of financial statements effects as limited and quite incomplete. A first criticism refers to the data used to show the accounting choices by different jurisdictions as well as industries. The two graphs detailing the accounting method by country and industry, which are also reported below, are based on a rather small sample of 144 companies (of which more than 80% are registered in Europe, while the main others in Hong Kong and South Africa)[7]. More precisely, data have been retrieved from a survey by KPMG[8] on the first IFRS consolidated financial statements for annual periods ending on or before 31 December 2005 and the main arguments supporting the difference in accounting choices refer to the influence coming from a company's country of domicile and its previous accounting standards[9]. Furthermore, the IASB took for granted the value relevance of the ratio from KPMG, expressing the use of proportionate consolidation versus equity method, being exactly 50:50[10].

Accordingly, in order to measure the effects of the IFRS 11, the IASB assumed first that the population of joint venture transactions (with approximately 37% of independent firms) was equal to the population of arrangements within the scope of IAS 31, and second that half of the jointly controlled entities were proportionately consolidated. As a result, this reasoning meant that only 37% of all joint arrangements in IAS 31 were jointly controlled entities, half of which adopted the proportionate consolidation[11]. Consequently, the IASB believed that almost 19% of those jointly controlled entities would have been required to change their accounting treatment from PC to EM. In this regard, Demerens et al. (2014) along with Saccon et al. (2012) show disagreement. Indeed, they think that it would have been more reasonable to consider larger national databases where to run an analysis by country. The following figures represent the choice between equity method and proportionate consolidation by country and industry, as shown in the IASB's Effect Analysis.

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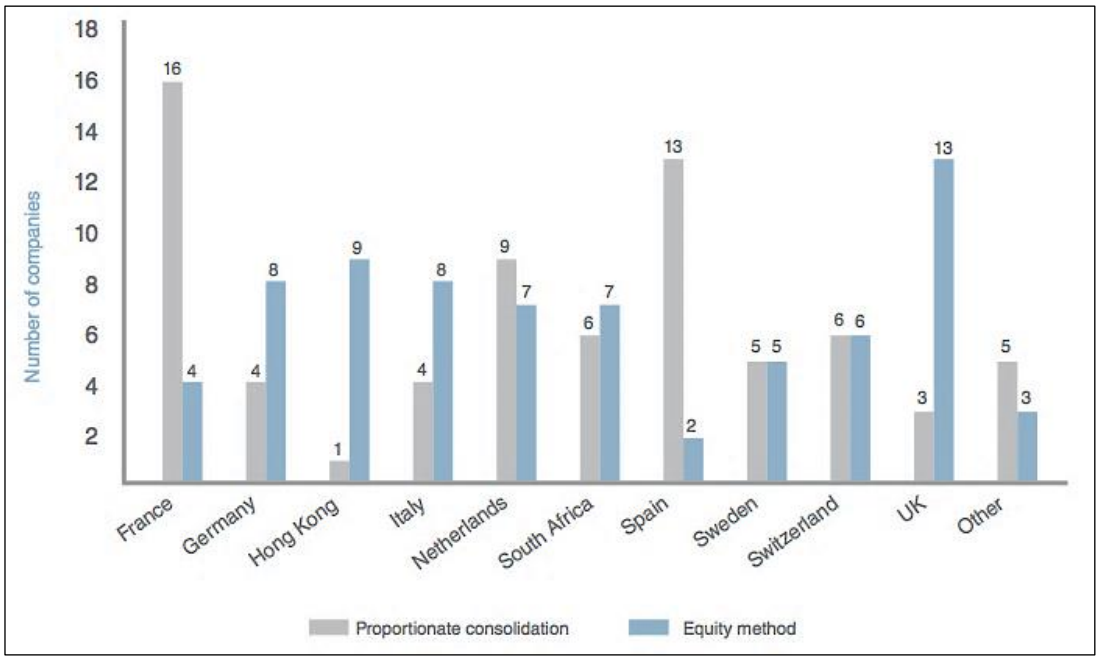
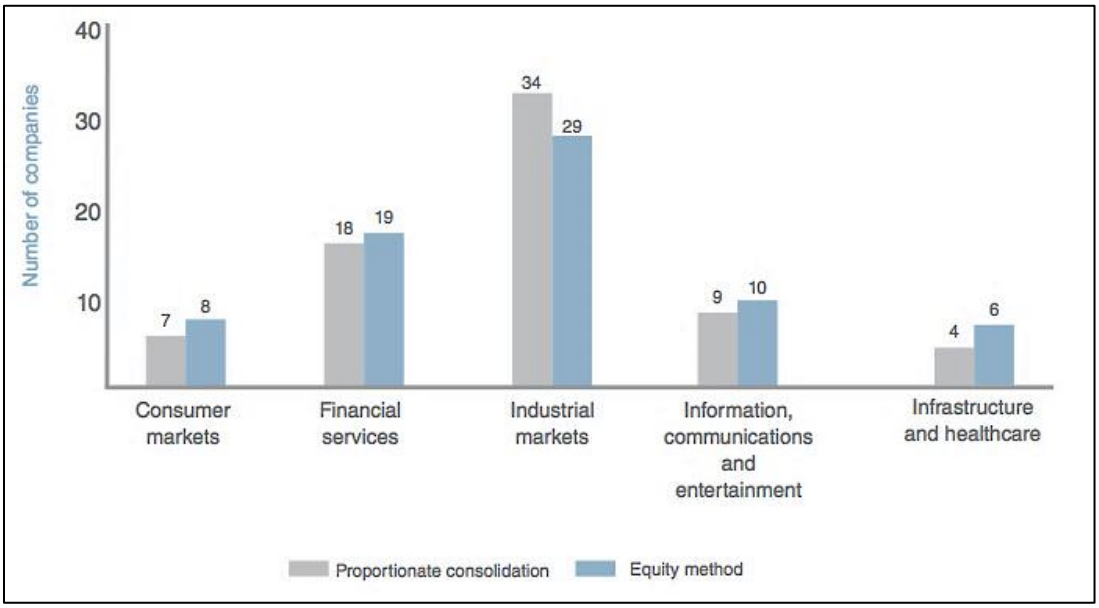
[6] IFRS Foundation. *Effect Analysis*. (2011).
[7] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).
[8] KPMG, Co-author Prof. Dr. Von Keitz, I. *The Application of IFRS. Choices in Practice*. (2006).
[9] IFRS Foundation. *Effect Analysis*. (2011).
[10] KPMG, Co-author Prof. Dr. Von Keitz, I. *The Application of IFRS. Choices in Practice*. (2006).
[11] IFRS Foundation. *Effect Analysis*. (2011).

FIGURE 4.1.1 – **ACCOUNTING METHOD BY COUNTRY**



Source: IFRS Foundation. *Effect Analysis.* (2011)

FIGURE 4.1.2 – **ACCOUNTING METHOD BY INDUSTRY**



Source: IFRS Foundation. *Effect Analysis.* (2011)

The Board expected that the arrangements most affected by IFRS 11 would have been those previously proportionately consolidated which had to switch to the equity method. The two tables presented below list the significant changes in financial statements and on return on capital and its components that might occur following the introduction of IFRS 11, as shown in the IASB's Effect Analysis[12].

TABLE 4.1.1 – **EFFECTS ON FINANCIAL STATEMENTS OF ENTITIES CHANGING FROM PC TO EM**

Financial Statements	Effects due to the accounting change
Statement of financial position	• Reported figures will decline to the extent of the entity's previously recognised share in the individual assets and liabilities of the joint venture, thus total assets and total liabilities will decline. • The investment in the joint venture will be captured in a single line item.
Statement of comprehensive income	• Reported figures will decline to the extent of the entity's previously recognised share in revenue and expenses of the joint venture, thus total revenue and total expenses will decrease. • **No changes in net income**.
Statement of changes in equity	• **No changes in the statement of changes in equity**.
Statement of cash flows	• Reported operating, investing and financing cash flow figures will decline to the extent of the entity's previously recognised share in the cash flows of the joint venture. • Dividends received from joint ventures will be presented as cash flows.

Source: IFRS Foundation. *Effect Analysis.* (2011)

TABLE 4.1.2 – **EFFECTS OF THE ACCOUNTING CHANGE ON RETURN ON CAPITAL AND ITS COMPONENTS**

Ratios	Effects due to the accounting change
Return on capital (Net income/Shareholders' Equity)	• The accounting change will not affect this ratio.
Profitability (Net income/Revenue)	• The removal of the proportionate share of revenue will cause profitability to increase.
Total assets turnover (Revenue/Assets)	• The accounting change will cause reported revenue and total assets to be smaller. The final effect on this ratio will depend upon the absolute and relative changes of revenue and assets.
Financial Leverage (Net debt/Capital employed, Debt/Shareholders' Equity)	• The removal of the entity's proportionate share of debt will cause the leverage ratio to be smaller.

Source: IFRS Foundation. *Effect Analysis.* (2011)

[12] IFRS Foundation. *Effect Analysis.* (2011).

The unique empirical analysis presented by the IASB is based on a sample of 19 firms either European or non-European that commented on the Exposure Draft ED 9 and used proportionate consolidation for reporting their jointly controlled entities. These firms belong to a limited number of industries, specifically 3 to the Banking industry, 11 to the Energy industry, 2 to the Engineering industry, 2 to the Food & Beverages industry and 1 to the Telecommunications industry. On the basis of this sample, the Effect Analysis details the change from proportionate consolidation to the equity method for three financial indicators: assets, revenues and profitability ratio[13]. Conversely, effects on liabilities, expenses and other components of the ROE ratio are just mentioned but not disclosed. As visible from Table 4.1.3, the Energy industry seems to be the one to have the highest ratios in terms of assets and revenues coming from the JCEs compared to total consolidated assets and revenues. Instead, the Telecommunications industry appears to be the one most favoured by the increase in the profitability ratio (980 basis point, approximately 9.80% increase).

TABLE 4.1.3 – **THE EFFECT ANALYSIS OF THE IASB**

Table VIII: Effects of IFRS 11 on a sample of respondents to ED 9 *Joint Arrangements*

Industry	Number of respondents to ED 9	Respondents that use proportionate consolidation	Jointly controlled entities' assets/consolidated assets			Jointly controlled entities' revenues/consolidated revenues			Profitability increase as an eliminating proportionate consolidation (basis points)*		
			Min	Median	Max	Min	Median	Max	Min	Median	Max
Banking**	9	3		3.9%			14.3%			98	
Energy	14	11	2.0%	10.9%	26.3%	2.8%	15.8%	35.5%	50	190	400
Telecommunications	3	1		13.7%			28.1%			980	
Industrial engineering	2	2	8.6%	9.1%	9.6%	7.6%	11.6%	15.5%	30	39	50
Food and beverages	2	2	1.7%	2.0%	2.3%	2.6%	2.9%	3.1%	20	56	90
Total	30	19									

Source: IFRS Foundation. *Effect Analysis.* (2011)

Saccon et al. (2012) question the results coming from the IASB's empirical analysis and affirm that they are not reliable since the sample used is not homogeneous; for instance, the results of 11 firms belonging to one specific industry are compared with only 1, 2 or 3 firms of other industries. What is more, Demerens et al. (2014) point out that the weaknesses in the IASB's analysis are also proved by what the Board affirms in a caveat to its Financial Statement Effects Analysis[14]:

> *This analysis focuses on the financial statements of those entities that commented on the proposals. Entities are more likely to have responded if they believe that their financial reporting will be affected and, therefore, the data displayed in Table VIII is* ***not representative*** *of all entities. Additionally, this analysis assumes that all proportionate consolidated jointly controlled entities will be 'joint ventures' in accordance with IFRS 11. As a result, this analysis is likely to significantly* ***overstate the average effect of IFRS 11****.*

[13] Profitability is measured by the basis points increase in the net income to revenues ratio. IFRS Foundation. *Effect Analysis.* (2011). 1 bp=0.0001.
[14] IFRS Foundation. *Effect Analysis.* (2011).

To overcome the weaknesses of the IASB's Effect Analysis, Saccon et al. (2012) as well as Demerens et al. (2014) undertake an empirical study on a larger sample of European companies in order to obtain more convincing results on the effects coming from a transition from proportionate consolidation to the equity method. Firms were extracted from the four major European indexes for market capitalisation: CAC 40 (French Index), DAX 30 (German Index), FTSE 100 (British Index, the study was limited to the first 50 FTSE capitalisation) and IBEX 35 (Spanish Index). The initial sample was composed of 155 companies, of which 24 had no joint venture, 67 were using the equity method and 64 the proportionate consolidation.

Demerens et al. (2014) and Saccon et al. (2012) focus only on those companies using proportionate consolidation in 2008 and 2009. However, of the 64 companies, only 35 firms were included in the final sample since they disclosed enough financial details concerning joint ventures to create pro-forma equity method financial statements. The sample distribution is visible from Table 4.1.4[15].

TABLE 4.1.4 – **SAMPLE DISTRIBUTION**

Joint Venture Accounting								
		No joint venture or No joint venture information	**Equity Method**	**Proportionate Consolidation**				
				Total	No joint venture Information	Final Sample	%	Total
INDEX	CAC40	2	9	29	17	12	34%	40
	DAX30	7	20	3	0	3	9%	30
	FTSE100	9	29	12	2	10	29%	50 (only first 50 firms)
	IBEX35	6	9	20	10	10	29%	35
Total		**24**	**67**	**64**	**29**	**35**	**100%**	**155**

Source: Saccon et al. (2012)

Saccon et al. (2012) along with Demerens et al. (2014) find that most of the joint ventures provide revenues and profits to their venturers. Indeed, on average, joint ventures revenues count for about 10.85% of the venturer's total revenues while joint ventures profit amounts on average to 22.42%

[15] The final sample is composed of 35 European firms using proportionate consolidation and observed for fiscal years 2008-2009 with in total 70 observations. Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014). Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).

compared to the venturer's total net income (medians being equal respectively to 5.62% and 7.02%) with most of the joint ventures (95.7%) reporting positive earnings[16].

As expected, the conversion from proportionate consolidation to the equity method reduces assets and liabilities, on average respectively -6.19% and -8.46% (specifically, companies from DAX 30 and FTSE 100 are less impacted than firms within CAC 40 and IBEX 35). The transition affects obviously the working capital of venturers. As affirmed by Demerens et al. (2014), differences in current assets and current liabilities are great, respectively -9.69% and -10.43% on average. Besides, despite net income is the same using both methods, revenues and expenses are impacted as well. On average revenues are reduced by 10.85% whereas the latter by 10.25% (the English and German Indexes are once again the less affected).

Finally, Demerens et al. (2014) report the results obtained in the computations of the ROE components as from the Du Pont Model (Profit Margin * Total Assets Turnover * Leverage ratio) and find that on average the conversion from PC to EM generates an increase of 1.67% in profit margin. Indeed, on average the profit margin ratio of the venturers increases from 10.99% to 12. 66% (from a median of 7.05% to 9.04%). Even the total assets turnover and the leverage ratio are impacted, even if not that much (on average they decrease)[17].

Table 4.1.5 shows differences in the values of the median between the results of the IASB's Effect Analysis and the outcomes of the Demerens et al. (2014) and Saccon et al. (2012) ex ante research. It displays that, unlike what affirmed by the IASB in a caveat to its Financial Statement Effects Analysis, the Board's results **do not overstate** the average effects of IFRS 11[18].

[16] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014). Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).

[17] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).

[18] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).

TABLE 4.1.5 – **MEDIAN DIFFERENCES BETWEEN IASB'S EFFECT ANALYSIS AND SACCON ET AL./DEMERENS ET AL. RESEARCH**

Medians	Assets (impact -)	Liabilities (impact -)	Revenue (impact -)	Profit Margin (impact +)
IASB	From -2% to -13.70%	-	From -2.90% to -28.10%	From +0.39 to +9.80 (points)
Demerens et al. (2014) & Saccon et al. (2012)	-2.50%	-4.10%	-5.62%	+1.99 (points)

Source: Demerens et al. (2014)

Demerens et al. (2014) along with Saccon et al. (2012) state that their results supplement the IASB's Effect Analysis with a larger sample and a higher number of indicators and that overall the effects coming from the transition are not insignificant as the structure of the balance sheet and income statement would change for many venturers. In this regard, Saccon et al. (2012) argue that overtime firms' management might be able to restructure their joint arrangements moving from one type to the other one, just to change accounting method[19]. Another extremely significant point remarked by Demerens et al. (2014) is that the IASB should deeply question about the numerous traps related to an ex ante effect analysis, mainly due to the lack of data available. This should lead the Board to strengthen its relationship with academicians, firms and stakeholders in general[20], as **joining efforts would permit to improve the standard setting due-process**.

There is another study worthy of mention contributing to investigate the impact on financial figures as well as ratios following the introduction of IFRS 11. It is the empirical research run by Leitner-Hanetseder and Stockinger (2014). Their cross-sectional study tries to quantify the impacts in practice using data of 350 European companies from different indexes, industries and countries in EU. More precisely, the analysis examines the effects on total assets, liabilities, sales, EBIT and the implications on components of the ROE as expressed by the Du Pont Model. Unlike, Saccon et al. (2012) and Demerens et al. (2014), Leitner-Hanetseder and Stockinger (2014) show the impact on profit margin computed as either Earnings after tax/Sales or EBIT/Sales[21].

[19] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. 33ème Congrès de l'AFC. (2012).
[20] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).
[21] Leitner – Hanetseder, S., Stockinger, M. *How does the elimination of the proportionate consolidation method for joint venture investments influence European companies?* ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).

2010 Annual Reports were analysed, and pro-forma equity financial statements were created thanks to companies' disclosures in the footnotes. Table 4.1.6 shows the sample selection and the final composition of the sample, while Table 4.1.7 displays the relevance in the choice between PC and EM by index and Table 4.1.8 presents the choice by industry. Results indicate that the EM is preferred within single indexes apart from Euronext 100 index (maybe because in France PC was mandatory before IFRS adoption). Furthermore, results indicate that more than half of the sampled firms in the basic materials, industrials, and finance industries prefer PC for accounting for JVs. As highlighted by Leitner-Hanetseder and Stockinger (2014), at least 40% of companies forming the final sample (227 out of which 100 used PC method) would have been concerned with the impacts of the change[22].

TABLE 4.1.6 – **SAMPLE SELECTION BY INDEX**

INDEX	STOCK EXCHANGE	COUNTRY	N	%
ATX Prime	Austrian Stock Exchange	Austria	40	11.43%
DAX	German Stock Exchange	Germany	30	8.57%
MDAX	German Stock Exchange	Germany	50	14.29%
TecDAX	German Stock Exchange	Germany	30	8.57%
FTSE 100	London Stock Exchange	United Kingdom	100	28.57%
Euronext 100	NYSE Euronext (it includes companies from the Netherlands, Belgium, Portugal and Luxembourg)	France	100	28.57%
Total Initial Sample			**350**	**100%**
Total Final Sample	• 1 company from FTSE 100 did not provide the annual report; • 6 firms did not follow IFRS; • 97 firms without JVs; • 2 firms used Fair Value; • 17 firms provided no information on the accounting method.		**227**	

Source: Leitner-Hanetseder and Stockinger. (2014)

[22] Leitner – Hanetseder, S., Stockinger, M. ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).

TABLE 4.1.7 – **RELEVANCE OF ACCOUNTING METHODS BY INDEX**

INDEX	ACCOUNTING METHOD				TOTAL	
	EQUITY METHOD		PROPORTIONATE CONSOLIDATION			
	N	%	N	%	N	%
ATX Prime	11	52.38%	10	47.62%	21	100%
DAX	18	81.82%	4	18.18%	22	100%
MDAX	18	56.25%	14	43.75%	32	100%
TecDAX	6	75.00%	2	25.00%	8	100%
FTSE 100	46	69.70%	18	27.27%	64	100%
Euronext 100	28	35.00%	52	65.00%	80	100%
TOTAL	**127**	**55.95%**	**100**	**44.05%**	**227**	**100%**

Source: Leitner-Hanetseder and Stockinger. (2014)

TABLE 4.1.8 – **RELEVANCE OF ACCOUNTING METHODS BY INDUSTRY**

INDUSTRY	ACCOUNTING METHOD				TOTAL	
	EQUITY METHOD		PROPORTIONATE CONSOLIDATION			
	N	%	N	%	N	%
Oil & Gas	11	78.57%	3	21.43%	14	100%
Basic Materials	12	42.86%	16	57.14%	28	100%
Industrials	23	48.94%	24	51.06%	47	100%
Consumer Goods	17	58.62%	12	41.38%	29	100%
Health Care	5	71.43%	2	28.57%	7	100%
Consumer Services	24	75.00%	8	25.00%	32	100%
Telecommunications	5	71.43%	2	28.57%	7	100%
Utilities	7	50.00%	7	50.00%	14	100%
Finance	19	42.22%	24	53.33%	43	100%
Technology	4	66.67%	2	33.33%	6	100%
TOTAL	**127**	**55.95%**	**100**	**44.05%**	**227**	**100%**

Source: Leitner-Hanetseder and Stockinger. (2014)

Findings confirm that transitioning from PC to EM affect total assets (Mean -3.17, Median -1.70), total liabilities (Mean -5.75, Median -3.13), total sales (Mean -7.87, Median -4.43) and EBIT (Mean -16.51, Median -2.75). According to Leitner-Hanetseder and Stockinger (2014), the changes are material (on average the impact is higher than 5%) apart from the effects on total assets as on average the impact is lower than 5%. As regards the effects on single industries, results show that the oil & gas, utilities, finance, basic materials and consumer services sectors are the most materially affected by a reduction in total liabilities. Instead, utilities and telecommunications industries are those on average most affected by a change in total sales with a decrease of -18.48% and -17.75% respectively. Regarding EBIT, which might be seen as a rough proxy for operating cash flows, the authors specify that in the sample examined, one company (Salzgitter AG) experienced an increase by 15.38% when switching to EM, because its joint venture negative EBIT was not proportionally consolidated. Overall, however, in eight out of ten of the sampled industries the reduction on the EBIT has been considerable (oil & gas, industrials, consumer goods, technology, finance, utilities, telecommunications and consumer services)[23].

As for the impacts on key financial ratios, authors find that moving from PC to EM causes a change in the profit margin computed with both formulations (profit margin with EBIT: Mean +1.16, profit margin with Net income: Mean +2.84), in the asset turnover ratio[24] (Mean -2.05), in the leverage ratio (Mean -13.62, Median -4.47) and in the ROE expressed as EBIT/Shareholders' Equity (Mean -1.90, Median -0.88). Indeed, the highest impact occurred from the change is visible in financial leverage. In fact, on the basis of 2010 data, there are material effects in six out of ten industries (oil & gas, industrials, consumer services, utilities, finance and technology). Conversely, changes occurred in the other ratios do not seem material for any industry, apart from profit margin whose increase is materially significant only for the finance industry[25].

