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AGREEMENT AND DISAGREEMENT REGARDING IASB'S PROPOSED CHANGES TO ACCOUNTING FOR JOINT VENTURES

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ABSTRACT

Preparing consolidated financial statements has been a common practice for groups of companies around the world for a relatively long time, going back one century in the USA and tens of years in different European countries. A highly actual issue regarding consolidation accounting is the treatment of interests in joint ventures. At international level, the primary determinant of accounting for joint ventures is the form of the arrangement. Also two methods of accounting for jointly controlled entities are applied: the proportionate consolidation and the equity method, which may impair comparability. We focus in our article on the changes proposed by the IASB (and reactions to them) regarding accounting for joint ventures, which have to be placed within the context of the short term IFRS – US GAAP convergence project. Thus we planed for our research to study the appropriate technical literature, the relevant legislation in the field of consolidations, the IASB's recently published Exposure Draft on Joint Arrangements and to conduct a quantitative and qualitative analysis of the reactions to the ED, based on the comment letters received by the Board. The objective of our study is to highlight the implications of the proposed changes to accounting for joint ventures on the consolidated financial reporting from the viewpoint of different categories of organizations.

Joint ventures, proportionate consolidation, equity method

1. LITERATURE REVIEW

Historically joint ventures have been common in the real estate and extractive industries (Goldberg & Wolf, 1993; Freedman, 1996). Joint ventures become as a topic of study because of the increase in international joint ventures during the business globalization of the 1980's and 1990's and because of the different joint venture accounting practices across countries and their definition of what constitutes a joint venture.

The prescribed accounting treatment for joint ventures varies cross nations, with two principal alternatives in wide use:

- proportionate consolidation, recommended by International Accounting Standards (IAS No. 31), preferred by continental countries in the European Union and required in Canada and;
- the equity method, required in some or all situations in the United States, the United Kingdom, Australia, and New Zealand.

In all periods there were opinion pro and contra for the investments in joint ventures accounting method.

Much of the early literature discusses potential problems with equity reporting (Kocan 1962). Standard setters (American Institute of Certified Public Accountants (AICPA, 1977); Financial Accounting Standards Board (FASB) (Milburn & Chant, 1999)); researchers (Nielsen, 1965), and practitioners (e.g. Dieter & Wyatt, 1978; Neuhausen, 1982; Reklau, 1977) question whether the current reporting methods, particularly the method used by the US, meets the informational needs of financial statement users.

For example, Recklau (1977) and Dieter and Wyatt (1978) started to analise of the inadequacies of the equity method of accounting as prescribed in APB Opinion no. 18. *The Equity Method of Accounting for Investments in Common Stock,* for joint ventures. The reasons given by Reklau are persuasive in his primary objective to improve financial reporting by investors in joint ventures. In supporting separate disclosures of joint venture interests, Dieter and Wyatt (1978) contend that proportionally consolidating fully controlled and jointly controlled assets and liabilities does not sufficiently portray risks and rewards associated with the joint venture, and they recommend additional disclosures on joint venture investments.

Accounting for Investments in Associates and Joint Ventures, published by the IASC (1986), into the definition of an associate emphasizes the need for an investor to have significant influence over the investee. Joint ventures are distinguished from associates by two or more investors' participation; a contractual arrangement; and joint consent for essential decisions. The ED proposes that investments in associates, and in joint ventures in which the investor has significant influence, generally should be accounted for in consolidated financial statements under the equity method. Investors conducting a significant proportion of their activities through joint ventures, or whose joint venture activities are an extension of their other activities, may use proportionate consolidation.

The FASB (1991) issued a discussion Memorand titled "Consolidation Policy and Procedures" that lists seven issues and many subissues. Issue 1 is "What condition(s) determine or indicate that a subsidiary should be included with its parent in consolidated financial statements?" Two primary factors traditionally considered in requiring consolidation are: percentage of ownership interests and presence or absence of control.