Net income after tax and equity should remain the same under both PC and EM, hence ROE expressed as Net income/Shareholders' Equity should also be the same. As previously mentioned, results prove that the difference between ROE (EBIT/Shareholders' Equity) under PC and that under EM is low. Following Leitner-Hanetseder and Stockinger (2014), ROE (EBIT/Shareholders' Equity) under the equity method decreases (increases) if the joint venture shows an operating profit (loss). Accordingly, the difference between ROE (EBIT/Shareholders' Equity) under PC and EM would be negative (positive) if the joint venture accounts for an operating profit (loss) in financial

[23] Leitner – Hanetseder, S., Stockinger, M. ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).
[24] Asset turnover ratio (Sales/Assets) decreases if the total sales of joint venture investments are higher than the decrease in total assets caused by the conversion and vice versa. Leitner – Hanetseder, S., Stockinger, M. (2014).
[25] Leitner – Hanetseder, S., Stockinger, M. ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).

statements under PC. Even if on average the decrease in ROE (EBIT/Shareholders' Equity) is not material, authors find significant effects on single firms, such as Warimpex Finanz-und Beteiligungs AG, where ROE (EBIT/Shareholders' Equity) under EM decreases by -11%. Of the same firm, it is astonishing the reduction in financial leverage (-272.72%)[26]. All in all, results prove that actually the transition from PC to EM may highly impact single firms and that however, not all industries are affected in the same way.

So far, it is clear that using both PC and EM leads to the same final outcome in terms of net income and shareholders' equity, however, what changes in consolidated financial statements is the different level of information provided to third users. Indeed, some respondents to the Exposure Draft, ED 9, argued that the elimination of proportionate consolidation would represent a loss of meaningful information for users of financial statements. The IASB believes that the elimination of proportionate consolidation would not cause a loss of information for users and that considering PC as able to provide more information for investments in joint venture is misleading and that the new disclosure requirements would help users to gain a better understanding of the magnitude and relevance of the activities that entities undertake thanks to their joint ventures[27].

As disclosure requirements in IFRS 12 should ensure that the elimination of PC would not cause a loss of information, Asenbrenerovà (2016) investigates whether venturers really disclose all requirements of IFRS 12, especially the summarised financial information for each material joint venture. Financial statements users might have access to all the relevant financial information about a venturer's investments in joint ventures only if the venturer discloses all the required information in the footnotes. According to IFRS 12, summarised financial information should be presented on 100 % basis and separately for each single material JV, otherwise aggregating financial information when a venturer holds different percentages of ownership in its joint ventures would not result in useful information[28]. Firms should not even aggregate JVs' disclosures with those of associates, so that information would not be confusing.

The research of Asenbrenerovà (2016) concentrates on companies listed on the Prague Stock Exchange and on their 2014 Financial Statements. The sample analysed included 9 firms (the initial sample included 83 firms, of which 73 had no joint control and 1 had a JV which was not material). As stated by Asenbrenerovà (2016) the biggest lack of information is in the category of summarised financial information, which is also the most significant for third users. Neither any risk associated

[26] Leitner – Hanetseder, S., Stockinger, M. ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).
[27] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[28] Asenbrenerovà, P. *Disclosure of Joint Ventures and Associates in Financial Statement under IFRS*. European Financial and Accounting Journal. Vol. 11, No. 3, 85-94. (2016).

with investments in joint ventures is disclosed, preventing financial analysts to properly assess the overall performances of entities having joint control over other entities.

Table 4.1.9 shows that more than half of the venturers did not provide information in accordance with IFRS 12. Only 2 of the 9 venturers disclosed all summarised information about joint ventures, whereas in the most of cases, venturers disclosed only total assets, total liabilities, expenses, revenue and profit[29].

TABLE 4.1.9 – **SUMMARISED FINANCIAL INFORMATION ABOUT MATERIAL JOINT VENTURES**

An investor should disclose for each material Joint Venture	Joint Ventures
Current assets	2/9
Cash and cash equivalents included in current assets	3/9
Non-current assets	2/9
Current liabilities	2/9
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	2/9
Non-current liabilities	2/9
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	2/9
Revenue	9/9
Profit or loss from continuing operations	7/9
Post-tax profit or loss from discontinued operations	n/a
Other comprehensive income	3/9
Total comprehensive income	3/9
Dividends received from Joint Ventures	3/9
Depreciation and amortisation	3/9
Interest income	3/9
Interest expense	3/9
Income tax expense or income	3/9

Source: Asenbrenerovà. (2016)

[29] Asenbrenerovà, P. European Financial and Accounting Journal. Vol. 11, No. 3, 85-94. (2016).

Certainly, this research has some weaknesses resulting from the restricted consideration of the Czech Republic market, the small sample of investigated companies and the analysis of only 2014 data, however, what emerges from this study is that financial statements preparers seem not motivated in providing detailed information. Accordingly, probably the IASB should not take for granted the fact that with IFRS 12 users would gain better financial disclosures about material JVs' net debt positon, profitability and operating cash flows and that with the elimination of PC method there would be no loss of precious information.

4.2 Literature Review

As already mentioned, accounting for joint ventures is a critical issue that has been debated for decades by academicians. As stated by Richardson et al. (2012) the key point in these debates is whether the co-venturer can really control the jointly controlled assets and accordingly whether the co-venturer is ultimately responsible for the joint liabilities[30]. Demerens et al. (2014) identify three main categories of papers about reporting methods for joint ventures: **theoretical papers**, **ex-post** or value relevance **studies** and **ex-ante studies**. The first category refers to papers that discuss different accounting solutions and might support one of them without including empirical studies; the second category, instead, intend to prove the value relevance of some disclosures on joint ventures activities or to identify the more value relevant reporting method for joint ventures. For this purpose, they use only accounting data published by firms in their annual report and they generally obtain different results. Finally, the third category seeks to compare the value-relevance for users of equity method versus proportionate consolidation. Consequently, these studies are not aimed to analyse the actual effects of a new standard, but they use pro-forma data simulating either the use of the one-line consolidation or the use of proportionate consolidation, but as for ex-post researches, findings may diverge[31].

Despite since the 90s academicians worldwide have been endeavoring in studying accounting for joint ventures, in literature there is lack of consent on the more appropriate reporting method. In this section, a brief literature review is exhibited. It is interesting to highlight that of the fifteen studies mentioned, none shows an overwhelming superiority of the EM over PC. In fact, using the identification proposed by Demerens et al. (2014) where **EM**=equity method is a better reporting method for joint ventures than proportionate consolidation; **PC**=proportionate consolidation is a better reporting method for joint ventures than equity method and last **NC**=do not conclude to

[30] Richardson, W., Roubi, R., Soonawalla, K. *Decline in Financial Reporting for Joint Ventures? Canadian Evidence on Removal of Financial Reporting Choice.* European Accounting Review. Vol. 21, No. 2, 373-393. (2012).
[31] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).

the superiority of one reporting method for JVs over another one[32], 8 studies over 15 are classified as NC, while the remaining as PC. As a result, it seems that academic investigations do not support the final IASB decision to eliminate proportionate consolidation. Only Kothavala (2003) concludes that the equity method reveals to be more risk relevant in explaining bond ratings than PC. Instead, Bauman (2007) shows that it is PC to have a greater relevance than EM in explaining bond ratings. As acknowledged by Bauman (2007), such diverging findings might be due by the different sample composition[33]. Anyway, what is of interest is that there exist heterogeneous views and conclusions on the same matter and despite this the IASB has "solved" decades of debates by simply removing one of the two accounting options without providing even coherent justifications (the project for revising the equity method and the suitability of its application has been once again postponed after the publication of the IASB's *Post Implementation Review of IFRS 11*, probably due at the end of the first quarter 2018)[34].

It is worth considering one last literature example confirming the absence of a unanimous viewpoint. From the one side, Catuogno and Allini (2011) show that having multiple choices, such as the accounting option in IAS 31, considerably affects the level of comparability among different European countries as well as within the same country[35]. On the other side, Richardson et al. (2012) find that the reduction in accounting options like the one occurred with IFRS 11 causes a decrease in the value relevance of financial statements amounts for those firms required to switch to another accounting method and disclosure in footnotes of joint ventures information may offset the costs of removing accounting choices[36].

In respect of such a wide academic research activity, Demerens et al. (2014) recall the words of Barth (2007) stating:

Research can aid standard setters in identifying issues, structuring their thinking about a particular issue, and providing evidence that informs the debate about the issue [37]***.***

Indeed, it is time for the IASB to recognise the due value to academicians in its due-process. A first step may be that to include them in its upcoming revision project of the equity method; their contribution may help the Board to identify potential problems related to this accounting method.

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[32] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).
[33] Bauman, M. *Proportionate consolidation versus the equity method: Additional evidence on the association with bond ratings.* International Review of Financial analysis. Vol. 16, 496-507. (2007).
[34] IFRS Foundation. *The IASB tentatively decides to defer work on the equity method research project.* (2016). www.ifrs.org.
[35] Catuogno, S., Allini, A. *Multiple evaluation options & comparability: equity investments in Italy and Spain.* Accounting and Management Information Systems. Vol. 10, No. 2, 249-274. (2011).
[36] Richardson, W., Roubi, R., Soonawalla, K. *Decline in Financial Reporting for Joint Ventures? Canadian Evidence on Removal of Financial Reporting Choice.* European Accounting Review. Vol. 21, No. 2, 373-393. (2012).
[37] Demerens, F., Le Manh, A., Delvaille, P., Paré, J. Association de recherches et publications en management Gestion 2000. 4 (31), 65-89. (2014).

Literature Review

❖ Bierman (1992) – PC – Normative Paper

Proportionate Consolidation and Financial Analysis

Bierman argues that proportionate consolidation is the only consolidation method reporting the amount of debt directly related to the common stock investments owned. The author states that without proportionate consolidation, there would be an understatement of debt on the investor's consolidated balance sheet when the investor owns 50 percent or less of the investee's common stock. Thus, the primary benefit of proportionate consolidation is that it eliminates an arbitrary boundary between investments consolidated and those that are not.
What is more, the study suggests that the equity method fails to portray liabilities of the investees and may allow these investees to be used as off-balance sheet financing devices. Thus, Bierman believes that leverage calculations under equity method do not accurately represent the riskiness of the firm, since investing in the common stock of a highly levered firm has different financial consequences than investing in the common stock of a zero-debt firm. Accordingly, the author concludes that PC might improve reporting of financial affairs of corporations owning common stocks of other companies.
Besides, although Bierman recognises that limited liability rules for corporations might result in the investor not having to pay for the debts of its investees, the author argues that this issue does not appear a relevant aspect able to preclude proportionate consolidation. As a matter of fact, for example, the debt for which the investor is not liable should be tagged *"Debt of corporations in which common stock is owned"* with detailed explanation in the footnotes.
Moreover, another aspect mentioned is that proportionate consolidation results in proportionate inclusion of cash flows, which are relevant financial information for credit analysts in evaluating a company's creditworthiness. All in all, the paper recommends proportionate consolidation for any material common stock investment, instead of limiting consolidation to a limited set of firms meeting certain ownership and control criteria[38].

❖ Davis and Largay (1999) – PC – Ex ante study

Financial Reporting of "Significant-Influence" Equity Investments: Analysis and Managerial Issues

The purpose of the study is to identify the appropriate reporting model for significant-influence investments, namely situations where one entity owns more than a passive investment in another entity but does not control that entity. The authors critically compare the three principal methods worldwide used: *the equity method*, *the expanded equity method*[39] and *proportionate consolidation* and assess the ability of each of them in providing sufficient and relevant analytical information to managers and analysts.
Davis and Largay affirm that in an increasingly complex and challenging business environment, where significant equity investments may represent a way to off-balance-sheet financing, firms' management should strive to provide useful information to assist financial statements users in making sound economic decisions.

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[38] Bierman, H. *Proportionate Consolidation and Financial Analysis*. Accounting Horizons. (1992).
[39] The expanded equity method presents separately the investor's proportionate share of the investee's assets and liabilities, generally broken down into current assets, non-current assets, current liabilities and long-term liabilities. This format appears also in the income statement as well as cash flow statement. It is a compromise between the aggregated approach and the one-line consolidation. Davis, M., Largay, J. (1999).

In this regard, both PC and EEM offer substantially more relevant information rather than the equity method. However, the study suggests that PC seems more appropriate than EEM for presenting investors and investees when they are operationally integrated.
The study presents some examples to explain the effects on financial statements of the different methods. The one-line equity method understates liabilities as none of the investee's liabilities is reported. As far as the impact on ratio analysis, the equity method overstates profitability ratios such as ROA and ROS (the denominator total assets or sales is lower under EM but income in the numerator is the same). Furthermore, the equity method misstates the total assets turnover ratio, which is a measure of assets utilisation. In the example analysed by the authors, the ratio is understated as the numerator (sales) is lower by more than total assets in the denominator (in cases where the investor has a higher total assets turnover than the investee, the equity method overstates the ratio). Moreover, the equity method understates solvency ratios as for instance the total liabilities/total assets and long-term liabilities/equity ratios as long as the investee's solvency position is worse than that of the investor.
All in all, they do not find any substantive justification for continuing using the equity method given the limited information provided. Managers may be able to reduce information asymmetry and costs of capital by voluntarily disclosing information about their significant investees using the PC or the EEM[40].

- **Nobes (2002) – NC – Normative Paper**

An Analysis of the International Development of the Equity Method

Nobes traces the history of the diffusion of the equity method. As early as 1910s in the US and UK, it became a common practice for consolidating subsidiaries and afterwards a widespread method to account for associates and joint ventures even abroad (e.g. Australia). However, what emerges from the Nobes' analysis is that the equity method has reached such a wide diffusion because it was primarily used by the two strongest accounting nations (US and UK) rather than because it was supported by precise conceptual arguments and clear theoretical justifications[41]. Nobes explicitly argues that although the equity method is used for various purposes around the world, the rationales for this are not well explained[42].

- **Bauman (2003) – NC – Ex ante study**

The Impact and Valuation of Off-Balance-Sheet Activities Concealed by Equity Method Accounting

Some analysts regard the equity method as enabling firms to avoid balance sheet recognition of the assets and liabilities of investees. From a financial analysis perspective, the lack of detail about investee activities is a weakness of the equity method. Accordingly, proponents of proportionate consolidation believe that the equity method provides a distorted picture of firms' profitability and risk by relegating details about investees' balance sheet and income statement composition only to the footnotes.

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[40] Davis, M., Largay, J. *Financial Reporting Of "Significant-Influence" Equity Investments: Analysis and Managerial Issues.* Journal of Managerial Issues. Vol. 11, No. 3, 280-298. (1999).
[41] For instance, the threshold of 20%, now commonly used to refer to the concept of significant influence, had arisen pragmatically in the UK and then accepted in the US as a compromise. Thus, this is an arbitrary threshold lacking basis of convincing theory. Nobes, C. (2002).
[42] Nobes, C. *An Analysis of the International Development of the Equity Method.* Abacus. Vol. 38, No. 1. (2002).

The research relies on a final sample of 75 US manufacturing firms and precisely 150 firm-year observations for the years 2000-2001 for examining footnote disclosures of the equity accounted investees with the purpose to assess their relevance in explaining the market value of companies' equity. The study reveals that an aggregated presentation of investees' information prevents an accurate estimation of the off-balance-sheet assets and liabilities by market participants. Hence, Bauman suggests firms to improve the usefulness of the equity accounted investments' footnote disclosures. For instance, the author argues that as data are usually provided in aggregation, it is difficult to prepare pro-forma financial statements based on proportionate consolidation.
In the sample, only the 13% of firms discloses the amount of interest expenses of their investees to compute their interest coverage (earnings before interests & taxes/interest expenses) and less than one-third of sampled firms discloses the amount of their investees' interest-bearing debt. Moreover, the study uses a general equity valuation model which expresses the market value of firms' equity as a function of the firms' net income from continuing operations, reported total assets, total liabilities and additional assets/liabilities resulting from proportionate consolidation. All in all, findings confirm that investors place more weight on off-balance-sheet liabilities than assets for firms that provide explicit guarantees for their investees' obligations[43].

- **Graham, King and Morrill (2003) – PC – Ex ante study**

Decision Usefulness of Alternative Joint Venture Reporting Methods

The study focuses on the analysis of a sample of 78 Canadian companies, providing disclosures about joint ventures during the 1995-2001 period. Graham et al. collected the venturers' financial statement information and footnote disclosures on their joint ventures for the 1995-2001 period. The history of joint ventures accounting in Canada is enigmatic and well portray the uncertainty and lack of theoretical basis characterising standard setters' decisions for preferring one method over the other. Prior to 1974, Canadian GAAP required equity method to report investments in joint ventures. Following disapproval of some corporations, which preferred PC, in 1977, the Canadian Institute of Chartered Accountants allowed firms to use either EM or PC. However, such an unjustified alternative led the Canadian standard setter to reconsider the topic, and once the IASB recommended PC in IAS 31, in 1994 the CICA revised Section 3055 and only required PC to account for joint ventures from 1995 onwards.
Graham et al. created pro-forma equity method balance sheets from proportionate consolidation balance sheets by subtracting the joint ventures' liabilities from the venturers' total assets and total liabilities, and likewise, equity method income statements were created from proportionate consolidation income statements by eliminating both joint ventures' revenues and expenses and adding the generated difference to the venturers' other revenues and expenses.
On average the conversion to equity method reduced assets and liabilities by 7.35% and 14.18% respectively. Moreover, even if the conversion did not affect net income, on average venturers' sales and expenses were reduced by 13.50% and 11.96%, as well as a reduction in operating cash flows was evident[44].

[43] Bauman, M. *The Impact and Valuation of Off-Balance-Sheet Activities Concealed by Equity Method Accounting.* Accounting Horizons. Vol. 17, No. 4, 303-314. (2003).
[44] Graham, R., King, R., Morrill, C. *Decision Usefulness of Alternative Joint Venture Reporting Methods.* Accounting Horizons. Vol. 17, No. 3, 123-137. (2003).

To examine how financial statements differences coming from the use of PC and EM influence financial ratios, Graham et al. studied the Du Pont Model, which disaggregates the rate of return on common shareholders' equity (*ROCSE or ROE= Profit Margin * Total Assets Turnover * Leverage Ratio* where *ROE=Net Income/Average Common Shareholders' Equity, Profit Margin=Net Income/Sales, Total Assets Turnover=Sales/Average Total Assets, Leverage Ratio or Equity Multiplier=Average Total Assets/Average Common Shareholders' Equity*). As expected, they found that the value of the profit margin was generally greater under the equity method (mean 4.63% against 4.55%), since income is the same under PC and EM, but under EM sales are generally lower. Similarly, not surprisingly, leverage ratio was higher under PC (mean 2.55% against 2.33%), since the amount of total assets is generally greater under PC, whereas the shareholders' equity is the same under either method. Finally, Graham et al. examined the predictive ability of the components of the ROCSE using a set of regression models and found that the ROE components: the profit margin, asset turnover and leverage ratio predicted future returns on common shareholders' equity better when ratios were based on proportionate consolidation rather than on equity method.
All in all, the results of the Graham et al.'s study suggest that the one-line consolidation provides less information for predicting future profitability than does proportionate consolidation[45].

- **Kothavala (2003) – NC – Ex ante study**

Proportional Consolidation versus the Equity Method: a risk measurement perspective on reporting interests in joint ventures

The study investigates risk measurement implications of using alternative accounting treatments (proportionate consolidation and equity method) and provides market-based evidence relevant to the ongoing debate on accounting for joint venture investments. More precisely, the research examines the risk relevance of the two accounting methods and if disclosures on disaggregated joint venture accounting amounts provide information that is incrementally risk relevant. In this regard, risk relevance refers to the ability of financial statements amounts to explain variation in market risk benchmarks[46].
The study adopts **share price volatility** and **bond ratings** as benchmarks and investigates their association with accounting ratios and financial measures (e.g. return on assets, profit margin, leverage ratio: total liabilities/shareholders' equity, size, ROA variability and revenues variability) calculated using both the EM and the PC. Kothavala remarks that price volatility refers to the standard deviation of share prices, whereas bond ratings range from "D" (the lowest rating) to "AAA" (highest quality).
Using a sample of 117 Canadian firms from 1995 to 2000, the study finds that proportionally consolidated accounting ratios have higher risk relevance than equity method accounting ratios for explaining price volatility. For instance, Kothavala remarks that, as expected, return on assets has significant negative coefficients, while the return on assets variability as well as the revenues variability have significant positive coefficient in explaining price volatility. Accordingly, results are consistent with the common belief that proportionally consolidated financial statements are generally more comprehensive in portraying risks and rewards of joint venture investments.

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[45] Graham, R., King, R., Morrill, C. *Decision Usefulness of Alternative Joint Venture Reporting Methods.* Accounting Horizons. Vol. 17, No. 3, 123-137. (2003).
[46] Market risk consists of components of financial and operating risk. The former is a function of capital structure and represents the ability to raise capital and fulfil financial obligations. The latter, also referred to as asset risk, reflects the riskiness of cash flows or earnings generated from the firm's assets. Financial and operating risks are not mutually exclusive and once debt is introduced, the earnings stream of common shareholders become more volatile. Kothavala, K. (2006).

Conversely, surprisingly, findings show that the equity method ratios have higher risk relevance to explain bond ratings. Consequently, findings are consistent with the assertions made by equity method proponents supporting that jointly controlled activities should not be consolidated[47].
All in all, results highlight that not all market participants view equity method and proportionally consolidated financial statements in the same way. Price volatility entails a broader spectrum of financial statements users, while bond ratings represent a smaller, but maybe more sophisticated set of users, and these differences might explain the divergent results. Furthermore, findings also suggest that not disclosing joint venture accounting amounts separately masks information that instead may help market participants in assessing risk[48].

- **Lim, Yeo and Liu (2003) – NC – Ex post study**

Information asymmetry and accounting disclosures for joint ventures

Using data from a set of 122 firms listed in the Singapore Stock Exchange, this study explores the effects of the disclosure of supplementary information for joint ventures (e.g. share of assets, liabilities, revenues and expenses) on the information asymmetry among market participants as expressed by the relative bid-ask spreads, measured as the difference between ask and bid prices divided by the average share price.
The findings show that the disclosure of supplementary information for joint ventures is linked with a significant decline in bid-ask spread. As expected, the decline in information asymmetry is larger when the investment in joint venture is significantly material. Additionally, larger firms tend to have a smaller decline in the information asymmetry compared with smaller firms. This is consistent with the fact that generally larger firms have more public available information than smaller firms that usually have higher initial levels of information asymmetry.
All in all, Lim, Yeo and Liu highlight the important role played by financial disclosure and the consequent relevance of the implications of their study for international policy-makers[49].

- **Stoltzfus and Epps (2005) – PC – Ex ante study**

An empirical study of the value-relevance of using proportionate consolidation accounting for investments in joint ventures

The study examines how creditors of companies with investments in joint ventures interpret the off-balance sheet debts of the joint venture. The interpretation of the joint venture obligations relies upon the way in which creditors view the relationship between the venturers and the joint venture. This study suggests two views of joint venture debt: the *legal view* and the *implicit view*. The former believes that potential losses on the joint venture investments are only limited to the cost of the investment, while the latter suggests that the operations of the venturers and joint venture are so closely related that the joint venture liabilities implicitly belong to the venturers.
Accordingly, the legal model tends to represent investments where the joint venture is organised as a corporation, a limited liability company, or limited partnership with no debt guarantees. By contrast, the implicit model might refer to vertically integrated joint ventures which provide the co-venturers raw materials, marketing or R&D services. This study aims to determine creditors'

[47] Kothavala, K. *Proportional consolidation versus the equity method: A risk measurement perspective on reporting interests in joint ventures.* Journal of Accounting and Public Policy. 22, 517-538. (2003).
[48] Kothavala, K. *Proportional consolidation versus the equity method: A risk measurement perspective on reporting interests in joint ventures.* Journal of Accounting and Public Policy. 22, 517-538. (2003).
[49] Lim, C., Yeo, G., Liu, C. *Information asymmetry and accounting disclosures for joint ventures*. The International Journal of Accounting. 38, 23-39. (2003).

interpretation of joint venture debt by examining the degree of association between bond risk premiums and the accounting information in the financial statements computed either using the equity method or the proportionate consolidation[50].
When using the entire sample of companies (data from 287 listed US companies for years 1995-1998) results demonstrate that risk premiums are better explained by equity accounted financial measures. Therefore, data support the legal view, while surprisingly there is no improvement in the association between bond premiums and proportionally accounted financial information. In this precise case, it seems that creditors do not get better information with accounting data based on proportionate consolidation. However, when the study restricts the sample to those companies guaranteeing debt for their joint ventures, findings change and suggest that accounting numbers proportionally consolidated confirm a stronger association to bond risk premiums than the equity accounted measures. Hence, the higher association between bond risk premiums and measures of default risk proves that creditors consider commitments that are off-the balance sheet in their risk assessment. All in all, the results of the study suggest that standard setters should require PC when there is evidence of guarantees or other agreements because financial statements numbers provide more value-relevant information for creditors[51].

- **Soonawalla (2006) – NC – Ex post analysis**

Accounting for Joint Ventures and Associates in Canada, UK, and US: Do US Rules Hide Information?

The study investigates the potential loss of value-relevant information from failing to provide detailed disaggregated income statement and balance sheet information about joint ventures and associates. To this purpose, the research revolves around two main questions: *(1) Is there loss of information for earnings forecasting and equity valuation when joint venture earnings are aggregated with earnings from associates, and joint venture investment values are aggregated with associate investment values? (2) Is there a loss of information for forecasting and valuation purposes when joint venture revenues and expenses are aggregated together as joint venture earnings?*
This study relies on data from Canadian and UK firms for the years 1995-2000 and 1997-2000, respectively, precisely 105 Canadian firms and 132 UK firms. Where possible, the study runs the same investigations for a sample of US firms reporting equity investments and earnings for the years 1995-2000, precisely 1,903 US firms.
As expected, findings prove that aggregating joint venture and associate investment numbers in financial statements results in loss of forecasting and valuation relevant information. In fact, for instance, shareholders might assign the same valuation multiples on joint ventures or associates. Differently from what predicted, the results do not provide clear evidence that aggregating joint venture and associate earnings results in loss of information. Moreover, as expected, the study confirms that aggregating joint venture revenues and expenses results in significant information loss.
In conclusion, failure to separately report joint venture and associate investment numbers as well as joint venture revenues and expenses results in loss of information that could be used otherwise to predict future earnings and estimate share prices. Consequently, accounting regimes that do not require detailed and separate disclosures about joint ventures and associates (e.g. US GAAP) might mask potentially relevant information for financial statements users[52].

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[50] Stoltzfus, R., Epps, R. Accounting Forum. 29 (2), 169-190. (2005).
[51] Stoltzfus, R., Epps, R. *An empirical study of the value-relevance of using proportionate consolidation accounting for investments in joint ventures.* Accounting Forum. 29 (2), 169-190. (2005).
[52] Soonawalla, K. *Accounting for Joint Ventures and Associates in Canada, UK, and US: Do US Rules Hide Information?* Journal of Business Finance and Accounting. 33 (3) & (4), 395-417. (2006).

- **Bauman (2007) – PC – Ex ante analysis**

Proportionate consolidation versus the equity method: additional evidence on the association with bond ratings

The study provides additional evidence about the association between bond ratings and financial statements amounts computed under proportionate consolidation versus equity method. While Kothavala (2003) finds that financial measures based on the equity method are more relevant to explain bond ratings, the results of this study prove that proportionately consolidated financial statements have greater relevance than equity method statements for explaining bond ratings. Moreover, unlike Stoltzfus and Epps (2005), the higher explanatory power of proportionately vs equity method statements does not depend on the exclusive consideration of debt guarantees. In fact, in the Bauman's study many sample firms disclose the presence of debt guarantees, while others do not.
The final sample analysed consists of 39 US companies belonging to the manufacturing industry, with a total of 173 firm-year observations for 1997-2001. Limiting the sample to manufacturing firms allowed a greater homogeneity among firms and a higher comparability of ratio values. Indeed, Bauman believes that one possible explanation for the different results obtained from Kothavala relies upon the sample composition. While in this study only manufacturing firms are considered, Kothavala (2003) takes into account a more heterogeneous group of companies.
In general, total assets and leverage are greater under PC due to the elimination of joint ventures assets and liabilities under EM. Accordingly, the suppression of assets determines higher ROA under EM as well. Even profit margin is higher under EM as the joint ventures' share of sales is not reported in the venturer's income statement[53].

- **O' Hanlon and Taylor (2007) – NC – Ex post study**

The value relevance of disclosures of liabilities of equity-accounted investees: UK evidence

The study stems from the significant concerns that single-line equity accounted investments may boost off-balance-sheet financing, given that information regarding investees' debt is concealed from the investor's financial statements. Precisely, O' Hanlon and Taylor examine the usefulness to investors of the mandatory disclosures requested to UK firms by the standard FRS 9 *(Associates and Joint Ventures)* of the investor's share of liabilities relative to all its equity accounted associates and joint ventures, separately provided. Furthermore, the study investigates whether the negative valuation impact caused by investee-liability disclosures is more pronounced for joint ventures rather than for associates and whether the relevance of information differs in cases of guarantees or non-guarantees by the investor for the investees' debt. To this purpose, this study uses data of UK companies from 1998 to 2003[54].
Findings confirm Bauman's conclusions (2003) that disclosures of equity-accounted investees' liabilities have a negative valuation impact on the market value of firms' equity. Accordingly, this provides regulators evidence that for investors such disclosures represent a negative signal, and for this reason information about joint ventures and associates' liabilities should always be clearly reported. Contrary to expectations, there is no convincing evidence that joint venture disclosures overall have a stronger negative valuation impact than associate disclosures overall or that overall disclosures in guaranteed cases have a stronger negative valuation effect rather than disclosures in

[53] Bauman, M. *Proportionate consolidation versus the equity method: Additional evidence on the association with bond ratings.* International Review of Financial analysis. 16, 496-507. (2007).
[54] O' Hanlon, J., Taylor, P. *The value relevance of disclosures of liabilities of equity-accounted investees: UK evidence.* Accounting and Business Research. Vol. 37, No. 4, 267-284. (2007).

non-guaranteed situations. There is only a little evidence that disclosures of guarantees in joint ventures have a stronger negative relevance than disclosures in the absence of guarantees or for associate guarantees[55].

- **Lourenço and Curto (2010) – PC – Ex post study**

Determinants of the Accounting Choice between Alternative Reporting Methods for Interests in jointly controlled entities

The study investigates what determines venturers' accounting choice to report interests in jointly controlled entities using the equity method or proportionate consolidation. The research is based on the UK accounting setting, where firms had to change their reporting method from the gross equity method to either the equity method or proportionate consolidation following mandatory adoption of IFRS in 2005. Precisely, the authors used a sample of 159 firms listed in the London Stock Exchange (FTSE All shares). The research relies upon the belief that managers exercise their discretion to choose accounting methods on the basis of their insights into the underlying economics of their JCEs. According to the authors the type of JCEs plays a determinant role in the management choice between EM and PC.
In such a scenario, Lourenço and Curto support the classification of JCEs proposed by Hennart (1988) distinguishing between *Scale* and *Link JCEs*. Scale JCEs are created when the venturers belong to the same industry and they enter a stage of production, distribution or a new market together (homogeneous cooperation), whereas Link JCEs refer to heterogeneous cooperation and are set up when venturers come from different industries to enter a new business together and each of them contributes relevant resources to develop the new business. While the equity method appears to be more appropriate for reporting interests in Scale JCEs, the proportionate consolidation seems more suitable for Link JCEs. The authors suppose that probably venturers change their reporting method to proportionate consolidation when their JCEs are cases of Link joint ventures.
All in all, findings prove that Link venturers are more likely to apply proportionate consolidation than Scale ones, unless their leverage results lower than but approximate to the industry median, their return on assets is lower than the cost of debt or the change to proportionate consolidation would cause an important impact on their total assets or total liabilities. Accordingly, the findings support the belief that the type of JCEs plays a significant role in the management decision and also, they show the relevance of other variables such as debt covenant costs or monitoring costs. The former refers to the fact that usually PC carries an increase in the leverage and a decrease in the return on assets (ROA), while the latter relates to the propensity of firms to adopt the method supposed to be the most widely used by companies with similar economic conditions to reduce shareholders' monitoring costs over management's performances. Besides, their findings suggest that requiring all venturers to report interests in JCEs using just one method, the equity method according to the IASB decision, would reduce the reliability of financial statements, as financial statements would not represent the substance of the JCEs anymore[56].

[55] O' Hanlon, J., Taylor, P. *The value relevance of disclosures of liabilities of equity-accounted investees: UK evidence.* Accounting and Business Research. Vol. 37, No. 4, 267-284. (2007).
[56] Lourenço, I., Curto, J. *Determinants of the Accounting Choice between Alternative Reporting Methods for Interests in Jointly Controlled Entities.* European Accounting Review. Vol. 19, No. 4, 739-773. (2010).

❖ **Catuogno and Allini (2011) – NC – Ex post study**

Multiple evaluation options & comparability: equity investments in Italy and Spain

In the context of the harmonisation accounting process following the mandatory application of IFRS within EU member states, this study investigates if the level of comparability has increased after the introduction of IAS/IFRS. Using a sample of 129 Italian and 54 Spanish listed groups from 2004 to 2009, the authors prove that having multiple choices, such as the accounting option in IAS 31, heavily affects the de-facto level of harmonisation and comparability among different European countries as well as within the same country. Therefore, the adoption of the same set of international accounting standards does not guarantee a real comparability if firms may choose among different measurement options.
The empirical investigation is also used to understand which of the two consolidation methods (proportionate consolidation or equity method) is preferred in practice, bearing in mind that for both the Italian and the Spanish GAAP the benchmark treatment is proportionate consolidation. As shown in the following table, the overall level of comparability across years in Italy and Spain is not completely satisfactory.
In fact, looking at the data, companies adopting the equity method in Italy are more than those in Spain. In this way, the comparability or C index (Van der Tas, 1988) reveals a medium degree of comparability and precisely an evident decrease from 0.569 in 2004 to 0.525 in 2009[57].

TABLE 4.2.1 – **THE COMPARABILITY FOR INVESTMENTS IN JOINT VENTURES**

Joint Ventures	**2009**			**2008**			**2007**		
	ITALY	SPAIN	TOT	ITALY	SPAIN	TOT	ITALY	SPAIN	TOT
PC	32	29	61	24	25	49	24	25	49
EM	31	6	37	27	8	35	25	8	33
TOT	63	35	98	51	33	84	49	33	82
	C index	**0.525**		C index	**0.508**		C index	**0.513**	
	2006			**2005**			**2004 (Local GAAP)**		
	ITALY	SPAIN	TOT	ITALY	SPAIN	TOT	ITALY	SPAIN	TOT
PC	24	26	50	26	24	50	18	23	41
EM	25	5	30	21	5	26	16	2	18
TOT	49	31	80	47	29	76	34	25	59
	C index	**0.525**		C index	**0.544**		C index	**0.569**	

Source: Catuogno and Allini. (2011)

These results should make the IASB reflect on the reason why companies belonging to the same country and with the same accounting culture are pushed to choose different accounting options and then actively put effort in understanding the merits and drawbacks of both methods.

[57] Catuogno, S., Allini, A. *Multiple evaluation options & comparability: equity investments in Italy and Spain.* Accounting and Management Information Systems. Vol. 10, No. 2, 249-274. (2011).

- **Richardson, Roubi and Soonawalla (2012) – NC – Ex post study**

Decline in Financial Reporting for Joint Ventures? Canadian Evidence on Removal of Financial Reporting Choice

The study contributes to the research on accounting for joint ventures and precisely it focuses on the balance sheet components such as assets and liabilities that have been at the centre of the debates about joint ventures. Thus, the authors investigate whether the reduction in accounting options as the one introduced by the IASB with IFRS 11 causes a decrease in the value relevance of total assets and total liabilities for firms required to switch to another accounting method. For this purpose, the study analyses the Canadian situation, as the standard setter before to require only proportionate consolidation in 1995, allowed the choice between PC and EM for all joint venturers.
Using a sample of Canadian companies over the period 1985-2003, the authors try to understand if firms that used EM between 1985-1994 experienced a decline in value relevance of key balance sheet amounts such as their total assets and liabilities once forced to use PC from 1995 onwards. Moreover, since from 1995 Canadian companies were also required to disclose in the footnotes their share of joint venture assets and liabilities in addition to revenues, expenses and cash flows, this research aims to figure out if disaggregate joint venture assets and liabilities are incrementally and overall value relevant.
All in all, results show that companies using EM experienced a decline in value relevance of total assets and total liabilities in explaining their share price when forced to apply PC, compared with those using PC method even before. This may be explained by the fact that under EM only the net investment in joint ventures is reported, and this net amount is likely much smaller than the proportionate share of the joint venture assets and liabilities reported in the co-venturers' balance sheet. Furthermore, findings prove that market participants price disclosures of joint ventures' assets and liabilities. Therefore, such disclosures are incrementally value relevant when assessing venturers' share price and they may mitigate some of the costs of removing accounting choices[58].

- **Catuogno, Allini and D'Ambrosio (2015) – PC – Ex post study**

Information Perspective and Determinants of Proportionate Consolidation in Italy. An Ante IFRS 11 Analysis

The study examines the determinants of the managerial choice between PC and EM to account for JCEs. More precisely, by means of an ex ante analysis, Catuogno et al. question which of the two accounting methods is preferred by Italian venturers[59].
The authors assume that companies choose the more informative accounting method to reduce agency costs, information asymmetry and political pressures. Accordingly, they expect that the type of JCEs, leverage, bond covenants and size play a significant role in the choice of adopting proportionate consolidation. The analysis refers to a sample of 89 Italian listed firms for financial years 2009 and 2010. Results show that the type of JCEs (precisely the prevalence of Link JCEs) and the venturer issuance of bonds significantly explain the adoption of PC. Indeed, in the first case, with PC, venturers can provide more information regarding the benefits obtained through their strategic forms of business whereas in the second case, they may reduce costs of negotiating or renegotiating contracts. Thus, they may reduce potential conflicts with creditors by providing

[58] Richardson, W., Roubi, R., Soonawalla, K. *Decline in Financial Reporting for Joint Ventures? Canadian Evidence on Removal of Financial Reporting Choice.* European Accounting Review. Vol. 21, No. 2, 373-393. (2012).
[59] Catuogno, S., Allini, A., D'Ambrosio, A. *Information Perspective and Determinants of Proportionate Consolidation in Italy. An Ante Analysis of IFRS 11.* Rivista dei Dottori Commercialisti. (2015).

more information for valuing their companies' default probability. Conversely, findings do not support the hypothesis that larger companies and high-leveraged firms prefer PC. For the latter, a possible explanation may be that lenders might acquire information also privately and may rely even on non-accounting information.

All in all, the study stresses the relevance of *informative perspective* in the accounting method choice, according to which managers choose the more informative accounting method to reduce agency costs, information asymmetry and political pressures, since information asymmetry would cause higher costs for trading shares, higher rate of return and lower stock prices. Thus, the elimination of PC by the IASB is not supported as it would decrease transparency especially when venturers rely on bond covenants and Link JCEs[60].

[60] Catuogno, S., Allini, A., D'Ambrosio, A. *Information Perspective and Determinants of Proportionate Consolidation in Italy. An Ante Analysis of IFRS 11*. Rivista dei Dottori Commercialisti. (2015).

CHAPTER 5.

FINANCIAL STATEMENTS ANALYSIS ON A SAMPLE OF EUROPEAN LISTED COMPANIES TO UNDERSTAND THE EFFECTS OF IFRS 11

5.1 Research Design and Sample Selection

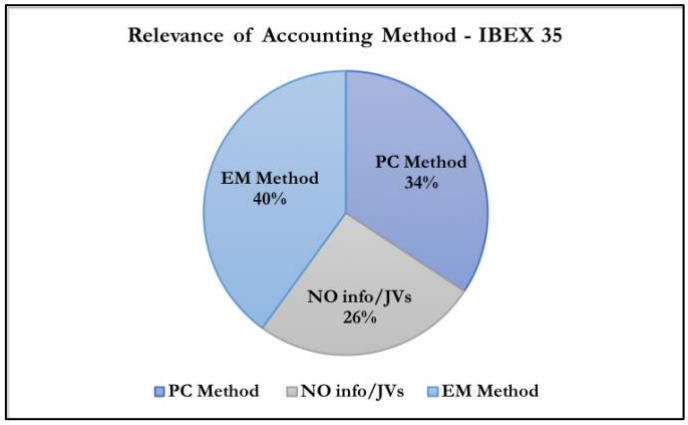
The following analysis aims to provide a contribution in the research activity concerning the accounting for joint ventures. So far, academicians have based their studies on the analysis of pro forma financial statements. By contrast, this analysis considers the actual variations occurred in the financial statements of those companies listed in three European indexes with large capitalisation: CAC 40 (French Index), IBEX 35 (Spanish Index) and FTSE MIB (Italian Index)[1] during the first year of IFRS 11 adoption (in Europe 2014). DAX 30 and FTSE 100 have been excluded from the present study provided that previous researches (e.g. Saccon et al. (2012), Leitner-Hanetseder and Stockinger (2014)) proved that firms from these two indexes were less impacted than firms within other European indexes. Unlike previous analyses, FTSE MIB has been included to see the effects in some of the largest Italian companies.

More precisely, variations have been computed for the fiscal year 2013, when IFRS 11 was applied from 2014, or for fiscal year 2012, in cases where companies opted for early application of the standard. Accordingly, 2014, 2013 or 2012 Annual Reports were retrieved from firms' website (section Investor Relations) and data were hand-collected from firms' financial statements. Indeed, this was feasible when firms provided a restatement of their financial figures to show the transition from the application of proportionate consolidation to equity method for reporting their interest in JCEs.

Of course, for each index, only those companies adopting PC under IAS 31 were considered. However, when no restatement or adjustment following IFRS 11 was disclosed in the notes, those companies were excluded from the analysis even if they previously used PC. Tables 5.1.1, 5.1.2 and 5.1.3, that follow, show the list of firms composing IBEX 35, FTSE MIB and CAC 40 respectively, and for each firm they display the industry and the accounting method used before IFRS 11 in case of joint ventures. As illustrated in Figures 5.1.1 and 5.1.2, most firms in IBEX 35 and FTSE MIB used EM in 2013 (or 2012) respectively 40% and 55%, while only in CAC 40 companies preferred PC (52%) (see Figure 5.1.3).

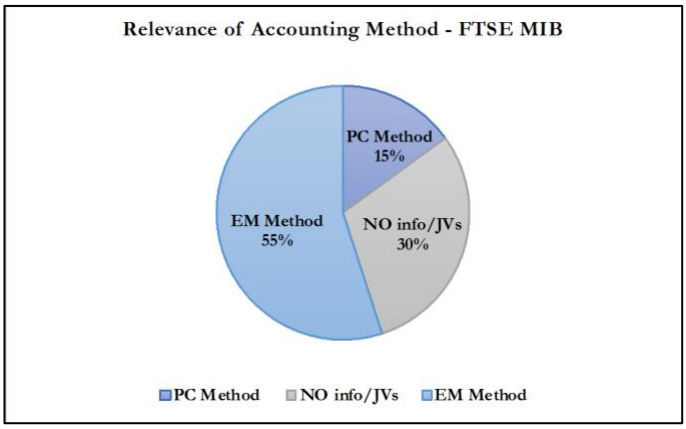
[1] The components for each Index were retrieved from *www.investing.com*.