Bierman (1992) continue the analise and one of the author question was if proportionate consolidation should be used for all material intercorporate common stock investments. The paper concludes that when the common stock ownership of a subsidiary is less than 100 percent, the financial statements of corporations consolidated on a proportionate basis provide financial information useful to financial analysts. Bierman (1992) argues that proportionate consolidation is superior and should be used for all material equity investments, even majority-owned subsidiaries. Davis and Largay (1999: 281) find "no substantive justification for continued use of the equity method…due to the method's intrinsically limited informational characteristics."

The 1999 report of the G4+1 recommends that venturers use the equity method to account for interests in joint ventures, but cautions that there is very little empirical evidence on the decision usefulness of one approach over the other.

The primary arguments for the equity method focus on the lack of a theoretical basis for recording the proportionate share of joint venture accounts because resources and claims subject to joint control do not fit with the traditional definitions of assets and liabilities. Proponents of the equity method do not see joint control as equivalent to actual control. Rather, joint control is more like significant influence, the primary criterion in applying the equity method. "[A] venturer cannot control (that is, use or direct the use of) its pro rata share of individual assets in a joint venture," yet proportionate consolidation displays the joint venture as if the venturer can (Milburn & Chant 1999: 3.12). To others, the power of joint control is substantively greater than that significant influence and should be distinguished from investments accounted for by the equity method (Bierman, 1992).

Under the equity method, a significant influence equity investment is reflected in the investor's financial statements as single lines in the balance sheet and income statement. This presentation of net amounts is criticized as a means of facilitating off-balance sheet activities and potentially hindering effective financial analysis (e.g., Penman, 2004; Stickney & Brown, 1999; White *et al.,* 2003). Under proportionate consolidation, the investor combines on a line-byline basis its accounts with its pro rata share of the investee's accounts. Accordingly, proportionate consolidation provides a more comprehensive view of the investor's operations and financial condition.

Research has examined various aspects of credit analysis (e.g., Carleton *et al.,* 1993; Laitinen, 1999) and the differences between financial statements prepared under proportionate consolidation versus the equity method (Kothavala, 2003).

Whittred and Zimmer (2002) analised the Australian accounting for unincorporated joint ventures and they concludes that it is varies systematically between firms in different phases in the extractive industries (explorer vs. producer). Differences in accounting method can be explained by differences in the type of assets and the manner in which they are owned and financed.

It is important to mention Nobes (2002) work, who developed an exhaustive analysis of the international development of the equity method in which he traces the developments across time and space, and criticizes several of the past and present applications of the equity method.

In 2003, Graham *et al.* (2003) find that financial statements prepared under proportionate consolidation provide better predictions of future profitability than pro forma statements prepared under the equity method, and Lim *et al.* (2003) followed the special report of the Financial Accounting Foundation recommending the use of the equity method supplemented with appropriate disclosures for corporate joint ventures in the United States, this study, using data for corporate joint ventures in Singapore, provides some preliminary evidence regarding the effect of the supplementary information disclosure on information asymmetry among market participants as measured by bid–ask spreads.

Not all studies find in favor of proportionate consolidation. Using a sample of Canadian firms, Kothavala (2003) finds that equity method statements are more relevant for bond ratings than are proportionately consolidated statements. Stoltzfus and Epps (2005) find that financial statements prepared under proportionate consolidation are more strongly associated with bond risk premiums than equity method statements only for firms that guarantee the debt of joint venture investments.

Bauman (2007) consider that from a financial analysis perspective, proportionate consolidation of significant influence equity investments is often presumed to provide more useful information than equity method accounting.

Kazbi Soonawalla (2006) analise the requirements of accounting principles in Canada and the UK concerning the disclosure of disaggregated components of joint ventures and associates and they concludes that current US accounting principles likely mask information that financial statement users could use to predict future earnings and explain share prices.