FIGURE 5.1.1 – **RELEVANCE OF ACCOUNTING METHOD – IBEX 35**



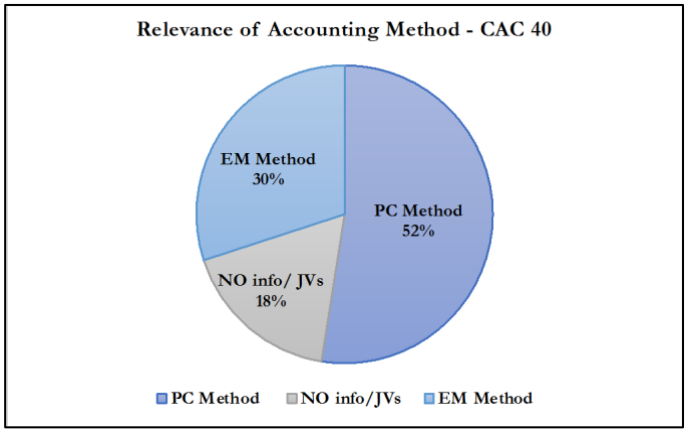
Source: Authorial Elaboration

FIGURE 5.1.2 – **RELEVANCE OF ACCOUNTING METHOD – FTSE MIB**



Source: Authorial Elaboration

FIGURE 5.1.3 – **RELEVANCE OF ACCOUNTING METHOD – CAC 40**



Source: Authorial Elaboration

TABLE 5.1.1 – **LIST OF COMPANIES LISTED IN THE IBEX 35**

IBEX 35 LIST OF COMPANIES	INDUSTRY	NO JV OR NO INFORMATION	METHOD USED BEFORE IFRS 11
ABERTIS	Telecommunications, Transportation, Networks, Television, Motor Way Toll Road, Concessions		**PC**
ACCIONA	Infrastructure (construction & renewable energy)	X	
ACERINOX	Steel	X	
ACS	Infrastructure (construction & telecommunications)		EM
AENA	Aviation	X	
AMADEUS	Travel Technology		EM
ARCELORMITTAL	Steel		EM
B. SABADELL	Financial Services		EM
BANKIA	Financial Services		EM
BANKINTER	Financial Services		EM
BBVA	Financial Services		**PC** (IFRS 11 early application in 2013)
CAIXABANK	Financial Services		EM
CELLNEX TELECOM	Telecommunications		**PC**
DIA	Retail	X	
ENAGAS	Oil & Gas		**PC**
ENDESA	Energy		**PC**
FERROVIAL	Infrastructure (urban services, toll roads, construction, airport)		EM
GAMESA	Industrials		EM
GAS NATURAL	Oil & Gas, Energy		**PC**
GRIFOLS	Chemicals, Pharmaceuticals		EM
IAG	Aviation	X	
IBERDROLA	Energy	X	
INDITEX	Retailing (fashion)		**PC**
INDRA A	Consulting		PC (2013 financial statements not adjusted following IFRS 11)
INMOBILIARIA COLONIAL	Real Estate	X	
MAPFRE	Financial Services		EM
MEDIASET	Telecommunications (Mass Media)		EM
MELIA HOTELS	Travel, Hospitality		EM
MERLIN PROPERTIES SA	Real Estate	X	
RED ELECTRICA	Energy		PC (2013 financial statements not adjusted following IFRS 11)
REPSOL	Oil & Gas		**PC**
SANTANDER	Financial Services	X	
TECNICAS REUNIDAS	Infrastructure		**PC**
TELEFONICA	Telecommunications		PC (2012 financial statements not adjusted following IFRS 11)
VISCOFAN	Plastic Casings		EM

Source: Authorial Elaboration

TABLE 5.1.2 – **LIST OF COMPANIES LISTED IN THE FTSE MIB**

FTSE MIB LIST OF COMPANIES	INDUSTRY	NO JV OR NO INFORMATION	METHOD USED BEFORE IFRS 11
A2A	Energy		EM
ATLANTIA	Construction, Transportation		EM
AZIMUT HOLDING	Investment	X	
BANCA GENERALI	Financial Services	X	
BANCO BPM	Financial Services	X	
BPER BANCA	Financial Services	X	
BUZZI UNICEM	Building Materials		**PC**
CAMPARI	Drinks		EM
CNH INDUSTRIAL NV	Agricultural Equipment, Trucks and Commercial Vehicles, Industrial and Marine powertrains		EM
ENEL	Energy		**PC**
ENI	Energy		EM
EXOR	Investment		EM
FERRARI NV	Automotive	X	
FIAT	Automotive		EM
FINECOBANK	Financial Services		EM
FRENI BREMBO	Automotive		EM
GENERALI	Financial Services		EM
INTESA SANPAOLO	Financial Services		EM
ITALGAS	Oil & Gas	X	
LEONARDO	Aerospace, Defence and Security		**PC**
LUXOTTICA	Eyewear	X	
MEDIASET	Telecommunications (Mass Media)		EM
MEDIOBANCA	Financial Services	X	
MONCLER SPA	Fashion	X	
PIRELLI & C	Automotive		EM
POSTE ITALIANE	Financial Services		EM
PRYSMIAN	Manufacturing, Technology		**PC**
RECORDATI	Pharmaceuticals	X	
SAIPEM	Oil & Gas		**PC**
SALVATORE FERRAGAMO	Fashion		EM
SNAM	Oil & Gas		EM
STMICROELECTRONICS	Semiconductors		EM
TELECOM ITALIA	Telecommunications		EM
TENARIS	Oil & Gas	X	
TERNA	Energy		EM
UBI BANCA	Financial Services		EM
UNICREDIT	Financial Services		**PC**
UNIPOL GRUPPO	Financial Services		EM
UNIPOLSAI ASSICURAZIONI	Financial Services		EM
YOOX NET-A-PORTER GROUP	Fashion and Leisure	X	

Source: Authorial Elaboration

TABLE 5.1.3 – **LIST OF COMPANIES LISTED IN THE CAC 40**

CAC 40 LIST OF COMPANIES	INDUSTRY	NO JV OR NO INFORMATION	METHOD USED BEFORE IFRS 11
ACCOR	Hospitality, Tourism		**PC**
AIR LIQUIDE	Chemicals, Engineering, Health Care		PC (2013 financial statements not adjusted following IFRS 11)
AIRBUS GROUP	Aviation		**PC**
ARCELORMITTAL	Steel		EM
ATOS	IT Services and Consulting		PC (2013 financial statements not adjusted following IFRS 11)
AXA	Financial Services		**PC**
BNP PARIBAS	Financial Services		**PC**
BOUYGUES	Real Estate, Civil Engineering, Media, Telecommunications		**PC**
CAP GEMINI	Consulting	X	
CARREFOUR	Retail		EM
CREDIT AGRICOLE	Financial Services		**PC**
DANONE	Food	X	
ENGIE	Energy		**PC**
ESSILOR INTERNATIONAL	Medical Equipment		PC (2013 financial statements not adjusted following IFRS 11)
KERING	Fashion		EM
L'OREAL	Personal Care		**PC**
LAFARGEHOLCIM	Building Materials	X	
LEGRAND	Electrical Equipment	X	
LOUIS VUITTON	Fashion		**PC**
MICHELIN	Automotive and trucks parts	X	
ORANGE	Telecommunications		EM
PERNOD RICARD	Drinks	X	
PEUGEOT	Automotive		EM
PUBLICIS	Advertising	X	
RENAULT	Automotive		**PC** (IFRS 11 early application in 2013)
SAFRAN	Aerospace, Defence		**PC**
SAINT GOBAIN	Building Materials		**PC**
SANOFI	Pharmaceuticals		EM
SCHNEIDER ELECTRIC	Energy Management and Automation		PC (2013 financial statements not separately restated under IFRS 11)
SOCGEN	Financial Services		**PC**
SODEXO SA	Food Service, Facilities Management,		EM
SOLVAY	Chemicals		EM
STMICRO	Semiconductors		EM
TECHNIPFMC	Oil & Gas		**PC**
TOTAL	Oil & Gas		EM
UNIBAIL RODAMCO	Real Estate, Property		**PC**
VALEO SA	Automotive		**PC**
VEOLIA ENVIRONNEMENT	Environment Services		**PC**
VINCI	Construction		EM
VIVENDI	Telecommunications, Media		EM

Source: Authorial Elaboration

The initial sample included 115 firms, however after the classification showed in the previous tables, the final sample consisted of 9 firms from IBEX 35, 6 companies from FTSE MIB and 17 companies from CAC 40, in total 32 firms. Variations[2] have been computed for some balance sheet and income statement accounts, and precisely for *total assets*, *total liabilities*, *operating revenues*, *operating expenses* and *EBIT*.

For all the analysed firms, operating revenue was computed by summing up all those figures referring to operating income (e.g. Net sales + Other operating income). In the same way, operating expenses were computed by summing up all those income statement items referring to operating expenses (e.g. raw materials, changes in inventories, services, staff costs or other administrative expenses, depreciation/amortisation and other operating expenses). More specifically, Figure 5.1.4, that follows, depicts an example of the computations made.

Regarding EBIT, an interesting issue to highlight is the fact that some sampled firms reported their share of profit coming from their equity accounted investments (joint ventures or associates) within the computation of the operating profit or EBIT. Probably, their intent was to mitigate the effects coming from the transition from proportionate consolidation to equity method. Anyway, in order to align the entire sample, it was decided not to include the profit of equity accounted joint ventures (or other associates) within the computation of EBIT, so that it is more evident the direct effects derived from the change in accounting treatment. This decision is in line with what affirmed by Leitner – Hanetseder and Stockinger (2014), namely generally the most common way in practice is to show the earnings coming from equity accounted joint ventures as financial earnings and not operating income, even if companies can choose one of the two alternatives to report such earnings as there is no precise rule within IFRS[3].

Surprisingly, despite in literature studies point out that the final outcome of the consolidated financial statements, namely net income and shareholders' equity, does not change when moving from PC to EM, indeed some firms reported changes in either their consolidated net profit or their total shareholders' equity. An example of these differences is visible from Figures 5.1.4 and 5.1.5. Unfortunately, firms did not explain the precise rationale for such variations, however presumably changes may derive from the complexities hidden behind the adjustments of intragroup balances and profits or losses from intragroup transactions needed to correctly measure the opening balance

[2] Variation computed as: $(P_t - P_{t-1})/P_{t-1}$.

[3] Leitner – Hanetseder, S., Stockinger, M. *How does the elimination of the proportionate consolidation method for joint venture investments influence European companies?* ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).

of joint venture investments as argued by Rinaldi and Gavana (2014)[4], or from the adjustments to retained earnings, necessary for instance in case of any impairment to the value of the investment. For sure, such unpredicted changes definitely stress the need for the IASB to deeply analyse equity accounting and all the operational complexities it brings within financial statements. Anyway, since overall variations were immaterial (see Appendix for further information) in order to conduct the analysis on firms' financial ratios, whose results will be displayed thereafter, the amount before the restatement of both net income and shareholders' equity was chosen to run computations.

FIGURE 5.1.4 – **EXAMPLE OF RESTATEMENT COMPUTATION I**

Consolidated income statement

(thousands of euro)	Note	2013 reported	IFRS 11 adjustments	2013 restated
Net sales	29	**2,753,050**	**(242,960)**	**2,510,090**
Changes in inventories of finished goods and work in progress		(4,905)	1,662	(3,243)
Other operating income	30	107,405	(172)	107,233
Raw materials, supplies and consumables	31	(1,137,536)	79,419	(1,058,117)
Services	32	(678,904)	65,710	(613,194)
Staff costs	33	(466,695)	15,371	(451,324)
Other operating expenses	34	(91,255)	3,009	(88,246)
Operating cash flow (EBITDA)		**481,160**	**(77,961)**	**403,199**
Depreciation, amortization and impairment charges	35	(331,401)	14,656	(316,745)
Operating profit (EBIT)		**149,759**	**(63,305)**	**86,454**
Gains on disposal of investments		4,563	-	4,563
Finance revenues	36	51,571	(3,537)	48,034
Finance costs	36	(162,022)	3,148	(158,874)
Equity in earnings of associates and joint ventures	37	6,385	29,467	35,852
Profit (loss) before tax		**50,256**	**(34,227)**	**16,029**
Income tax expense	38	(79,233)	20,049	(59,184)
Profit (loss) for the period		**(28,977)**	**(14,178)**	**(43,155)**
Attributable to:				
Owners of the company		(50,678)	-	(50,678)
Non-controlling interests		21,701	(14,179)	7,522

Source: Buzzi Unicem 2013 Annual Report. FTSE MIB.

[4] Rinaldi, L., Gavana, G. *IFRS 11: quali complessità nascondono le regole per la transizione?* Rivista dei Dottori Commercialisti. Giuffrè. No. 4, 689. (2014).

FIGURE 5.1.5 – **EXAMPLE OF RESTATEMENT COMPUTATION II**

(thousands of euro)	Note	Dec 31, 2013 reported	IFRS 11 adjust-ments	Dec 31, 2013 restated	Jan 1, 2013 reported	IFRS 11 adjust-ments	Jan 1, 2013 restated
Equity							
Equity attributable to owners of the company							
Share capital	20	123,637	-	123,637	123,637	-	123,637
Share premium		458,696	-	458,696	458,696	-	458,696
Other reserves	21	41,219	-	41,219	156,324	-	156,324
Retained earnings		1,642,079	-	1,642,079	1,694,273	-	1,694,273
Treasury shares		(4,768)	-	(4,768)	(4,768)	-	(4,768)
		2,260,863	**-**	**2,260,863**	**2,428,162**	**-**	**2,428,162**
Non-controlling interests	22	113,332	(75,457)	37,875	174,461	(82,564)	91,897
Total Equity		**2,374,195**	**(75,457)**	**2,298,738**	**2,602,623**	**(82,564)**	**2,520,059**

Source: Buzzi Unicem 2013 Annual Report. FTSE MIB.

In line with studies in literature (e.g. Graham et al. (2003); Saccon et al. (2012); Demerens et al. (2014); Leitner – Hanetseder and Stockinger (2014)) variations have been calculated for some important financial measures, namely the *components of the ROE* as expressed by the Du Pont Model (*Profit Margin * Leverage Ratio * Asset Turnover*) and *ROA* (which may be decomposed as *Profit Margin * Asset Turnover*). The aim is to confirm previous results in literature.

It is worth recalling that Return on Equity measures the return generated on shareholders' equity. A firm can create shareholders' value (economic profits) if the ROE is higher than its cost of equity capital (the expected return shareholders require for investing in a certain company given its specific risk)[5]. Return on Assets, as well, is a profitability measure, computed as the ratio between net income and total assets that reveals how the capital invested within the firm is able to generate profit and accordingly it permits to judge if assets are efficiently employed within the company[6]. Profit Margin refers to the ratio net income over revenues, it is useful to evaluate the profitability of a business, because it measures how much profit a firm makes on every unit (€) of sales. Leverage Ratio calculated as total assets over shareholders' equity indicates how a firm finances its activity, namely the assets it holds to run the business. Accordingly, a relatively high index might indicate that the company is mainly financing its business through debt[7].

[5] Financial Times – Lexicon. *Definition of Return on Equity ROE*. http://lexicon.ft.com/Term?term=return-on-equity—roe.
[6] Borsa Italiana – Glossario. *Return on Assets*. - Financial Times – Lexicon. *Definition of Return on Assets ROA*. www.borsaitaliana.it/bitApp/glossary.bit?target=GlossaryDetail&word=Return%20on%20Assets. http://lexicon.ft.com/Term?term=return-on-assets
[7] Financial Times – Lexicon. *Definition of Return on Equity ROE*. http://lexicon.ft.com/Term?term=return-on-equity—roe.

After having analysed the significance of variations in different financial measures, the study strives to assess whether disclosures required in IFRS 12 are actually provided in footnotes or not. This last step aims to broaden the analysis run by Asenbrenerovà (2016) and evaluate whether really IFRS 12 requirements have improved companies' disclosures about their investments in JVs. More specifically, the analysis is focused on checking the provision of summarised financial information for each material joint venture, which in the IASB's view shall outweigh the benefits coming from proportionally consolidating, in the investor's financial statements, the share of each joint ventures' item.

5.2 Empirical Results – General Overview

This section presents the results obtained from the assessment of the implications caused by the introduction of IFRS 11. As expected and proved by previous studies in literature, the transition from proportionate consolidation to the equity method caused on average a decrease in total assets, total liabilities, operating revenues, operating expenses and EBIT in all the three European indexes analysed. As explained by academicians, these variations were imaginable given that under EM joint ventures' assets, liabilities, revenues and expenses are no longer proportionally consolidated, while only a single line item depicting respectively the net investment on the balance sheet and the profit in the income statement is reported. On average, even the decrease in EBIT can be justified because the JVs' share of EBIT is not included in the venturer's income statement. However, as remarked by Leitner – Hanetseder and Stockinger (2014), the impacts on EBIT are not so straightforward as the effects depend on whether the entity or its joint ventures report a positive operating profit. For instance, if the joint ventures show a negative EBIT, a transition to equity method would bring the group's EBIT to rise, as a negative result would not be proportionally included[8]. By contrast, those firms whose joint ventures significantly contribute to increase operating profit would experience a material decline in EBIT. Following the materiality threshold recognised by Leitner – Hanetseder and Stockinger (2014), even in this study variations are judged to be material if they are above a materiality threshold of 5%. Accordingly, on average, material changes occurred in IBEX 35 with total liabilities decreasing on average by -5.07% and EBIT by -8.61%. In those firms listed in FTSE MIB, significant variations occurred on average for operating revenues, expenses and EBIT with decreases of -6.21%, -5.33% and -93.19% respectively. Concerning CAC 40, no material change occurred, even if the greatest variation came up in the EBIT with an average decrease of -4.05%.

[8] Leitner – Hanetseder, S., Stockinger, M. *How does the elimination of the proportionate consolidation method for joint venture investments influence European companies?* ACRN Journal of Finance and Risk Perspectives. Vol. 3, Issue 1, 1-18. (2014).

Table 5.2.1 shows a summary of the variations occurred in IBEX 35, FTSE MIB and CAC 40 by highlighting the percentage value of the mean, median, min. and max. per each financial item. On average changes in total liabilities are more relevant than those in total assets. Even the medians, which remove the effects of too high or too low observations, confirm this trend, apart from FTSE MIB, whose median variation in total assets is slightly higher (-2.35%) than the one in total liabilities (-2.15%). Interestingly, in all three indexes the most significant change appeared in the EBIT with decreases on average by -8.61% in IBEX 35, -93.19% in FTSE MIB and -4.05% in CAC 40. The value of the median for all three indexes is of course lower than the respective mean, -2.72% against -8.61% in IBEX 35, -9.73% against -93.19% in FTSE MIB and -2.80% against -4.05% in CAC 40.

TABLE 5.2.1 – **SUMMARY OF THE VARIATIONS IN IBEX 35 – FTSE MIB – CAC 40**

IBEX35				
Δ %	**Min.**	**Mean**	**Median**	**Max.**
Total Assets	-14.66%	-3.22%	-2.32%	-0.01%
Total Liabilities	-24.40%	**-5.07%**	-2.81%	-0.01%
Operating Revenues	-15.93%	-3.97%	-3.54%	-0.10%
Operating Expenses	-13.69%	-3.59%	-3.22%	-0.13%
EBIT	-62.70%	**-8.61%**	-2.72%	1.99%
Profit Margin	0.10%	4.38%	3.67%	18.95%
Leverage Ratio	-14.66%	-3.22%	-2.32%	-0.01%
Asset Turnover	-2.11%	-0.79%	-1.24%	0.60%
ROA	0.01%	3.54%	2.37%	17.17%
FTSE MIB				
Δ %	**Min.**	**Mean**	**Median**	**Max.**
Total Assets	-8.03%	-2.86%	-2.35%	-0.42%
Total Liabilities	-9.19%	-3.17%	-2.15%	-0.62%
Operating Revenues	-14.40%	**-6.21%**	-4.35%	-2.32%
Operating Expenses	-13.07%	**-5.33%**	-3.49%	-2.36%
EBIT	-502.17%	**-93.19%**	**-9.73%**	6.80%
Profit Margin	2.38%	**6.84%**	4.55%	16.82%
Leverage Ratio	-8.03%	-2.86%	-2.35%	-0.42%
Asset Turnover	-6.92%	-3.49%	-2.61%	-0.75%
ROA	0.42%	3.01%	2.40%	8.73%
CAC 40				
Δ %	**Min.**	**Mean**	**Median**	**Max.**
Total Assets	-12.66%	-1.95%	-1.15%	-0.22%
Total Liabilities	-14.56%	-2.62%	-1.60%	-0.26%
Operating Revenues	-19.19%	-3.15%	-2.17%	-0.03%
Operating Expenses	-18.76%	-3.08%	-1.75%	-0.02%
EBIT	-30.14%	-4.05%	-2.80%	5.74%
Profit Margin	0.03%	3.48%	2.22%	23.74%
Leverage Ratio	-12.66%	-1.95%	-1.15%	-0.22%
Asset Turnover	-7.47%	-1.27%	-0.78%	0.51%
ROA	0.22%	2.08%	1.16%	14.49%

Source: Authorial Elaboration

Despite variations may appear overall not so material, since their median values are in most cases lower than 5%, it must be remarked that results prove that the transition from PC to EM impacted to a great extent single firms in each European index. For instance, looking at the min. values, the materiality of some changes is astonishing, noticeable are the min. values of EBIT variations in all three indexes: -62.70% in IBEX 35, -502.17% in FTSE MIB and -30.14% in CAC 40. Significant are even the min. values of operating revenues and expenses variations: respectively -15.93% and -13.69% in IBEX 35, -14.40% and -13.07% in FTSE MIB, -19.19% and -18.76% in CAC 40. These findings highlight that, for some individual firms, JVs represent operationally an important strategic tool to run their business. Moreover, the fact that effects in EBIT are not always straightforward appears clear by looking at the EBIT max. value of each index. In all three indexes there is a positive change: +1.99% in IBEX 35, +6.80% in FTSE MIB and +5.74% in CAC 40, meaning that for some firms, moving to the equity method brought the consolidated operating profit to increase, as a result of not proportionally consolidating negative JVs' operating losses.

Table 5.2.1 exhibits also the overall results obtained from the computations of the variations occurred after the introduction of IFRS 11 for some significant financial ratios. Even in this case, changes are regarded to be material if above a materiality threshold of 5%. As showed by previous studies in literature, results confirm that on average in all indexes the profit margin increased since operating revenues at the denominator decrease while net income is kept unchanged. Precisely, the profit margin increased on average by 4.38% in IBEX 35, 6.84% in FTSE MIB and 3.48% in CAC 40. It is remarkable that, among all variations occurred in financial ratios, only the average increase of the profit margin in FTSE MIB may be evaluated as material (+6.84%). Corresponding median values, instead, are slightly lower (3.67% in IBEX 35, 4.55% in FTSE MIB and 2.22% in CAC 40) as they remove the effects of some extreme changes visible for instance in the column of the max. values (+18.95% in IBEX 35, +16.82% in FTSE MIB and +23.74% in CAC 40).

Likewise, findings confirm that on average ROA increased within all three European indexes. This trend was already anticipated in literature and in the present analysis it was easily conceivable given the decrease in total assets at the denominator. Anyway, looking at Table 5.2.1, on average percentage increases in ROA appeared not material (+3.54% in IBEX 35, +3.01% in FTSE MIB and +2.08% in CAC 40) although as proved by the max. values in each index, significant variations in ROA occurred for single companies: +17.17% in IBEX 35, +8.73% in FTSE MIB and +14.49% in CAC 40.