Richard and Gordon (2006) examines equity accounting adoption by Australian companies before and after standard AAS 14 (1984), the first standard on equity accounting in Australia. AAS 14 and its successor ASRB 1016 (1989) required that equity accounting of associates appear in supplementary disclosures (third-column or footnote) and not in consolidated accounts. Before AAS 14, extensive voluntary adoption of equity accounting occurred in consolidated accounts. Equity accounting adopters from 1971 to 1989 were matched in their adoption years with companies that could have used equity accounting but did not. The results are consistent with equity accounting being adopted opportunistically; there is limited evidence to support contractual efficiency motives.

2. IASB PROPOSAL FOR A NEW APPROACH TOWARDS JOINT ARRANGEMENTS

2.1 Historical background

Since its issuance in 1990 *IAS 31 Financial Reporting of Interests in Joint Ventures* has been revised (or reformatted) several times (1994, 1998, 2003 and 2008 – the last revision being a result of Business Combinations Phase II Project). According to this standard, accounting for interests in joint ventures follows the form (the legal structure) of an arrangement rather than its substance and allows (in the case of jointly controlled entities) a choice of using the proportionate consolidation method or the equity method, the first being explicitly preferred. On the other hand US GAAP through *APB 18 The Equity Method of Accounting in Common Stock* (issued in 1971 and modified lastly in 2001), generally requires the equity method, except in certain specialized industries (such as extractive industries and construction) where the proportionate consolidation method is allowed.

The nowadays renowned Memorandum of Understanding (known also as the Norwalk Agreement issued in 2002) between the IASB and the FASB affirms the commitment of both standard setters to the convergence of US GAAP and IFRS with the ultimate goal of developing high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. Both standard setters recognize the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States and acknowledge that their contribution to achieving the reconciliation is continued and measurable progress on the FASB-IASB convergence program. (The removal of the reconciliation requirement has been recently achieved (November 2007) when SEC approved the rule amendments under which financial statements from foreign private issuers in the U.S. will be accepted without reconciliation to U.S. GAAP only if they are prepared using IFRS as issued by the IASB). The convergence program is focused on a short-term convergence and on other joint projects.

One of the topics of the short-term convergence which have been stated in the Memorandum to be examined by the IASB regards joint ventures (FASB and IASB, 2006). Thus at the December 2005 meeting the IASB agreed to consider the accounting for interests in joint ventures within the short-term convergence project. Several Board meetings regarding this topic took place during the following two years and have been limited by the Board to the following two issues:

- ✓ the possibility of removing the option of accounting for jointly controlled entities using proportionate consolidation; and
- ✓ the existing definition of a joint venture and the differences between a joint venture entity and direct interests in assets and liabilities of a joint arrangement.

The Board has not reconsidered all of the requirements in IAS 31 therefore a working group was not considered necessary for this project. Also the development and publication of a discussion paper has not been considered necessary for this project because its objective consist in reducing differences between IAS 31 and US GAAP and the proposed amendments to IAS 31 take as their starting point the definition of assets and liabilities in the IASB's F*ramework* (IASB, 2007). The staff presented in April 2007 a draft of the proposed amendments to IAS 31 to the Board. Subsequent to the last changes to the draft made by the Board in the June and July 2007 meetings, an Exposure Draft ED 9 Joint Arrangements was published on 13 September 2007 for public comment. The draft proposes a new IFRS X named *Joint Arrangements*, rather than a revision of *IAS 31 Interests in Joint Ventures.*

2.2 Main coordinates of ED 9 regarding the New Approach towards Joint Arrangements

The exposure draft on joint arrangements is basically structured on the following three major sections: the definition and description of the types of joint arrangement, the financial reporting regarding the different types of joint arrangement, and disclosures concerning joint arrangements. Integral part of the draft IFRS are also Appendix A (Defined Terms), Appendix B (Application Guidance) and Appendix C (Amendments to other IFRSs).

According to the ED a joint arrangement is a contractual arrangement whereby two or more parties undertake an economic activity together and share decision-making relating to that activity. Joint arrangements include joint assets, joint operations and joint ventures. The ED proposes that the form of an arrangement should not be the most significant factor in the determination of the appropriate accounting for the arrangement. The draft effectively adopts a '*substance over form'* approach to the accounting for joint venture arrangements, focusing on the rights and obligations contractually agreed by the parties (Deloitte, 2007).