Finally, the average decline in leverage ratio and asset turnover confirms previous pro-forma findings in literature. The decline in leverage ratio is caused by an overall decrease of total assets at the nominator, while total shareholders' equity at the denominator is kept unchanged. Considering

median values, leverage ratio decreased by -2.32% in IBEX 35, -2.35% in FTSE MIB and -1.15% in CAC 40. On average variations are slightly higher (-3.22% in IBEX 35, -2.86% in FTSE MIB and -1.95% in CAC 40) because of the greater impact of the transition on some single companies, as proved by the min. values (-14.66% in IBEX 35, -8.03% in FTSE MIB and -12.66% in CAC 40). Overall, even the decrease in asset turnover is not that much significant within all three indexes, although again single companies were more affected than others (e.g. -6.92% in FTSE MIB and -7.47% in CAC 40). As in the case of EBIT, not all sampled companies showed a decrease in asset turnover. In fact, in limited cases there was an increase of the ratio as total assets at the denominator decreased by more than total operating revenues at the nominator (e.g. max. 0.60% in IBEX 35 and 0.51% in CAC 40).

Overall, looking at the values of the mean and median, firms listed in the IBEX 35 and FTSE MIB appear to have been more affected than those listed in CAC 40. More specifically, focusing on the median values, IBEX 35 showed greater changes in total liabilities than FTSE MIB, whereas this latter was more significantly affected than IBEX 35 in variations of assets, revenues, expenses, EBIT, profit margin, leverage ratio, asset turnover and ROA.

5.2.1 Empirical Results – Into the details of each European Index

The following section presents the details of the firms for each European index and it depicts the variations that every single firm experienced after the introduction of IFRS 11 for each financial statement figure and financial ratio mentioned above. This is useful to see which firms were more affected than others from the transition to the equity method.

For instance, companies that showed positive changes in operating profit in the first year of IFRS 11 adoption were Gas Natural and Tecnica Reunidas in IBEX 35 with +1.99% and +0.38% respectively (see Table 5.2.1.3), Saipem in FTSE MIB with +6.80% (see Table 5.2.1.6) and finally Louis Vuitton and Renault in CAC 40 with +0.46% and +5.74% respectively (see Table 5.2.1.9). In their footnotes these firms pointed out that their JCEs showed negative operating profits, this was the rationale behind the increase of the consolidated EBIT after the application of the equity method. Furthermore, the astonishing variation in EBIT mentioned above (-502.17%) referred to Leonardo, one of the firms listed in FTSE MIB.

It has already been explained that not all firms showed a decrease in asset turnover since in some cases the greater decrease in total assets rather than the one occurred in operating revenues led the ratio to rise slightly. Companies that experienced such an increase after the introduction of the new IFRS 11 were Endesa (+0.04%) and Gas Natural (+0.60%) in IBEX 35 as well as Airbus Group (+0.49%), Axa (+0.20%) and Engie (+0.51%) in CAC 40. All the relative tables follow.

TABLE 5.2.1.1 – **VARIATION IN TOTAL ASSETS AND TOTAL LIABILITIES – IBEX 35**

IBEX 35	Total Assets IAS 31 (PC)	Total Assets IFRS 11 (EM)	Δ %	Total Liabilities IAS 31 (PC)	Total Liabilities IFRS 11 (EM)	Δ %
ABERTIS (values in thousands of €)	28,133,532	27,627,582	**-1.80%**	21,543,909	21,037,959	**-2.35%**
BBVA (values in millions of €)	637,785	621,072	**-2.62%**	593,983	577,270	**-2.81%**
CELLNEX TELECOM (values in thousands of €)	838,606	833,404	**-0.62%**	351,123	345,921	**-1.48%**
ENAGAS (values in thousands of €)	7,210,600	7,043,498	**-2.32%**	5,071,225	4,904,123	**-3.30%**
ENDESA (values in millions of €)	56,457	55,957	**-0.89%**	29,688	29,195	**-1.66%**
GAS NATURAL (values in millions of €)	44,945	43,511	**-3.19%**	29,935	28,544	**-4.65%**
INDITEX (values in thousands of €)	13,756,261	13,363,603	**-2.85%**	4,477,898	4,254,544	**-4.99%**
REPSOL (values in millions of €)	65,086	55,547	**-14.66%**	37,166	28,097	**-24.40%**
TECNICA REUNIDAS (values in thousands of €)	2,362,948	2,362,695	**-0.01%**	1,924,428	1,924,175	**-0.01%**

Source: Authorial Elaboration

TABLE 5.2.1.2 – **VARIATION IN OPERATING REVENUES AND EXPENSES – IBEX 35**

IBEX 35	Operating Revenues IAS 31 (PC)	Operating Revenues IFRS 11 (EM)	Δ %	Operating Expenses IAS 31 (PC)	Operating Expenses IFRS 11 (EM)	Δ %
ABERTIS (values in thousands of €)	5,200,319	4,998,844	**-3.87%**	3,479,799	3,421,015	**-1.69%**
BBVA (values in millions of €)	39,912	38,383	**-3.83%**	38,253	36,801	**-3.80%**
CELLNEX TELECOM (values in thousands of €)	387,144	384,589	**-0.66%**	290,172	288,806	**-0.47%**
ENAGAS (values in thousands of €)	1,308,124	1,261,859	**-3.54%**	639,254	612,127	**-4.24%**
ENDESA (values in millions of €)	31,203	30,940	**-0.84%**	26,901	26,711	**-0.71%**
GAS NATURAL (values in millions of €)	25,233	24,574	**-2.61%**	22,270	21,552	**-3.22%**
INDITEX (values in thousands of €)	16,725,741	16,002,801	**-4.32%**	13,654,861	13,056,542	**-4.38%**
REPSOL (values in millions of €)	56,298	47,330	**-15.93%**	53,727	46,371	**-13.69%**
TECNICA REUNIDAS (values in thousands of €)	2,846,101	2,843,269	**-0.10%**	2,698,068	2,694,678	**-0.13%**

Source: Authorial Elaboration

TABLE 5.2.1.3 – **VARIATION IN EBIT – IBEX 35**

IBEX 35	EBIT IAS 31 (PC)	EBIT IFRS 11 (EM)	Δ %
ABERTIS (values in thousands of €)	1,720,520	1,673,789	**-2.72%**
BBVA (values in millions of €)	1,659	1,582	**-4.64%**
CELLNEX TELECOM (values in thousands of €)	96,972	95,783	**-1.23%**
ENAGAS (values in thousands of €)	668,870	649,732	**-2.86%**
ENDESA (values in millions of €)	4,302	4,229	**-1.70%**
GAS NATURAL (values in millions of €)	2,963	3,022	**1.99%**
INDITEX (values in thousands of €)	3,070,880	2,946,259	**-4.06%**
REPSOL (values in millions of €)	2,571	959	**-62.70%**
TECNICA REUNIDAS (values in thousands of €)	148,033	148,591	**0.38%**

Source: Authorial Elaboration

TABLE 5.2.1.4 – **VARIATION IN TOTAL ASSETS AND TOTAL LIABILITIES – FTSE MIB**

FTSE MIB	Total Assets IAS 31 (PC)	Total Assets IFRS 11 (EM)	Δ %	Total Liabilities IAS 31 (PC)	Total Liabilities IFRS 11 (EM)	Δ %
BUZZI UNICEM (values in thousands of €)	5,309,908	5,175,487	**-2.53%**	2,935,713	2,876,749	**-2.01%**
ENEL (values in millions of €)	164,148	163,455	**-0.42%**	111,309	110,623	**-0.62%**
LEONARDO (values in millions of €)	29,034	26,703	**-8.03%**	25,355	23,024	**-9.19%**
PRYSMIAN (values in millions of €)	5,702	5,529	**-3.03%**	4,507	4,346	**-3.57%**
SAIPEM (values in millions of €)	17,043	16,877	**-0.97%**	12,299	12,133	**-1.35%**
UNICREDIT (values in thousands of €)	845,838,444	827,538,083	**-2.16%**	795,663,677	777,482,398	**-2.29%**

Source: Authorial Elaboration

TABLE 5.2.1.5 – **VARIATION IN OPERATING REVENUES AND EXPENSES – FTSE MIB**

FTSE MIB	Operating Revenues IAS 31 (PC)	Operating Revenues IFRS 11 (EM)	Δ %	Operating Expenses IAS 31 (PC)	Operating Expenses IFRS 11 (EM)	Δ %
BUZZI UNICEM (values in thousands of €)	2,860,455	2,617,323	**-8.50%**	2,710,696	2,530,869	**-6.63%**
ENEL (values in millions of €)	80,535	78,663	**-2.32%**	70,591	68,923	**-2.36%**
LEONARDO (values in millions of €)	16,907	14,473	**-14.40%**	16,861	14,658	**-13.07%**
PRYSMIAN (values in millions of €)	7,338	7,062	**-3.76%**	6,978	6,733	**-3.51%**
SAIPEM (values in millions of €)	12,433	12,018	**-3.34%**	12,286	11,861	**-3.46%**
UNICREDIT (values in thousands of €)	24,402,169	23,196,206	**-4.94%**	18,190,538	17,658,738	**-2.92%**

Source: Authorial Elaboration

TABLE 5.2.1.6 – **VARIATION IN EBIT – FTSE MIB**

FTSE MIB	EBIT IAS 31 (PC)	EBIT IFRS 11 (EM)	Δ %
BUZZI UNICEM (values in thousands of €)	149,759	86,454	**-42.27%**
ENEL (values in millions of €)	9,944	9,740	**-2.05%**
LEONARDO (values in millions of €)	46	-185	**-502.17%**
PRYSMIAN (values in millions of €)	360	329	**-8.61%**
SAIPEM (values in millions of €)	147	157	**6.80%**
UNICREDIT (values in thousands of €)	6,211,631	5,537,468	**-10.85%**

Source: Authorial Elaboration

TABLE 5.2.1.7 – **VARIATION IN TOTAL ASSETS AND TOTAL LIABILITIES – CAC 40**

CAC 40	Total Assets IAS 31 (PC)	Total Assets IFRS 11 (EM)	Δ %	Total Liabilities IAS 31 (PC)	Total Liabilities IFRS 11 (EM)	Δ %
ACCOR (values in millions of €)	7,060	7,003	**-0.81%**	4,304	4,251	**-1.23%**
AIRBUS GROUP (values in millions of €)	93,311	90,274	**-3.25%**	82,257	79,368	**-3.51%**
AXA (values in millions of €)	757,143	755,441	**-0.22%**	701,829	699,998	**-0.26%**
BNP PARIBAS (values in millions of €)	1,800,139	1,792,556	**-0.42%**	1,708,977	1,701,601	**-0.43%**
BOUYGUES (values in millions of €)	34,304	34,215	**-0.26%**	25,620	25,546	**-0.29%**
CREDIT AGRICOLE (values in millions of €)	1,518,811	1,489,943	**-1.90%**	1,470,928	1,442,060	**-1.96%**
ENGIE (values in millions of €)	205,448	201,213	**-2.06%**	134,145	129,781	**-3.25%**
L'ORÉAL (values in millions of €)	31,298	30,879	**-1.34%**	8,656	8,236	**-4.85%**
LOUIS VUITTON (values in millions of €)	55,674	55,551	**-0.22%**	27,951	27,828	**-0.44%**
RENAULT (values in millions of €)	75,414	74,997	**-0.55%**	50,867	50,450	**-0.82%**
SAFRAN (values in millions of €)	23,973	23,698	**-1.15%**	17,159	16,885	**-1.60%**
SAINT GOBAIN (values in millions of €)	45,726	45,615	**-0.24%**	27,856	27,744	**-0.40%**
SOCGEN (values in millions of €)	1,235,262	1,214,193	**-1.71%**	1,181,161	1,160,223	**-1.77%**
TECHNIPFMC (values in millions of €)	13,251	12,737	**-3.88%**	9,077	8,563	**-5.66%**
UNIBAIL RODAMCO (values in millions of €)	29,571	29,422	**-0.50%**	15,086	14,937	**-0.99%**
VALEO SA (values in millions of €)	9,042	8,871	**-1.89%**	6,509	6,343	**-2.55%**
VEOLIA ENVIRONNEMENT (values in millions of €)	44,612	38,965	**-12.66%**	35,486	30,319	**-14.56%**

Source: Authorial Elaboration

TABLE 5.2.1.8 – **VARIATION IN OPERATING REVENUES AND EXPENSES – CAC 40**

CAC 40	Operating Revenues IAS 31 (PC)	Operating Revenues IFRS 11 (EM)	Δ %	Operating Expenses IAS 31 (PC)	Operating Expenses IFRS 11 (EM)	Δ %
ACCOR (values in millions of €)	5,536	5,425	**-2.01%**	3,777	3,694	**-2.20%**
AIRBUS GROUP (values in millions of €)	59,492	57,839	**-2.78%**	57,231	55,752	**-2.58%**
AXA (values in millions of €)	125,207	125,174	**-0.03%**	118,467	118,447	**-0.02%**
BNP PARIBAS (values in millions of €)	38,822	37,286	**-3.96%**	30,990	29,758	**-3.98%**
BOUYGUES (values in millions of €)	34,785	34,556	**-0.66%**	33,532	33,328	**-0.61%**
CREDIT AGRICOLE (values in millions of €)	15,681	15,338	**-2.19%**	14,025	13,811	**-1.53%**
ENGIE (values in millions of €)	91,407	89,975	**-1.57%**	83,578	82,290	**-1.54%**
L'ORÉAL (values in millions of €)	22,977	22,124	**-3.71%**	19,237	18,492	**-3.87%**
LOUIS VUITTON (values in millions of €)	29,149	29,016	**-0.46%**	23,255	23,095	**-0.69%**
RENAULT (values in millions of €)	41,270	40,720	**-1.33%**	41,148	40,591	**-1.35%**
SAFRAN (values in millions of €)	14,939	14,598	**-2.28%**	13,459	13,181	**-2.07%**
SAINT GOBAIN (values in millions of €)	42,025	41,761	**-0.63%**	39,261	39,007	**-0.65%**
SOCGEN (values in millions of €)	22,831	22,433	**-1.74%**	20,451	20,096	**-1.74%**
TECHNIPFMC (values in millions of €)	9,370	8,882	**-5.21%**	8,526	8,065	**-5.41%**
UNIBAIL RODAMCO (values in millions of €)	3,922	3,837	**-2.17%**	1,426	1,401	**-1.75%**
VALEO SA (values in millions of €)	12,110	11,662	**-3.70%**	11,315	10,896	**-3.70%**
VEOLIA ENVIRONNEMENT (values in millions of €)	29,439	23,791	**-19.19%**	28,344	23,026	**-18.76%**

Source: Authorial Elaboration

TABLE 5.2.1.9 – **VARIATION IN EBIT – CAC 40**

CAC 40	EBIT IAS 31 (PC)	EBIT IFRS 11 (EM)	Δ %
ACCOR (values in millions of €)	536	521	**-2.80%**
AIRBUS GROUP (values in millions of €)	2,261	2,087	**-7.70%**
AXA (values in millions of €)	6,740	6,727	**-0.19%**
BNP PARIBAS (values in millions of €)	7,832	7,528	**-3.88%**
BOUYGUES (values in millions of €)	1,253	1,228	**-2.00%**
CREDIT AGRICOLE (values in millions of €)	1,656	1,527	**-7.79%**
ENGIE (values in millions of €)	7,829	7,685	**-1.84%**
L'ORÉAL (values in millions of €)	3,740	3,632	**-2.89%**

LOUIS VUITTON (values in millions of €)	5,894	5,921	**0.46%**
RENAULT (values in millions of €)	122	129	**5.74%**
SAFRAN (values in millions of €)	1,480	1,417	**-4.26%**
SAINT GOBAIN (values in millions of €)	2,764	2,754	**-0.36%**
SOCGEN (values in millions of €)	2,380	2,337	**-1.81%**
TECHNIPFMC (values in millions of €)	845	817	**-3.31%**
UNIBAIL RODAMCO (values in millions of €)	2,496	2,436	**-2.40%**
VALEO SA (values in millions of €)	795	766	**-3.65%**
VEOLIA ENVIRONNEMENT (values in millions of €)	1,095	765	**-30.14%**

Source: Authorial Elaboration

TABLE 5.2.1.10 – **VARIATION IN PROFIT MARGIN AND LEVERAGE RATIO – IBEX 35**

IBEX 35	Profit Margin Net Income/Revenues IAS 31 (PC)	Profit Margin Net Income/Revenues IFRS 11 (EM)	Δ %	Leverage Ratio Total Assets/Shareholders' Equity IAS 31 (PC)	Leverage Ratio Total Assets/Shareholders' Equity IFRS 11 (EM)	Δ %
ABERTIS	0.14363465	0.149423747	**4.03%**	4.269368976	4.192589166	**-1.80%**
BBVA	0.058303267	0.060625798	**3.98%**	14.5606365	14.17907858	**-2.62%**
CELLNEX TELECOM	0.202741099	0.204088	**0.66%**	1.720277425	1.709606284	**-0.62%**
ENAGAS	0.309034923	0.320365429	**3.67%**	3.370423605	3.292315746	**-2.32%**
ENDESA	0.094317854	0.095119586	**0.85%**	2.109044043	2.090365722	**-0.89%**
GAS NATURAL	0.065945389	0.067713844	**2.68%**	2.994337109	2.898800799	**-3.19%**
INDITEX	0.142389207	0.148821759	**4.52%**	1.482617246	1.440297496	**-2.85%**
REPSOL	0.003463711	0.004120008	**18.95%**	2.331160458	1.989505731	**-14.66%**
TECNICA REUNIDAS	0.045136838	0.045181796	**0.10%**	5.388461188	5.387884247	**-0.01%**

Source: Authorial Elaboration

TABLE 5.2.1.11 – **VARIATION IN ASSET TURNOVER AND ROA – IBEX 35**

IBEX 35	Total Assets Turnover Revenues/Total Assets IAS 31 (PC)	Total Assets Turnover Revenues/Total Assets IFRS 11 (EM)	Δ %	ROA Net Income/Total Assets IAS 31 (PC)	ROA Net Income/Total Assets IFRS 11 (EM)	Δ %
ABERTIS	0.184844157	0.180936718	**-2.11%**	0.026550026	0.027036242	**1.83%**
BBVA	0.062579082	0.061801208	**-1.24%**	0.003648565	0.003746748	**2.69%**
CELLNEX TELECOM	0.461651837	0.461467668	**-0.04%**	0.093595801	0.094180014	**0.62%**
ENAGAS	0.181416803	0.179152319	**-1.25%**	0.056064128	0.05739421	**2.37%**
ENDESA	0.552686115	0.552924567	**0.04%**	0.052128168	0.052593956	**0.89%**
GAS NATURAL	0.561419513	0.564776723	**0.60%**	0.037023028	0.038243203	**3.30%**
INDITEX	1.215863889	1.1974915	**-1.51%**	0.173125895	0.178212792	**2.94%**
REPSOL	0.864978644	0.852071219	**-1.49%**	0.002996036	0.003510541	**17.17%**
TECNICA REUNIDAS	1.204470433	1.203400778	**-0.09%**	0.054365987	0.054371808	**0.01%**

Source: Authorial Elaboration

TABLE 5.2.1.12 – **VARIATION IN PROFIT MARGIN AND LEVERAGE RATIO – FTSE MIB**

FTSE MIB	Profit Margin Net Income/Revenues IAS 31 (PC)	Profit Margin Net Income/Revenues IFRS 11 (EM)	Δ %	Leverage Ratio Total Assets/Shareholders' Equity IAS 31 (PC)	Leverage Ratio Total Assets/Shareholders' Equity IFRS 11 (EM)	Δ %
BUZZI UNICEM	-0.010130207	-0.011071236	**9.29%**	2.236508796	2.179891289	**-2.53%**
ENEL	0.059353076	0.060765544	**2.38%**	3.106569012	3.093453699	**-0.42%**
LEONARDO	0.004376885	0.005112969	**16.82%**	7.891818429	7.258222343	**-8.03%**
PRYSMIAN	0.020986645	0.021806854	**3.91%**	4.771548117	4.626778243	**-3.03%**
SAIPEM	-0.010938631	-0.011316359	**3.45%**	3.592537943	3.557546374	**-0.97%**
UNICREDIT	-0.556637814	-0.585577228	**5.20%**	16.85784498	16.49311262	**-2.16%**

Source: Authorial Elaboration

TABLE 5.2.1.13 – **VARIATION IN ASSET TURNOVER AND ROA – FTSE MIB**

FTSE MIB	Total Assets Turnover Revenues/Total Assets IAS 31 (PC)	Total Assets Turnover Revenues/Total Assets IFRS 11 (EM)	Δ %	ROA Net Income/Total Assets IAS 31 (PC)	ROA Net Income/Total Assets IFRS 11 (EM)	Δ %
BUZZI UNICEM	0.538701424	0.505715308	**-6.12%**	-0.005457157	-0.005598893	**2.60%**
ENEL	0.490624315	0.481251721	**-1.91%**	0.029120062	0.029243523	**0.42%**
LEONARDO	0.582317283	0.541999026	**-6.92%**	0.002548736	0.002771224	**8.73%**
PRYSMIAN	1.286916871	1.277265328	**-0.75%**	0.027008067	0.027853138	**3.13%**
SAIPEM	0.729507716	0.712093382	**-2.39%**	-0.007979816	-0.008058304	**0.98%**
UNICREDIT	0.028849681	0.028030379	**-2.84%**	-0.016058823	-0.016413952	**2.21%**

Source: Authorial Elaboration

TABLE 5.2.1.14 – **VARIATION IN PROFIT MARGIN AND LEVERAGE RATIO – CAC 40**

CAC 40	Profit Margin Net Income/Revenues IAS 31 (PC)	Profit Margin Net Income/Revenues IFRS 11 (EM)	Δ %	Leverage Ratio Total Assets/Shareholders' Equity IAS 31 (PC)	Leverage Ratio Total Assets/Shareholders' Equity IFRS 11 (EM)	Δ %
ACCOR	0.025108382	0.02562212	**2.05%**	2.561683599	2.541001451	**-0.81%**
AIRBUS GROUP	0.02479325	0.025501824	**2.86%**	8.441378686	8.166636512	**-3.25%**
AXA	0.0382247	0.038234777	**0.03%**	13.68808981	13.65732003	**-0.22%**
BNP PARIBAS	0.140100974	0.145872445	**4.12%**	19.74659398	19.66341239	**-0.42%**
BOUYGUES	-0.018628719	-0.01875217	**0.66%**	3.950253339	3.940004606	**-0.26%**
CREDIT AGRICOLE	0.184044385	0.188160125	**2.24%**	31.71921141	31.11632521	**-1.90%**
ENGIE	-0.097465183	-0.099016393	**1.59%**	2.881337391	2.821942976	**-2.06%**
L'ORÉAL	0.128867998	0.133836558	**3.86%**	1.382237336	1.363732721	**-1.34%**
LOUIS VUITTON	0.117877114	0.118417425	**0.46%**	2.008224218	2.003787469	**-0.22%**
RENAULT	0.042040223	0.042608055	**1.35%**	3.072228786	3.055240966	**-0.55%**
SAFRAN	0.094718522	0.096931086	**2.34%**	3.518197828	3.477839742	**-1.15%**
SAINT GOBAIN	0.015014872	0.015109791	**0.63%**	2.558813654	2.552602126	**-0.24%**
SOCGEN	0.110595243	0.112557393	**1.77%**	22.83251696	22.44307869	**-1.71%**
TECHNIPFMC	0.060832444	0.064174735	**5.49%**	3.174652611	3.051509344	**-3.88%**
UNIBAIL RODAMCO	0.429372769	0.438884545	**2.22%**	2.041350269	2.031064476	**-0.50%**
VALEO SA	0.038728324	0.040216086	**3.84%**	3.799159664	3.727310924	**-1.89%**
VEOLIA ENVIRONNEMENT	0.018003329	0.022277332	**23.74%**	4.888450581	4.269669077	**-12.66%**

Source: Authorial Elaboration

TABLE 5.2.1.15 – **VARIATION IN ASSET TURNOVER AND ROA – CAC 40**

CAC 40	Total Assets Turnover Revenues/Total Assets IAS 31 (PC)	Total Assets Turnover Revenues/Total Assets IFRS 11 (EM)	Δ %	ROA Net Income/Total Assets IAS 31 (PC)	ROA Net Income/Total Assets IFRS 11 (EM)	Δ %
ACCOR	0.784135977	0.774667999	**-1.21%**	0.019688385	0.019848636	**0.81%**
AIRBUS GROUP	0.637566846	0.640704965	**0.49%**	0.015807354	0.016339145	**3.36%**
AXA	0.165367705	0.165696593	**0.20%**	0.006321131	0.006335372	**0.23%**
BNP PARIBAS	0.021566112	0.020800466	**-3.55%**	0.003021433	0.003034215	**0.42%**
BOUYGUES	1.014021688	1.009966389	**-0.40%**	-0.018889925	-0.018939062	**0.26%**
CREDIT AGRICOLE	0.010324524	0.010294354	**-0.29%**	0.001900171	0.001936987	**1.94%**
ENGIE	0.444915502	0.447162957	**0.51%**	-0.043363771	-0.044276463	**2.10%**
L'ORÉAL	0.734136367	0.716473979	**-2.41%**	0.094606684	0.095890411	**1.36%**
LOUIS VUITTON	0.523565758	0.522330831	**-0.24%**	0.061716421	0.061853072	**0.22%**
RENAULT	0.547245869	0.542955052	**-0.78%**	0.023006338	0.023134259	**0.56%**
SAFRAN	0.623159388	0.61600135	**-1.15%**	0.059024736	0.05970968	**1.16%**
SAINT GOBAIN	0.919061366	0.915510249	**-0.39%**	0.013799589	0.013833169	**0.24%**
SOCGEN	0.018482719	0.018475646	**-0.04%**	0.002044101	0.002079571	**1.74%**
TECHNIPFMC	0.707116444	0.697338463	**-1.38%**	0.043015621	0.044751511	**4.04%**
UNIBAIL RODAMCO	0.132629941	0.130412616	**-1.67%**	0.056947685	0.057236082	**0.51%**
VALEO SA	1.339305463	1.314620674	**-1.84%**	0.051869056	0.052868899	**1.93%**
VEOLIA ENVIRONNEMENT	0.659889716	0.610573592	**-7.47%**	0.011880212	0.01360195	**14.49%**

Source: Authorial Elaboration

5.3 Analysis of the Disclosure Requirements in IFRS 12

This final section presents the results coming from the analysis of the disclosures provided in footnotes in accordance with IFRS 12. The aim is to broaden the analysis run by Asenbrenerovà (2016) that was focused only on the Prague Stock Exchange and evaluate whether really IFRS 12 requirements have improved companies' disclosures about their investments in JVs as assured by the IASB. More specifically, the analysis, whose results are put forward, is focused on checking the provision of summarised financial information for each material joint venture, which in the IASB's view should better inform users about JVs' activities and performances than PC method does.

Disclosures play a relevant role within financial statements as they permit to explain to users important aspects relative to business performances as well as they allow to clarify financial figures so that third users may acquire a faithful and complete representation of the overall activity of the firm. Nonetheless, taking for granted that companies provide clear, understandable and exhaustive information in the notes appears to be not properly wise.

Indeed, what emerges from the research of Asenbrenerovà (2016) is that financial statements preparers seem not motivated to provide detailed information about their investments in JVs. Even the analysis run in this research work and focusing on 32 firms listed in IBEX 35, FTSE MIB and CAC 40 confirms this trend. Despite all companies disclosed in their footnotes general descriptive information about the nature of their material joint arrangements (e.g. name, activities undertaken, place of business and proportion of ownership interest), the main lack regarded the provision of

summarised financial information for each material joint venture. In accordance with what required by IFRS 12, summarised financial information should be presented on 100% basis and separately for each material JV. From the analysis of the footnotes disclosures, it is evident that not all firms provided the required information in IFRS 12. Indeed, each firm seems to have its own degree of disclosure. On one side, it is the IASB to leave parties free to fix the right level of detail to disclose information, on the other, this is not a justification for not providing financial information at all.

Table 5.3.1 shows that more than half of analysed companies did not provide the disclosures about financial information required in IFRS 12 for each material JV. Some firms limited to provide aggregate information disclosing for instance total assets, total liabilities, revenues and profit.

TABLE 5.3.1 – **IFRS 12 – DISCLOSURE OF SUMMARISED FINANCIAL INFORMATION IN IBEX 35 – FTSE MIB – CAC 40**

IFRS 12 DISCLOSURES	n/N
Current assets	**15/32**
Cash and cash equivalents included in current assets	**13/32**
Non-current assets	**15/32**
Current liabilities	**15/32**
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	**11/32**
Non-current liabilities	**15/32**
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	**11/32**
Revenue	**20/32**
Profit or loss from continuing operations	**21/32**
Post-tax profit or loss from discontinued operations	**4/32**
Other comprehensive income	**13/32**
Total comprehensive income	**12/32**
Dividends received from Joint Ventures	**13/32**
Depreciation and amortisation	**11/32**
Interest income	**11/32**
Interest expense	**11/32**
Income tax expense or income	**14/32**

Source: Authorial Elaboration

While Table 5.3.1 depicts the aggregate results for all three European indexes, Tables 5.3.2, 5.3.3 and 5.3.4, that follow, show the details of the analysis for each index. The degree of disclosure is heterogeneous even within each index. Overall, companies listed in CAC 40 are those to disclose the less, while firms listed in FTSE MIB appear to be the ones to disclose the most comprehensive summarised financial information for each material JV.

TABLE 5.3.2 – **IFRS 12 – DISCLOSURE OF SUMMARISED FINANCIAL INFORMATION IN IBEX 35**

DISCLOSURES IN IBEX 35 COMPANIES	n/N
Current assets	5/9
Cash and cash equivalents included in current assets	3/9
Non-current assets	5/9
Current liabilities	5/9
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	3/9
Non-current liabilities	5/9
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	3/9
Revenue	6/9
Profit or loss from continuing operations	7/9
Post-tax profit or loss from discontinued operations	1/9
Other comprehensive income	2/9
Total comprehensive income	1/9
Dividends received from Joint Ventures	2/9
Depreciation and amortisation	3/9
Interest income	3/9
Interest expense	3/9
Income tax expense or income	3/9

Source: Authorial Elaboration

TABLE 5.3.3 – **IFRS 12 – DISCLOSURE OF SUMMARISED FINANCIAL INFORMATION IN FTSE MIB**

DISCLOSURES IN FTSE MIB COMPANIES	n/N
Current assets	5/6
Cash and cash equivalents included in current assets	5/6
Non-current assets	5/6
Current liabilities	5/6
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	4/6
Non-current liabilities	5/6
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	4/6
Revenue	6/6
Profit or loss from continuing operations	6/6
Post-tax profit or loss from discontinued operations	2/6
Other comprehensive income	5/6
Total comprehensive income	5/6
Dividends received from Joint Ventures	4/6
Depreciation and amortisation	4/6
Interest income	3/6
Interest expense	3/6
Income tax expense or income	4/6

Source: Authorial Elaboration

TABLE 5.3.4 – **IFRS 12 – DISCLOSURE OF SUMMARISED FINANCIAL INFORMATION IN CAC 40**

DISCLOSURES IN CAC 40 COMPANIES	n/N
Current assets	5/17
Cash and cash equivalents included in current assets	5/17
Non-current assets	5/17
Current liabilities	5/17
Current financial liabilities (excluding trade and other payables and provisions) included in current liabilities	4/17
Non-current liabilities	5/17
Non-current financial liabilities (excluding trade and other payables and provisions) included in non-current liabilities	4/17
Revenue	8/17
Profit or loss from continuing operations	8/17
Post-tax profit or loss from discontinued operations	1/17
Other comprehensive income	6/17
Total comprehensive income	6/17
Dividends received from Joint Ventures	7/17
Depreciation and amortisation	4/17
Interest income	5/17
Interest expense	5/17
Income tax expense or income	7/17

Source: Authorial Elaboration

Furthermore, this analysis proves that less than half of companies in each European index provided disclosure of the relevant risks, unrecognised commitments or contingent liabilities connected with their investments in joint arrangements. Consequently, it seems that for most firms providing clear and accurate disclosures to financial analysts is not a priority while preparing financial statements.

Concluding, the findings do not support the IASB affirmation that eliminating proportionate consolidation would not cause any loss of useful information given that disclosure requirements in IFRS 12 would compensate the elimination of proportionally consolidated JVs' financial figures.

5.4 Final Observations

It would be interesting to know the outcome of the IASB's *Post Implementation Review* of IFRS 11 and IFRS 12, whose publication is in delay. Findings gathered from the analysis presented in this research work might be a small foretaste of what we can expect from the final Board's review. While this analysis focused only on those firms listed on three major European indexes and on the first year of IFRS 11 adoption, probably the Board will gather the feedback of a larger number of preparers across more than one financial year. Anyway, the fact that overall results show variations in median values not so material may support, from one point of view, the IASB's belief that IFRS 11 would have not caused particular effects in financial statements figures. However, from another standpoint, the introduction of IFRS 11 with the new IFRS 12 changes the way in which preparers convey information about their investments in joint ventures, which in most of cases are significant strategic tools to run businesses. While the IASB believed that disclosure requirements in IFRS 12 would have compensated the elimination of proportionally consolidated JVs' financial figures and would have helped users to acquire a complete understanding of the magnitude and relevance of investments in JVs, in practice results do not confirm the IASB's expectations. Really, it seems that for most preparers providing clear and accurate disclosures to financial users is not a priority while drawing up their financial statements. Probably, the application of IFRS 12, ad hoc formulated for integrating disclosure requirements, is one of the major tricky matter the IASB will have to properly justify. If the general purpose of financial statements is to meet the need of users, the IASB should really work in this sense. Accordingly, in view of future actions concerning IFRS 11 or IFRS 12, the Board should really strive to properly justify its decisions and think about potential implications without taking for granted anything. For instance, a possible way to reach this objective may be to strengthen collaboration with audit firms whose activity mainly consists in checking and validating organisations' financial statements prepared under IFRS, and even more, involve academicians in the IASB's due-process.

Last but not least, one critical issue observed during the analysis of firms' financial statements which deserves a particular note is that corporate reporting is effectively changing. Nowadays, this topic is subject of several debates concerning which kind of information investors really want to look at when valuing an investment. Especially after the global financial crisis of 2008, the spotlight started to focus on the relevance of good corporate reporting to restore trust in the market. Already in 2013, KPMG affirmed that investors want to have forward-looking information about strategy, business model and the ability of the company to create sustainable long-term value. Regulators as well are demanding much more information from companies and more accountability from boards

and managers[9]. Thus, while in the past financial statements were the prime focus of reporting, now attention is on non-financial information: corporate social responsibility or ESG (Environmental, Social and Governance) reporting. For instance, looking at companies' annual reports, it is evident that organisations are placing more and more focus on communicating their sustainable approach in running businesses (for instance they follow the GRI Framework for disclosing their economic, environmental and social impact[10]) or even more, firms are moving towards integrated reporting, a new evolution of traditional corporate reporting based on the value creation and addressed to all capital providers instead of only investors[11]. Really, some companies did not provide the disclosures indicated in IFRS 12 for material JVs but presented extensive descriptions about their sustainable approach in doing business (e.g. how they treat employees or natural resources, etc.) or about how they are able to create value with integrity.

Just to be more precise, in accordance with the International <IR> Framework, an integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term. Basically, keeping in mind potential risks and opportunities, firms should disclose the strategy adopted and how they allocate resources (financial, manufactured, intellectual, human, social and relationship and natural capital) within their business model in order to be able to create value to all their stakeholders, such as providers of financial capital, customers, employees, business partners, suppliers or the society at large[12].

The Board affirmed to be aware of such progressing change and for this reason it signed a Memorandum of Understanding with the *International Integrated Reporting Council* (IIRC) in 2013 and it is currently part of *Corporate Reporting Dialogue* (CRD)[13] aiming to communicate about the ongoing development of reporting frameworks, standards and related requirements. Even before 2013, the awareness of the limitations of financial reporting led the IASB to issue a non-mandatory document the *Management Commentary Practice Statement* in 2010, which encouraged managers to provide context to financial statements by reporting strategies, objectives, performance indicators as well as major strategic, operational and financial risks[14].

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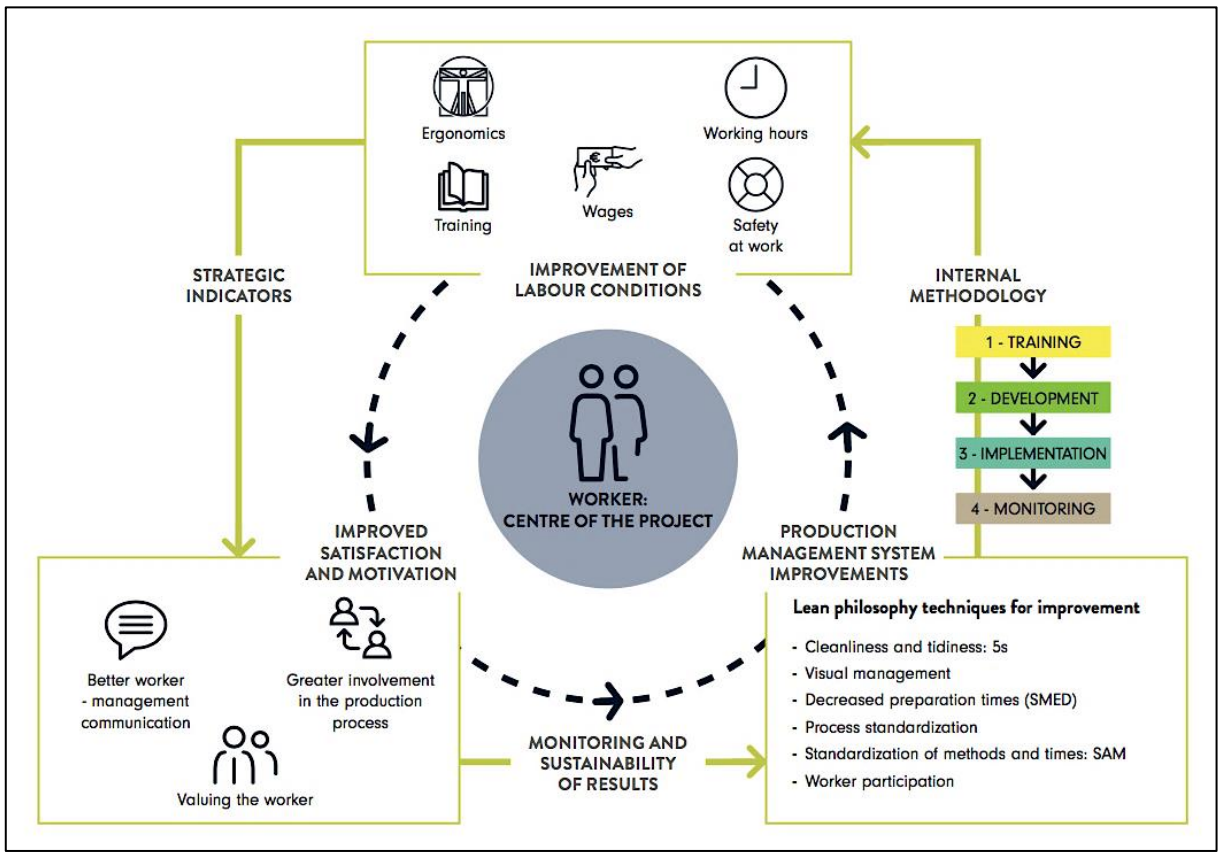
[9] KPMG. *The future of corporate reporting: towards a common vision*. (2013).
[10] GRI. *Sustainability Reporting*. www.globalreporting.org.
[11] IIRC. *Integrated Reporting. What? The tool for better reporting*. www.integratedreporting.org.
[12] IIRC. *Integrated Reporting. What? The tool for better reporting*. www.integratedreporting.org.
[13] IIRC. *Integrated Reporting. IFRS Foundation*. www.integratedreporting.org.
[14] IFRS Foundation. *IASB Chair's speech: the times, they are a-changin'*. (2017).

Probably in the forthcoming future an increasingly number of organisations will embrace the IR framework, thus maybe it is time for the IASB to intensify its cooperation for instance with the *International Integrated Reporting Council* (IIRC) to properly integrate financial reporting under IFRS with disclosures about business model, strategy, opportunities and risks. Certainly, this topic opens a new wide and complex field for further researches. Anyway, the evolution of corporate reporting should be a subject to work on for the IASB.

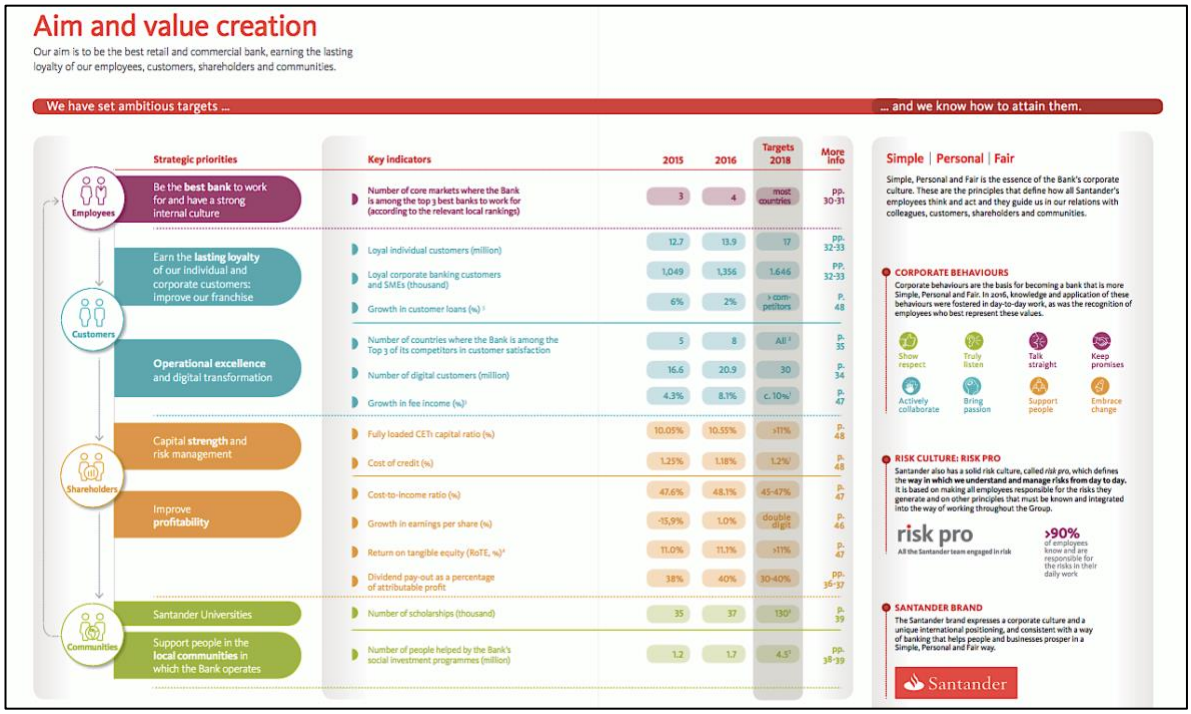
Figures 5.4.1 and 5.4.2 portray the direction taken by several companies for corporate reporting.

FIGURE 5.4.1 – **ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) REPORTING**



Source: Inditex 2016 Annual Report. IBEX 35.

FIGURE 5.4.2 – **TOWARDS INTEGRATED REPORTING**



Aim and value creation

Our aim is to be the best retail and commercial bank, earning the lasting loyalty of our employees, customers, shareholders and communities.

We have set ambitious targets ... ... and we know how to attain them.

	Strategic priorities	Key indicators	2015	2016	Targets 2018	More info
Employees	Be the **best bank** to work for and have a strong internal culture	Number of core markets where the Bank is among the top 3 best banks to work for (according to the relevant local rankings)	3	4	most countries	pp. 30-31
Customers	Earn the **lasting loyalty** of our individual and corporate customers: improve our franchise	Loyal individual customers (million)	12.7	13.9	17	pp. 32-33
		Loyal corporate banking customers and SMEs (thousand)	1,049	1,356	1.646	pp. 32-33
		Growth in customer loans (%) [1]	6%	2%	> competitors	p. 48
	Operational excellence and digital transformation	Number of countries where the Bank is among the Top 3 of its competitors in customer satisfaction	5	8	All [2]	p. 35
		Number of digital customers (million)	16.6	20.9	30	p. 34
		Growth in fee income (%) [3]	4.3%	8.1%	c.10% [3]	p. 47
Shareholders	Capital **strength** and risk management	Fully loaded CET1 capital ratio (%)	10.05%	10.55%	>11%	p. 48
		Cost of credit (%)	1.25%	1.18%	1.2% [3]	p. 48
	Improve **profitability**	Cost-to-income ratio (%)	47.6%	48.1%	45-47%	p. 47
		Growth in earnings per share (%)	-15.9%	1.0%	double digit	p. 46
		Return on tangible equity (RoTE, %) [4]	11.0%	11.1%	>11%	p. 47
		Dividend pay-out as a percentage of attributable profit	38%	40%	30-40%	pp. 36-37
Communities	Santander Universities	Number of scholarships (thousand)	35	37	130 [5]	p. 39
	Support people in the **local communities** in which the Bank operates	Number of people helped by the Bank's social investment programmes (million)	1.2	1.7	4.5 [5]	pp. 38-39

Simple | Personal | Fair

Simple, Personal and Fair is the essence of the Bank's corporate culture. These are the principles that define how all Santander's employees think and act and they guide us in our relations with colleagues, customers, shareholders and communities.