The exposure draft proposes that:

- ⇨ a party to a joint arrangement should recognize its *contractual rights and obligations* (and the related income and expenses) in accordance with applicable IFRSs; and
- ⇨ a party should recognize an interest in a joint venture (i.e. an interest in a share of the outcome generated by the activities of a group of assets and liabilities subject to joint control) using the *equity method*. Proportionate consolidation would not be permitted.

The draft also requires an entity to take a *holistic view* of its joint arrangements, which means that in some cases an arrangement, can have multiple aspects (components) which should be separately accounted for (Deloitte, 2007). In the end the draft proposes a number of *enhanced disclosure* requirements related to joint arrangements to a great extent in order to align the disclosures for joint ventures with those for associates according to IAS 28.

2.3 IASB's appeal for feedback through a Public Questionnaire

By issuing the ED 9, the IASB has invited comments on any aspect of the ED. Comment letters play a vital role in the IASB's formal deliberative process. The IASB invites public comments on all proposals that are published as a discussion paper or exposure draft. To give the public timely access to the comment letters sent to the IASB, the staff regularly posts the letters on the Website (IASB, 2006).

The invitation to comment on the ED 9 sets out a number of *six questions* dealing with the most important issues proposed by the draft. The six questions have been grouped by the Board into three categories, namely Definition and terminology (question 1), Accounting for joint arrangements (questions 2 and 3) and Disclosure (questions 4, 5 and 6). These three categories correspond (also following the same order) to the three major sections of the exposure draft, mentioned in the previous subchapter. The wording of the questions is listed below:

- *Question 1:* Do you agree with the proposal to change the way joint arrangements are described? If not, why?
- *Question 2:* 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?

- *Question 3:* 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?
- *Question 4:* Do you agree with the disclosures proposed for this draft IFRS? If not, why? Are there any additional disclosures relating to joint arrangements that would be useful for users of financial statements?
- *Question 5:* Do you agree with the proposal to restore to IAS 27 and IAS 28 the requirements to disclose a list and description of significant subsidiaries and associates? If not, why?
- *Question 6:* Do you agree that it is more useful to users if an entity discloses current and non-current assets and liabilities of associates than it is if the entity discloses total assets and liabilities? If not, why?

A brief analysis reveals that this *public questionnaire* (published by the IASB within the exposure draft on its Website and self-administered by the respondents) is a *special opinion questionnaire* as it is searching for the opinion of interested organizations on one single topic, namely joint arrangements. Its design is based on *open-ended questions*, which imply an unstructured response format. Generally, open-ended questions allow a greater freedom of expression; they are not biased due to limited response ranges and the respondents can qualify their answers. All six questions offer the possibility of a yes-or-no answer. However, in the case of a negative answer, the respondent is explicitly asked for a rationale. Moreover, the Board encourages respondents to comment on any additional issues and also implies that there is no need for a response to all of the questions. This indicates the prevailing qualitative character of the survey.

The IASB initially allowed a comment period of 120 days (ending on 11 January 208). This is common practice for the Board who offers such a comment period for its consultation documents. According to the Due Process Handbook, the IASB normally allows a comment period of more than 120 days for major projects. Even though the comment period has not been officially extended for ED 9, it appears that the IASB considered also comments received in writing after the 11 January 2008 (the last comment considered has been received on 25 February 2008), thus practically allowing a longer comment period than initially granted (120 days). After the extended period, the IASB received comment letters on the exposure draft from 114 respondents.

After the IASB members review the comment letters it is expected that the staff will provide (and post on the Website) a summary and analysis of the comments received. It is also common practice for the IASB, in order to be responsive to views received in comment letters, to post on the Website a summary of its position on the major points raised in the letters, once they have been considered. In addition, in the basis for conclusions on the final pronouncement the IASB will probably respond to the main issues raised in the considered comment letters (IASB, 2006).