CORPORATE BEHAVIOURS

Corporate behaviours are the basis for becoming a bank that is more Simple, Personal and Fair. In 2016, knowledge and application of these behaviours were fostered in day-to-day work, as was the recognition of employees who best represent these values.

Show respect · Truly listen · Talk straight · Keep promises · Actively collaborate · Bring passion · Support people · Embrace change

RISK CULTURE: RISK PRO

Santander also has a solid risk culture, called *risk pro*, which defines the **way in which we understand and manage risks from day to day.** It is based on making all employees responsible for the risks they generate and on other principles that must be known and integrated into the way of working throughout the Group.

risk pro — All the Santander team engaged in risk

>90% of employees know and are responsible for the risks in their daily work

SANTANDER BRAND

The Santander brand expresses a corporate culture and a unique international positioning, and consistent with a way of banking that helps people and businesses prosper in a Simple, Personal and Fair way.

Santander

Source: Santander 2016 Annual Report. IBEX 35.

CHAPTER 6.

IFRS 11 & THE CONVERGENCE ISSUE WITH US GAAP

6.1 Does a real convergence occur? The IASB's response

Numerous respondents to the Exposure Draft argued that the proposals of the IASB would not reduce differences between IFRSs and US GAAP, but indeed they could lead to new diversities. One of the comments made more frequently referred to the fact that US GAAP permits to use the proportionate consolidation method for unincorporated legal entities operating in the construction and extractive industries where there is a long-standing practice of using it[1]. Specifically, numerous respondents among which Deloitte and KPMG (2008) believed that the elimination of the option to proportionately consolidate would not reach a further convergence with the US accounting but would create even more circumstances of divergences in certain industries (e.g. mining and oil & gas) where for instance some arrangements fall within the definition of *joint venture* under IFRS 11, while under US GAAP the same are permitted to be proportionately consolidated[2].

Furthermore, the introduction of the principle-based approach, which goes beyond the mere assessment of the existence of a separate legal entity for the classification of joint arrangements, would lead to additional differences between IFRSs and US GAAP[3]. In this regard, KPMG (2008) remarked that within the US accounting system, the role of the legal form is critical in evaluating the applicability of the equity method. Thus, if an arrangement involves the establishment of a legal entity, it is accounted for by using the equity method under US GAAP, while it may be accounted for through recognition of assets, liabilities, revenues and expenses if the principle-based approach under IFRS 11 classifies that arrangement as a joint operation[4].

Before to officially issue the new IFRS 11, the IASB was aware of the differences persisting with respect to the US GAAP approach to joint ventures. Nonetheless, in its *Effect Analysis* (2011) the Board argues that IFRS 11 would achieve closer convergence with US GAAP than IAS 31 did[5]. Even in its *Feedback Statement* (2011) the IASB states that although the US GAAP requirements are more industry specific and very dependent on the legal form of the arrangements, the IASB expects that most of the arrangements established through unincorporated legal entities would be classified

[1] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[2] IFRS Foundation. *Comment Letters*. (2008). www.ifrs.org.
[3] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[4] IFRS Foundation. *Comment Letters*. (2008). www.ifrs.org.
[5] IFRS Foundation. *Effect Analysis*. (2011). www.ifrs.org.

as joint operations under IFRS 11. Therefore, this would bring the arrangements belonging to the extractive and construction industries to be accounted for similarly under IFRS 11 and US GAAP[6]. As regards arrangements structured through a separate legal entity, in its *Effect Analysis* (2011) the IASB expects that convergence would increase for those arrangements, such as corporations, that can be considered in their own right. Specifically, the IASB expects that most of the arrangements structured in separate vehicles would be joint ventures under IFRS 11 because the analysis of the terms of the contractual arrangements and other facts and circumstances would, in the majority of cases, be aligned with the effects caused by the assessment of the legal form of the separate vehicle[7]. In such cases, US GAAP requires the venturer to use the equity method, as well as IFRS 11, as a result of the elimination of proportionate consolidation.

Nevertheless, in its *Feedback Statement* (2011) the IASB acknowledges that some arrangements established through legal entities may be classified as joint operations in accordance with IFRS 11 and accordingly may be required to account for assets, liabilities, revenues and expenses, while the same would be accounted for using the equity method under US GAAP. To justify this divergence, the IASB has simply affirmed to consider the requirements provided in IFRS 11 to be able to give a more faithful representation than US GAAP and that the benefits of providing better information would outweigh the disadvantages caused in such cases by a lack of convergence with US GAAP[8].

As regards what stated by the IASB, Saccon et al. (2012) perceive the argumentations of the Board unpersuasive and *somewhat hopeful* and believe conversely that these differences between IFRS 11 and US GAAP might lead to *opportunistic classification and accounting treatment of joint arrangements* [9]. As a result, the joint arrangements short-term convergence project seems to have failed to bring a real convergence. Indeed, this was imaginable since in its July 2006 meeting, the IASB argued that the main goal of its revision project was to *converge with the US accounting literature for jointly controlled entities rather than to harmonise with existing US practice generally*[10].

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[6] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[7] IFRS Foundation. *Effect Analysis*. (2011). www.ifrs.org.
[8] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[9] Alexander, D., Delvaille, P., Demerens, F., Le Mahn, A., Saccon, C. *La consolidation des co-entreprises en IFRS: étude de l'impact du changement de méthodes pour les sociétés européennes. Reporting methods for Joint Ventures: which consequences for European listed companies?* 33ème Congrès de l'AFC. (2012).
[10] IASB. *IASB Update July 2006*. www.ifrs.org.

Even Baudot (2014) claims that IFRS 11 has brought only a partial convergence with respect to the requirements of US GAAP. Not by case, the approach to convergence for addressing the joint ventures project identified by Baudot (2014) refers to *direct emulation*, meaning that one of the existing IFRS or US GAAP standards was identified as best practice and essentially copied into the other standard setter's accounting system. Precisely for the joint ventures project, it was the IASB the one responsible for emulating the FASB's standards[11]. Thus, while referred to as a short-term convergence project, IFRS 11 involved only an initial coordination between the boards and mainly individual efforts by the IASB engaged with the revision of its old standard IAS 31. Additionally, Baudot (2014) sustains that the convergence process between the two boards and their standards appears to be somewhat influenced by a mix of cooperation and competition, in which in the case of the direct emulation approach, the IASB largely showed passivity in directly accepting US GAAP as the best practice without insisting on actively working together to deeply understand the more suitable approach in consideration of the existing environmental differences[12]. The absence of an active joint work in addressing the FASB and IASB short-term convergence projects is confirmed by what argued by one of the IASB's members in occasion of an interview with Baudot in 2011[13]:

> *The so-called 'short-term projects' were identified as possibly easy to solve in the short term and this was to be performed over a three years period from 2006 to 2009 – the period covered by the first tri-annual agreement. The approach here was to say let's compare and let's see why there is a difference. If in one case we found 'solution A is better than solution B,' so we adopt solution A, and in another case the opposite. As an example, what we did on IFRS 8 – Segment Reporting was to drop IAS 14 and adopt US GAAP because it seems to be better aligned with the needs of investors and there is more support for the US approach, so we adopted it. In other cases, FASB adopted the IASB solution.*

[11] Baudot, L. *GAAP convergence or convergence Gap: unfolding ten years of accounting change*. Accounting, Auditing & Accountability Journal. Vol. 27, Issue 6, 956-994. (2014).
[12] Baudot, L. Accounting, Auditing & Accountability Journal. Vol. 27, Issue 6, 956-994. (2014).
[13] Interview 4 in person with the IASB on 26th October 2011. Baudot, L. Accounting, Auditing & Accountability Journal. Vol. 27, Issue 6, p. 977. (2014).

6.2 Differences between IFRS 11 and US GAAP

As already introduced, substantial differences persist between the IASB and FASB approach to joint arrangements. Surprisingly, divergences exist even in the definitions of joint arrangements and joint control. Indeed, the concept of *joint arrangement* is not conceived in the US GAAP. Even more, the term *joint venture* refers only to jointly controlled entities, where the arrangement is carried out through a separate vehicle[14]. According to the *ASC Master Glossary* a joint venture is defined as: *a corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A noncontrolling interest held by public ownership, however, does not preclude a corporation from being a corporate joint venture*[15]. Considering the definition provided in ASC 323-10-20, Ernst & Young (2017) believes that to meet the definition of a joint venture under US GAAP, arrangements should meet several characteristics. Most importantly, as explicitly required, there must be a separate legal entity carrying out the activities with its own assets and liabilities. As a consequence, a joint venture must have a separate, legal decision-making identity with which the activities are jointly controlled by the venturers through their equity investments. Accordingly, entities might be organised in a variety of legal forms such as *corporations, partnerships, limited-liability companies, other unincorporated legal entities and trusts* (ASC 810-10-20)[16].

Even the concept of *joint operation* is not embodied within the US accounting system, which conversely defines *collaborative contractual relationships* as opposed to joint ventures. Since this type of collaboration does not entail the formation of a separate legal entity, it does not constitute a joint venture by definition, even if sometimes it is called *virtual joint venture*[17]. Usually, such arrangements involving a joint operating activity are designed to achieve marketing purposes or to develop and commercialise intellectual property, and because of their nature (each participating company retains

[14] Grant Thornton. *Comparison between US GAAP and IFRS Standards*. (2017).
[15] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 40. (2017).
[16] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* pp. 41-42. (2017).
[17] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 43. (2017).

its own assets and continues to run its activities separately from the other entities) they are recorded by recognising in the income statement costs incurred and revenues generated from transactions with third parties not participating in the same arrangement (in accordance with ASC 808-10)[18]. Clearly, this is another evident difference with respect to IFRS 11, which requires joint operators to account for their interest in joint arrangements not structured through a separate legal entity by recognising their share of assets, liabilities, revenues and expenses as indicated in their contractual arrangement[19].

What is more, US GAAP does not have an authoritative concept of *joint control*. Nonetheless, the *ASC Master Glossary* includes a general definition, that is *joint control occurs if decisions regarding the financing, development, sale, or operations require the approval of two or more of the owners*. Interestingly, joint control is not mentioned in the context of identifying joint ventures, rather it is only used once in the real estate industry guidance in the context of distinguishing between when to apply the equity method or proportionate consolidation to real property owned by undivided interests (ASC 970-323)[20]. Given the absence of a precise indication by the FASB, Ernst & Young (2017) believes that joint control exists when *all* of the significant decisions related to an entity require the unanimous consent of *all* the venturers (with the sole exception in case of small non-controlling interests held by public ownership). Consequently, as in the case of IFRS 11, venturers have more than a passive participation in a joint venture, since unanimous consent occurs when any individual venturer can prevent any other venturer or group of venturers from taking *significant decisions*[21] without its consent (e.g. via substantive approval[22] or veto rights)[23].

Under IFRS 11, the classification of a joint arrangement as a joint venture or a joint operation determines the accounting method to be followed by the investor. On the opposite case, US GAAP adopts an industry specific approach[24].

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[18] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 43. (2017).
[19] Grant Thornton. *Comparison between US GAAP and IFRS Standards*. p. 168. (2017).
[20] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 45. (2017).
[21] Under the Voting Model's framework, significant decisions are those related to significant financing, operating and investing activities undertaken in the normal course of business. For example: selecting, terminating or setting the compensation of the management, establishing the operating and capital decisions of the investee such as the budgets in the ordinary course of business Ernst & Young. pp. 45-46. (2017).
[22] To be substantive, rights must have no significant barriers to exercise (i.e. significant penalties or other hurdles). Ernst & Young. p. 45. (2017).
[23] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* pp. 44-45. (2017).
[24] PwC. *IFRS and US GAAP: similarities and differences.* pp. 12-9. (2017).

Precisely, US GAAP requires the equity method to account for corporations in accordance with ASC 323-10-30-2 and ASC 805-50-30[25]. This is the general requirements even for investors participating in unincorporated entities, as for example partnerships[26]. Nonetheless, because of the US GAAP industry specific approach, investments in unincorporated legal entities operating either in the construction or in the extractive industry, are permitted to use proportionate consolidation in accordance with ASC 810-10-45-14[27]. Specific guidance of US GAAP for the real estate industry causes another peculiarity for a real property owned by *undivided interests* (not structured through a separate vehicle) and subject to joint control by the owners. In such an event, the investor should account for neither by recording costs and revenues, nor by pro-rata consolidating, but by applying the equity method in accordance with ASC 970-323-25-12[28]. However, another exception emerges if the ownership is not subject to joint control, since in such a situation, ASC 970-810-45-1 should be applied. Under that guidance, an investment in real property may be presented by recording the undivided interest of the investor in the venture's assets, liabilities, revenues and expenses if all the following conditions are met:

- the real property is owned by undivided interests;
- the approval of two or more of the owners is not required for those decisions concerning the financing, development, sale, or operations of the real estate owned;
- each investor is entitled to only its pro-rata share of income;
- each investor is responsible to pay only its pro-rata share of expenses;
- each investor is severally liable only for indebtedness it incurs relative to its interest in the property[29].

All in all, it is evident from the argumentations exhibited so far that different approaches and different concepts inevitably cause significant **convergence gaps**.

[25] Grant Thornton. *Comparison between US GAAP and IFRS Standards*. p. 169. (2017).
[26] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 23. (2017).
[27] Grant Thornton. *Comparison between US GAAP and IFRS Standards*. p. 169. (2017).
[28] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 28. (2017).
[29] Ernst & Young. *Financial reporting developments. A comprehensive guide. Equity method investments and joint ventures.* p. 28. (2017).

6.3 Proposal for a convergence starting from the basis not from the standards

FASB and IASB have been committing in working together towards a convergence of their respective accounting principles since 2002. Despite the IASB sustains to have achieved with IFRS 11 a closer convergence with US GAAP, substantial differences between the boards' approaches to the joint venture argument persist[30], meaning that probably it is not sufficient to work on short-term convergence projects to attain the long-term objective of a common set of global standards.

Indeed, to reduce divergences in financial statements following the application of IFRS and US GAAP, it is reasonable thinking that the boards should put real effort in reaching a common conceptual and methodological basis from which then they might work to achieve convergence in the single standards addressing the accounting for specific items. Hence, it seems logical and fair to believe that before to intervene on single standards, the two boards should commit themselves in creating a **common conceptual framework** which might pose shared and common views from which starting to work on short-term convergence projects and other major joint projects.

It is worth recalling that in 2004 IASB and FASB started a **joint comprehensive project** on the conceptual framework with the aim of revising and converging their conceptual frameworks[31]. The project was structured into eight phases: **phase A** – *objectives and qualitative characteristics*, **phase B** – *definitions of elements, recognition and de-recognition*, **phase C** – *measurement*, **phase D** – *reporting entity concept*, **phase E** – *boundaries of financial reporting, presentation and disclosure*, **phase F** – *purpose and status of the framework*, **phase G** – *application of the frameworks to not-for profit entities* and **phase G** – *remaining issues* [32].

However, only phase A was jointly completed. In fact, in late 2010, the boards decided to postpone further joint actions until other major and more urgent projects were completed. Finally, it was agreed to stop any effort in working together on a common framework. Thus, the outcome of that joint comprehensive project was only the issuance of Chapter 1 – *The objective of general purpose financial reporting* and Chapter 3 – *Qualitative characteristics of useful financial information* [33] that currently form part of each standard setter's framework. As a matter of fact, all other relevant and critical issues such as revising the definition of assets and liabilities, resolving differences about recognition criteria concepts, choosing a common way to describe measurement bases, defining the boundary of the reporting entity and the connected concept of control were not agreed, leaving again room

[30] IFRS Foundation. *Project Summary and Feedback Statement*. (2011). www.ifrs.org.
[31] FASB. *Exposure Draft. Proposed Statement of Financial Accounting Concepts. Concepts Statement 8 – Conceptual Framework for financial reporting*. Chapter 7: Presentation. p. 1. (2016). www.fasb.org.
[32] Kaminski, K., Carpenter, J. *Accounting Conceptual Frameworks: a comparison of IASB and FASB approaches.* International Journal of Business, Accounting and Finance. Vol. 5, No. 1, 16-26. (2011).
[33] FASB. *Exposure Draft. Proposed Statement of Financial Accounting Concepts. Concepts Statement 8 – Conceptual Framework for financial reporting*. Chapter 7: Presentation. p. 1. (2016). www.fasb.org.

for different interpretations among IFRS and US GAAP users[34]. Afterwards, in 2012 the IASB restarted its conceptual framework project alone and in 2014 the FASB made the same. Thus, while the IASB is going to publish its new version around the end of the first quarter 2018[35], the FASB is proceeding following a step-by step approach, by working on one topic at a time, which once completed is issued through an exposure draft. At the moment, the FASB is supposed to work on the concepts for measurement and disclosures and on revising the definitions of the elements of financial statements (assets, liabilities, revenue, expenses, gains and losses)[36].

McGregor and Street (2007) sustain that the failure of the joint conceptual framework project would bring the framework to remain an incomplete document which would prevent the standard setters to have a clearly articulated conceptual basis on which relying their argumentations. Hence, the FASB and the IASB would probably continue to face debates about the merits of competing measurements. As a matter of fact, McGregor and Street (2007) claim the real urgency of the joint framework project and the necessity to make it a living document[37].

Despite having a common, *living* basis may help IASB and FASB draft accounting principles closer in substance, the significant role played by a joint framework has been undervalued by the boards since the beginning of their roadmap for convergence. This is proved from what they stated in the progress report for completion of the roadmap in 2008. Indeed, they argued that the joint conceptual framework project was not formally part of their Memorandum of Understanding work plan and accordingly, they gave a higher priority in terms of efforts in addressing those topics being part of their MoU[38].

If a real comparability of financial statements across countries is one of the main goals of the convergence process between FASB and IASB, they should seriously consider the necessity to start working from the foundations of each set of accounting standards. They should also agree on the status of the framework within the GAAP hierarchy. As sustained by McGregor and Street (2007), within US GAAP, the framework has *an insignificant status at the bottom of the hierarchy*[39], meaning that the framework does not have any real power or authority with respect to the US generally accepted accounting principles.

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[34] Kaminski, K., Carpenter, J. *Accounting Conceptual Frameworks: a comparison of IASB and FASB approaches.* International Journal of business, Accounting and Finance. Vol. 5, No 1, 16-26. (2011).
[35] IFRS Foundation. *Conceptual Framework. Current Stage.* www.ifrs.org.
[36] FASB. *The Conceptual Framework. What does the future hold for the framework?* www.fasb.org.
[37] McGregor, W., Street, D. *IASB and FASB Face Challenges in Pursuit of Joint Conceptual Framework.* Journal of International Financial Management and Accounting. 18:1. (2007).
[38] FASB – IASB. *Completing the February 2006 Memorandum of Understanding: a progress report and timetable for completion September 2008*. (2008).
[39] McGregor, W., Street, D. *IASB and FASB Face Challenges in Pursuit of Joint Conceptual Framework.* Journal of International Financial Management and Accounting. 18:1. (2007).

In confirmation of this, the FASB affirms that its conceptual framework mainly helps the standard setting process by providing common premises and precise terminologies that however do not override the authoritative standards[40]. On the opposite case, at least theoretically, the IASB recognises a more relevant role to its framework, as it should not only help the Board in developing standards based on consistent concepts, but it should assist preparers when no standard regulates a certain transaction or when a standard allows a choice of accounting policy and generally it should support financial statements users to understand and interpret accounting principles[41]. McGregor and Street (2007) support the extreme importance of elevating the status of the framework in the US. Indeed, in their view, including the framework in the GAAP hierarchy may contribute to make the body of GAAP more robust. In this way, if a transaction is not covered in existing standards, and a solution cannot be found by analogy or through interpretations, a consistent guide is obtained by applying a recognised framework. Moreover, McGregor and Street argue that if accountants are better equipped for problem-solving and if the GAAP hierarchy embodies a well-maintained and robust conceptual framework, standard setters might be less inclined to develop detailed standards and copious interpretations[42].

In conclusion, the words of Ian Mackintosh, Chair of the UK Accounting Standards Board, pronounced in 2007 are meaningful and significant as they express the importance of cooperating to set out a robust and joint conceptual framework[43]:

> *While many may think of the conceptual framework project as simply an academic subject far removed from the practical day to day world of accounting, that is not the case.*
> *The framework will have far-reaching practical implications in influencing the future direction of financial reporting.*

[40] IFRS Foundation. *Exposure Draft ED/2015/3. Conceptual Framework for Financial Reporting.* (2015).
[41] FASB. *The Conceptual Framework. What is the conceptual framework?* www.fasb.org.
[42] McGregor, W., Street, D. *IASB and FASB Face Challenges in Pursuit of Joint Conceptual Framework.* Journal of International Financial Management and Accounting. 18:1. (2007).
[43] McGregor, W., Street, D. *IASB and FASB Face Challenges in Pursuit of Joint Conceptual Framework.* Journal of International Financial Management and Accounting. 18:1. (2007).

As introduced at the beginning, in the research introduction, this study revolved around three main questions:

- *Why has the IASB decided to review IAS 31 and eliminate proportionate consolidation?*
- *Which effects and implications have occurred in companies consolidated financial statements following the introduction of IFRS 11?*
- *Is it possible to affirm that the IASB has reached a real convergence with the FASB as far as the accounting treatment for joint ventures is concerned?*

Practitioners and academics have debated the potential impacts of joint ventures on financial statements of investor firms and alternative accounting treatments since the sixties. During the 90s the research activity in this field became even more intense since joint ventures spread as a common strategic tool to develop a business. Despite accounting for JV has been at the centre of numerous studies, it still remains a critical issue, as no international consent on the more appropriate reporting method exists. In this framework, it was interesting to analyse the development of *IFRS 11 – Joint Arrangements* by the IASB as this research work revealed the unjustified inconsistency of the Board in the position taken regarding accounting reporting for joint ventures.