3. RESEARCH METHODOLOGY

Our research adopts both a quantitative and a qualitative approach. The data collection is based on the responses to the six questions within the 114 comment letters received by the IASB and published on its Website. Firstly, as we realized that the questions 2, 4 and 5 are to a certain degree "double barreled" (as more than one answer seemed to be sought), we considered as being useful to split them into two separate research questions, as follows:

- *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?
- *Question 4.1:* Do you agree with the disclosures proposed for this draft IFRS? If not, why?
- *Question 4.2:* Are there any additional disclosures relating to joint arrangements that would be useful for users of financial statements?
- *Question 5.1:* Do you agree with the proposal to restore to IAS 27 and IAS 28 the requirements to disclose a list of significant subsidiaries and associates? If not, why?
- *Question 5.2:* Do you agree with the proposal to restore to IAS 27 and IAS 28 the requirements to disclose a description of significant subsidiaries and associates? If not, why?

Thus the survey is based on a total number of *nine research questions* (Q 1, Q2.1, Q2.2, Q 3, Q 4.1, Q 4.2, Q 5.1, Q 5.2 and Q 6). A major issue of our survey research resided in recording and codifying the answers, as they were unstructured, due to the open-ended type of questions. To this end, we conducted a detailed qualitative analysis of the narrative through the content analysis of the text. We standardized (codified) the answers as follows: *y (yes)* if the answers appears to be affirmative, *p (partial)* if the answer shows a partial agreement (including significant disagreement elements, but the arguments for an agreement prevail over the arguments for a disagreement), *n (no)* if the answer indicates a total (straight) or a predominant negative answer. However not all respondents gave answers to all the questions, or gave answers which could not be easily interpreted (as yes, partial or no – answers). Of course, those answers (or non-answers) have been excluded from the analysis.

From the total of 114 comment letters received, 2 could not be downloaded from the IASB Website and 4 have been sent by private persons on their own behalf. We excluded them from our analysis as we aimed to find out the opinion of organizations (and not individual private persons) regarding joint arrangements. As a consequence, the number of comment letters (responses) we analyzed has been reduced to 108.

As a next step, in order to conduct a cluster analysis, we grouped the organizations which submitted comment letters into six clusters as presented in Table 1.

Tabel 1: **Groups (Clusters) of Organizations**

Accounting and Audit Profession (AAP)	27
Accounting Standards Setter (ASS)	18
Banking and Financial Services (BFS)	13
Construction & Extractive Industry (incl. Oil & Gas) (CEI)	15
Industry and Services (except Construction & Extractive) (IS)	29
Other (OTH)	6
TOTAL	**108**

The reason for separating the organizations pertaining to the Construction and Extractive Industry (including Oil & GAS) is the fact that they are very sensitive to the proportionate method of consolidation, taking into consideration that only for these specific industries US GAAP allows this consolidation method.

Using a Microsoft Excel spreadsheet, we summarized (counted) and/or displayed graphically the answers for each question both at the level of the entire sample and at the level of each group of companies. We used percentiles and frequency counts. However we did not interpret the results for the last group (Other) as this group is reduced in size, accounting for only 5% of the total number of respondents within the sample.

Taking into consideration that our quantitative analysis is based on a *convenience sample* (as the respondents submitted voluntarily the comment letters, no sampling method being employed) a *qualitative analysis* of the answers was also needed in order to reach relevant conclusions. Probably, based on this fact, the IASB stated that it would base its conclusions on the merits of the arguments for and against each alternative and not on the number of responses supporting each alternative. We focused the qualitative analysis on the answers received on two questions (Question 2.1 and Question 3) for two reasons:

1. They are related to the two aspects of IAS 31 that the Board considers an impediment to highly qualitative reporting for joint arrangements (and which are the main concerns addressed by the ED 9), namely

a) that the form of the arrangement is the primary determinant of the accounting and b) that an entity has a choice of accounting treatment for interests in jointly controlled entities.

2. They present the lowest percentage of agreement (y – answers) from all the questions (answers) according to the conducted quantitative analysis (*see Table 2 & Figure 1*).