Indeed, already in the 90s, bright debates among international standard-setters were focused on recognising the most suitable reporting method between proportionate consolidation and equity method: the former entails the proportional consolidation in venturers' financial statements of the JV's share of assets, liabilities, revenues and expenses, the latter, instead, depicts a single line item in the venturers' balance sheet (representing the value of the investment in the joint venture) and a single line item (portraying the venturer's proportion of the net income of the joint venture) in the income statement. As stated by Richardson et al. (2012) the key point in those debates regarded whether the co-venturer can really control the jointly controlled assets and accordingly whether the co-venturer is ultimately responsible for the joint liabilities. In such debatable context, the G4 + 1 report (1999) promoted by the FASB concluded that the equity method was the most appropriate method to report an interest in a joint venture, given the conceptual inconsistency of PC with the definitions of an asset and a liability, that is a venturer cannot control its pro-rata share of JV assets and it is not directly responsible for a portion of joint venture's debt.

At first, the revision of IAS 31 was conceived within a IASB project of reducing accounting options (boosted mainly by the SEC and the IOSCO) in 2001, afterwards in 2006 it became integral part of a roadmap of convergence with the FASB aimed to reduce differences between IFRSs and

US GAAP. Interestingly, the US standard-setter never took part on the outreach activity and in the final approval of the new standard. IFRS 11 introduced a *principle-based approach* for classifying joint arrangements into joint operations and joint ventures and it definitely removed PC, which in IAS 31 was judged to be the preferred and benchmark treatment while the EM was just regarded as the alternative allowed method. The IASB justified the issuance of a new standard by stating that there were two main weaknesses connected with IAS 31: first, the structure of the arrangement was the only determinant of the accounting, and second, an entity had a choice of accounting method that could lead arrangements common in substance to be accounted for differently. Indeed, across the time period of the revision project the Board used different argumentations to sustain its decisions: in December 2005 the IASB affirmed the need to be consistent with the Framework's definitions by recognising only controlled assets and present obligations and stressed the major comparability following the elimination of options and a convergence in principle with US GAAP; in 2006 instead the IASB, being conscious of the fact that US GAAP allows in limited cases for specific industries (e.g. oil & gas, extracting and construction industries) proportionate consolidation, clearly stated that the principal goal of its revision project was to converge with the US accounting literature for jointly controlled entities rather than achieve harmonisation with existing US practices; in 2011 in its *Basis for Conclusions on IFRS 11*, the IASB did not refer to any inconsistency argument, instead it mentioned first the principle-based approach as one of the reasons justifying the EM for reporting investments in JVs, second the better convergence with US GAAP, even if not complete, and third the better verifiability, comparability and understandability of financial statements achievable with IFRS 11. As a matter of fact, given that the IASB did not support its conclusions in favour of the equity method with clear and coherent arguments or with any theoretical research background, for several academicians this was an evident signal that the main concern for the IASB was to enhance its acceptance and that of its standards towards the SEC and the FASB which appear still reluctant to endorse or adopt IFRS for domestic issuers. The tendency of the Board to search for approval with regard to the accounting treatment for joint ventures was confirmed even during the issuance of the first version of IAS 31 in 1990. At that time, the choice of the proportionate consolidation as the preferred method revealed to be a pragmatic issue rather than a conceptual one as it was the preferred method for some constituents and the equity method was allowed as alternative to meet the preferences of the SEC, the UK standard setter and numerous US and UK firms. Hence, from the outset, the IASB and previously the IASC did not anchor their accounting requirements on a solid basis made up, for instance, of concrete researches or studies proving that one method was effectively more beneficial for financial information users. All these issues can seriously cast doubts about the real independence of the IASB in setting its standards.

Despite in literature the convergence issue is advocated as the main reason for the revision of IAS 31 and the elimination of proportionate consolidation, from this research work what comes out is that indeed IFRS 11 creates new divergences with respect to US GAAP, thus the short-term project seems to have failed to bring a real convergence between the two set of standards. Not by case, Baudot (2014) defines the approach used in developing IFRS 11 as direct emulation, meaning that US GAAP standards had been identified as best practice and the IASB had just to substantially copy the US GAAP approach into a new IFRS. Hence, the lack of an active cooperation with the FASB to understand the more suitable approach to propose for reporting investments in JVs, led ultimately to persistent differences. In fact, while IFRS 11 introduced a principle-based approach, US GAAP standards are basically industry specific. Accordingly, if from the one side equity method is the general accounting treatment, really exceptions are allowed for specific industries such as the real estate one. Divergences exist even in the definition of what is a joint venture, for instance the term *joint venture* refers only to jointly controlled entities under US GAAP. Even more, US GAAP standards do not entail the concept of *joint operation*, as they refer to *collaborative contractual relationships*, or more generally *virtual joint ventures*, which unlike joint operations are recorded by only recognising in the income statement costs incurred and revenues generated with third parties. Another diversity relies on the concept of joint control, which does not deserve an authoritative definition in the US accounting system. All in all, it is evident that different approaches and different concepts inevitably cause significant convergence gaps. Therefore, despite IASB and FASB have committed in working together since 2002 to attain a convergence of their accounting principles, substantial differences between the boards' approaches at least as far as the joint ventures' argument persist, meaning that probably it is not sufficient to work on short-term convergence projects to achieve the long-term objective of a common set of global standards.

Indeed, to reduce divergences in financial statements drawn up by following the application of IFRS and US GAAP, it is reasonable thinking that the boards should put real effort in reaching a common conceptual basis from which they can start working to achieve convergence in the single standards addressing the accounting for specific items. Hence, it seems logical and fair to believe that before to intervene on single standards, the two boards should commit themselves in creating a common conceptual framework which may pose shared and common views from which starting to work on short-term convergence projects and other major joint projects. McGregor and Street (2007) sustain that the failure of the joint conceptual framework project would bring the framework to remain an incomplete document preventing the two standard setters to have a clearly articulated conceptual basis on which relying their argumentations. Consequently, McGregor and Street (2007) claim the real urgency of the joint framework project and the necessity to make it a living document.

Although the significant role played by a joint framework has been undervalued by the boards since the beginning of their roadmap for convergence, the boards should seriously consider the need to start working from the foundations of each set of accounting standards if real comparability is the long-term goal. In this regard, they should agree on the status of the framework within the GAAP hierarchy, given that under US GAAP, the framework does not have any real power or authority, while, at least theoretically, the IASB recognises a more relevant role to its framework as it should assist preparers as well as users of financial statements. Indeed, including the framework within the GAAP hierarchy may contribute to make the body of GAAP more robust. Accountants would be better equipped for problem-solving with a well-maintained conceptual framework, hence standard setters would not need to develop detailed standards and copious interpretations.

Accounting for joint ventures has always been a controversial issue. Since the 90s researchers worldwide have been studying the merits and the drawbacks of the two methods, although without proving an overwhelming superiority of one of them. For instance, proponents of the PC associate to this method a higher degree of disclosures allowing a better predictability of future profitability, a higher risk relevance for explaining price volatility or bond ratings. Opponents, however, criticise the lack of conceptual consistency, which instead may be found under the equity method. The EM is not exempted from criticisms, though. For instance, the Nobes' analysis reveals that the EM has reached such a wide diffusion because it was primarily used by the two strongest accounting nations (US and UK) rather than because it was supported by precise conceptual arguments and coherent theoretical justifications. Furthermore, EM is questioned as it is a one-line consolidation failing to portray the investees' liabilities and allowing firms to use JVs as off-balance sheet financing devices.

Two months after the release of IFRS 11, the Board issued its *Effect Analysis* with the aim of assessing the potential effects and costs financial statements preparers and users have to face after the effective introduction of IFRS 11. The Board expected that the arrangements most affected by the new IFRS 11 would have been those previously proportionately consolidated required to switch to equity method. Furthermore, the IASB listed among the potential effects occurring in financial statements a decrease in total assets, liabilities, expenses, revenues or leverage ratio and an increase in profit margin. To supplement the limited empirical research of the *Effect Analysis*, which focused only on 19 firms transitioning from the proportionate consolidation to the equity method, Saccon et al. (2012) along with Demerens et al. (2014) present an empirical study based on a final sample of 35 European companies. Thanks to pro-forma financial statements, they quantify the magnitude of the impacts of the conversion from PC to the EM. As expected, on average total assets, liabilities, revenues and expenses decrease, while as far as the ROE components, profit margin increases, and asset turnover and leverage ratio decrease. Another study dealing with the analysis of the effects of

the transition from proportionate consolidation to equity method is the one of Leitner-Hanetseder and Stockinger (2014). Findings confirm that total assets, total liabilities, total sales and EBIT are affected by the change in accounting treatment: on average, variations are defined to be material, because higher than 5%, apart from the effects on total assets, which on average are lower than the fixed threshold. Results prove also the expected changes on key financial ratios: profit margin rises on average with both formulations EBIT/Revenues and Net Income/Revenues, conversely asset turnover, leverage ratio as well as ROE computed as EBIT/Total Equity decrease. However, only the average variation in leverage ratio is deemed to be material (-13.62%), while the others are not. Medians are anyway not material at all. All in all, results prove that actually the transition from PC to EM may highly impact single firms and that however, not all industries are affected in the same way.

The analysis proposed in this research work provides a contribution to understand what has actually occurred in financial statements of those firms listed in three European indexes: IBEX 35, FTSE MIB and CAC 40 during the first year of IFRS 11 adoption. Surprisingly, despite in literature studies based on pro-forma financial statements stress that total net income and total shareholders' equity do not change when moving from one method to the other, indeed, what has been found is that some firms reported changes in either their consolidated net profit or their total shareholders' equity. This is an interesting point the IASB might reason about, provided that in its *Effect Analysis* it affirmed that net income and shareholders' equity would have not changed. Presumably changes may derive from the complexities hidden behind the adjustments of intragroup balances and profits or losses from intragroup transactions necessary to correctly measure the opening balance of JV investments as argued by Rinaldi and Gavana (2014) or from the adjustments to retained earnings (e.g. in case of any impairment to the value of the investment). Anyway, such unpredicted changes definitely stress the need for the IASB to deeply analyse equity accounting and all the operational complexities it brings within financial statements.

As expected and proved by previous studies in literature, the transition from PC to EM on average brought to a decrease in total assets, total liabilities, operating revenues, operating expenses and EBIT in all three European indexes. As explained by academicians, variations were imaginable as under EM joint ventures' assets, liabilities, revenues and expenses are no longer proportionally consolidated, while only a single line item depicting respectively the net investment on the balance sheet and the profit in the income statement is reported. On average, even the decrease in EBIT can be justified because the JVs' share of EBIT is not included in the venturer's income statement. However, as remarked by Leitner – Hanetseder and Stockinger (2014), impacts on EBIT are not so straightforward since effects depend on whether the entity or its joint ventures report a positive

operating profit. On average, material changes occurred in IBEX 35 with total liabilities decreasing by -5.07% and EBIT by -8.61%. In firms listed in FTSE MIB, significant variations occurred on average for operating revenues, expenses and EBIT with decreases of -6.21%, -5.33% and -93.19% respectively. Concerning CAC 40, no material change occurred, even if the greatest variation came up in the EBIT with an average decrease of -4.05%. Interestingly, in all the three indexes the most significant change appeared in the EBIT with decreases on average by -8.61% in IBEX 35, -93.19% in FTSE MIB and -4.05% in CAC 40. The value of the median for all the three indexes is of course lower than the respective mean. Overall, even if variations may appear not so material (their median values are in most of cases lower than 5%) it must be remarked that the transition from PC to EM impacted to a great extent single firms in each European index and this is in line with what proved by previous findings in literature.

Furthermore, consistently with studies in literature, percentage variations were computed for some key financial ratios: the ROE components as expressed by the Du Pont Model (*Profit Margin * Leverage Ratio * Asset Turnover*) and ROA. As highlighted by previous studies, findings confirm that in all indexes on average the profit margin increased. It is remarkable that, among all variations occurred in financial ratios, only the average increase of profit margin in FTSE MIB may be judged to be material (+6.84%). Similarly, results prove that on average ROA increased within all the three European indexes. This trend already anticipated in literature is conceivable following the decrease in total assets at the denominator. Significant variations in ROA occurred for single companies, while on average percentage increases appeared not material. Finally, on average the leverage ratio and the asset turnover declined confirming previous pro-forma findings. Nonetheless, once again variations are not that much significant on average, although single firms were more affected than others.

Some respondents to the Exposure Draft, ED 9, argued that the elimination of proportionate consolidation would cause a loss of meaningful information for financial statements users. Anyway, the Board believes that the removal of PC would not result in any information loss as considering PC to be able to provide more information is misleading because it would mix shares of revenues, expenses, assets and liabilities that cannot be managed without the consent of other co-venturers with those individually controlled by the same investor. Accordingly, in the IASB's view disclosure requirements in IFRS 12 would help users in gaining a more thorough understanding of investors' involvement in joint arrangements and particularly in material joint ventures than PC did. However, the research by Asenbrenerovà (2016) as well as the results of the analysis run on the 32 companies listed in IBEX 35, FTSE MIB and CAC 40 confirm that financial statements preparers seem not motivated to provide detailed information about their investments in JVs. Despite a full disclosure

of the general descriptive information about the nature of their material joint arrangements (e.g. name, activities undertaken, place of business and proportion of ownership interest), the main lack regards the provision of summarised financial information for each material joint venture. On the one side, it is the Board to leave parties free to fix the right level of detail to disclose information, on the other side, this is not a justification for not providing financial information at all.

It would be interesting to know the outcome of the IASB's *Post Implementation Review* of IFRS 11 and IFRS 12, whose publication is in delay. Findings gathered from the analysis presented in this research work may be a small foretaste of what we can expect from the final Board's review. While this analysis focused only on those firms listed on three major European indexes and on the first year of IFRS 11 adoption, probably the Board will gather the feedback of a larger number of preparers across more than one financial year. Anyway, the fact that overall results show variations in median values not so material may support, from one point of view, the IASB's belief that IFRS 11 would have not caused particular effects in financial statements figures. However, from another standpoint, the introduction of IFRS 11 with the new IFRS 12 changes the way in which preparers convey information about their investments in joint ventures, which in most of cases are significant strategic tools to run businesses. While the IASB believed that disclosure requirements in IFRS 12 would have compensated the elimination of proportionally consolidated JVs' financial figures and would have helped users to acquire a complete understanding of the magnitude and relevance of investments in JVs, in practice results do not confirm the IASB's expectations. Really, it seems that for most preparers providing clear and accurate disclosures to financial analysts is not a priority while preparing financial statements. Probably, the application of IFRS 12, ad hoc formulated for integrating disclosure requirements, is one of the major tricky matter the IASB will have to properly justify. If the general purpose of financial statements is to meet the need of users, the IASB should really work in this sense. Accordingly, in view of future actions relative to IFRS 11 or IFRS 12, the Board should really strive to properly justify its decisions and think about potential consequences without taking for granted anything. To this purpose, why do not strengthen the collaboration with audit firms, whose activity consists in checking and validating organisations' financial statements prepared under IFRS standards? Even more, why do not involve academicians in the IASB's due-process? From this research work, it is clear the contrast between the IASB's activity and that of researchers who with copious papers and empirical analyses criticise the Board's decisions. Hence, it seems quite logical to start thinking about how to potentially involve them within the due-process activity. For instance, a first step may be that to include them in the upcoming revision project of the equity method. Their contribution might be precious to help the Board in identifying potential drawbacks or problems underlying such accounting method. This hypothetical collaboration may

prevent the IASB to take decisions just to meet the preferences of some constituents or increase its acceptance towards other powerful international accounting bodies.

A final aspect this work wants to highlight is that corporate reporting is changing. Probably in the past, annual reports focused mainly on providing to investors and shareholders only financial information, nowadays it is clear that organisations are moving away from that kind of reporting. In fact, in their annual report companies seem to be more interested in communicating their social responsibility by disclosing their sustainable approach in running businesses (e.g. they disclose their economic, environmental and social impact, for instance on the basis of GRI framework) or they are moving even further towards integrated reporting, whose fundamental concept consists in value creation, according to which an organisation should disclose the strategy adopted and the allocation of capital (financial, manufactured, intellectual, human, social and relationship and natural) within its business model to create value to all its stakeholders: providers of capital, customers, employees, suppliers, business partners and society at large. Of course, this should be done always keeping in mind potential risks and opportunities. Consequently, KPI of non-financial measures acquire more importance in comparison with traditional financial figures or disclosure. For example, some firms did not provide even the disclosures indicated in IFRS 12 for material JVs but presented extensive descriptions about their sustainable approach in running business or about how they create value with integrity.

Certainly, this topic opens a new wide and complex field for further researches. Anyway, the evolution of corporate reporting should be a subject to work on for the IASB. Accordingly, at least in the forthcoming future, the IASB should intensify its cooperation with the *International Integrated Reporting Council* (IIRC) to properly integrate financial reporting under IFRS with firms' disclosures about their business model, strategy, opportunities as well as risks.

APPENDIX

TABLE I - **VALUES OF NET INCOME AND SHAREHOLDERS' EQUITY – IBEX 35**

IBEX 35	Net Income	Shareholders' Equity	Net income after IFRS 11	Shareholders' Equity after IFRS 11	Δ % Shareholders' Equity	Δ % Net Income
ABERTIS (values in thousands of €)	746,946	6,589,623	746,590	–	–	-0.05%
BBVA (values in millions of €)	2,327	43,802	–	–	–	–
CELLNEX TELECOM (values in thousands of €)	78,490	487,483	–	–	–	–
ENAGAS (values in thousands of €)	404,256	2,139,375	–	–	–	–
ENDESA (values in millions of €)	2,943	26,769	–	26,762	-0.03%	–
GAS NATURAL (values in millions of €)	1,664	15,010	1,658	14,967	-0.29%	-0.36%
INDITEX (values in thousands of €)	2,381,565	9,278,363	–	–	–	–
REPSOL (values in millions of €)	195	27,920	–	27,450	-1.68%	–
TECNICA REUNIDAS (values in thousands of €)	128,464	438,520	–	–	–	–
Mean					**-0.50%**	**-0.10%**
Median					**-0.16%**	**-0.02%**

Source: Authorial Elaboration

TABLE II - **VALUES OF ROE – IBEX 35**

IBEX 35	**ROE (IAS 31)** Net Income/Total Equity	**ROE (IFRS 11)** Net Income/Total Equity	Δ %
ABERTIS	11.34%	11.33%	-0.05%
ENDESA	10.99%	11%	0.03%
GAS NATURAL	11.09%	11.08%	-0.07%
REPSOL	0.70%	0.71%	1.71%
Mean			**0.40%**
Median			**-0.01%**

Source: Authorial Elaboration

TABLE III - **VALUES OF NET INCOME/LOSS AND SHAREHOLDERS' EQUITY – FTSE MIB**

FTSE MIB	Net Income or Loss	Shareholders' Equity	Net income after IFRS 11	Shareholders' Equity after IFRS 11	Δ % Shareholders' Equity	Δ % Net Income
BUZZI UNICEM (values in thousands of €)	-28,977	2,374,195	-43,155	2,298,738	-3.18%	48.93%
ENEL (values in millions of €)	4,780	52,839	–	–	–	–
LEONARDO (values in millions of €)	74	3,679	–	–	–	–
PRYSMIAN (values in millions of €)	154	1,195	153	1,183	-1%	-0.65%
SAIPEM (values in millions of €)	-136	4,744	–	–	–	–
UNICREDIT (values in thousands of €)	-13,583,170	50,174,767	–	50,055,685	-0.24%	–
Mean					**-1.47%**	**24.14%**
Median					**-1%**	**24.14%**

Source: Authorial Elaboration

TABLE IV - **VALUES OF ROE – FTSE MIB**

FTSE MIB	**ROE (IAS 31)** Net Income/Total Equity	**ROE (IFRS 11)** Net Income/Total Equity	Δ %
BUZZI UNICEM	-1.22%	-1.88%	53.82%
PRYSMIAN	12.89%	12.93%	0.36%
UNICREDIT	-27.07%	-27.14%	0.24%
Mean			**18.14%**
Median			**0.36%**

Source: Authorial Elaboration

TABLE V - **VALUES OF NET INCOME/LOSS AND SHAREHOLDERS' EQUITY – CAC 40**

CAC 40	Net Income or Loss	Shareholders' Equity	Net income after IFRS 11	Shareholders' Equity after IFRS 11	Δ % Shareholders' Equity	Δ % Net Income
ACCOR (values in millions of €)	139	2,756	137	2,752	-0.15%	-1.44%
AIRBUS GROUP (values in millions of €)	1,475	11,054	1,483	10,906	-1.34%	0.54
AXA (values in millions of €)	4,786	55,314	–	55,443	0.23%	–
BNP PARIBAS (values in millions of €)	5,439	91,162	5,421	90,955	-0.23%	-0.33%
BOUYGUES (values in millions of €)	-648	8,684	–	8,669	-0.17%	–
CREDIT AGRICOLE (values in millions of €)	2,886	47,883	–	–	–	–
ENGIE (values in millions of €)	-8,909	71,303	-8,783	71,432	0.18%	-1.41%
L'ORÉAL (values in millions of €)	2,961	22,643	–	–	–	–
LOUIS VUITTON (values in millions of €)	3,436	27,723	–	–	–	–
RENAULT (values in millions of €)	1,735	24,547	–	–	–	–
SAFRAN (values in millions of €)	1,415	6,814	–	6,813	-0.01%	–
SAINT GOBAIN (values in millions of €)	631	17,870	632	17,871	0.01%	0.16%
SOCGEN (values in millions of €)	2,525	54,101	2,394	53,970	-0.24%	-5.19%
TECHNIPFMC (values in millions of €)	570	4,174	–	–	–	–
UNIBAIL RODAMCO (values in millions of €)	1,684	14,486	–	–	–	–
VALEO SA (values in millions of €)	469	2,380	–	–	–	–
VEOLIA ENVIRONNEMENT (values in millions of €)	530	9,126	453	8,646	-5.26%	-14.53%
Mean					**-0.70%**	**-3.17%**
Median					**-0.16%**	**-1.41%**

Source: Authorial Elaboration

TABLE VI - **VALUES OF ROE – CAC 40**

CAC 40	**ROE (IAS 31)** Net Income/Total Equity	**ROE (IFRS 11)** Net Income/Total Equity	Δ %
ACCOR	5.04%	4.98%	-1.30%
AIRBUS GROUP	13.34%	13.60%	1.91%
AXA	8.65%	8.63%	-0.23%
BNP PARIBAS	5.97%	5.96%	-0.10%
BOUYGUES	-7.46%	-7.47%	0.17%
ENGIE	-12.49%	-12.30%	-1.59%
SAFRAN	20.77%	20.77%	0.01%
SAINT GOBAIN	3.53%	3.54%	0.15%
SOCGEN	4.67%	4.44%	-4.96%
VEOLIA ENVIRONNEMENT	5.81%	5.24%	-9.78%
Mean			**-1.57%**
Median			**-0.17%**

Source: Authorial Elaboration

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