For each of the two questions, we selected the most frequent 5 argument sustaining positive answers and 5 arguments supporting negative answers.

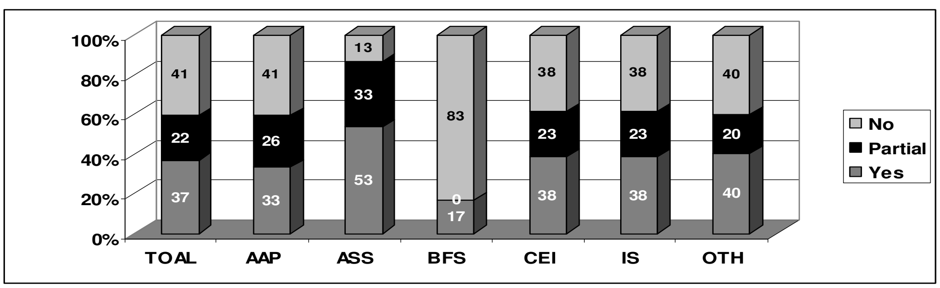
4. RESULTS

Within this chapter we present both the results of the quantitative and the qualitative analysis, starting with the former. As mentioned before, the quantitative analysis has been conducted both at the level of the entire sample and on the level of clusters.

4.1 Quantitative Analysis

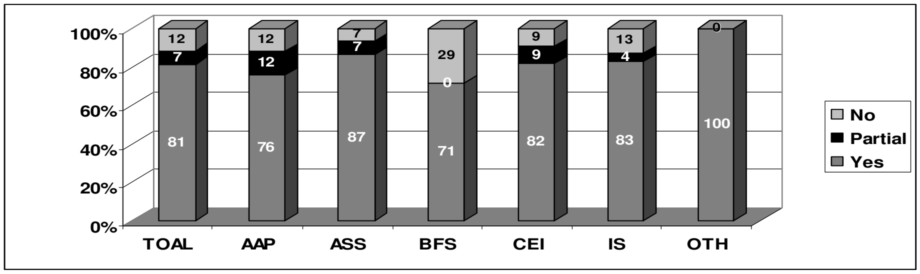
To the ***first question*** regarding the proposal to change the way joint arrangements are described, 58 respondents (representing 59%) agreed totally (36) or partially (22) with the proposed definitions and terminology. The highest percentage of total or partial agreement has been recorded for the Accounting Standards Setter – Group (86%) whereby the lowest percentage has been recorded in the case of the Banking and Financial Services – Group (17%). Remarkably, the respondents from both the Industry and Services – Group and the Construction & Extractive Industry – Group indicate an agreement with the proposal (61%).

Graphic 1: **Answers received for Question 1**



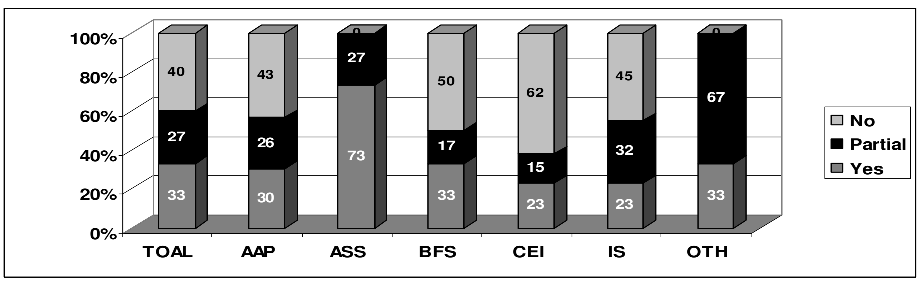
Responses to the ***question 2.1*** indicate a strong agreement (76 responses, representing 88 %) that a party to a joint arrangement should recognize its contractual rights and obligations relating to the arrangement. Again the Banking and Financial Services – Group recorded a slightly lower agreement percentage (71%).

Graphic 2: **Answers received for Question 2.1**



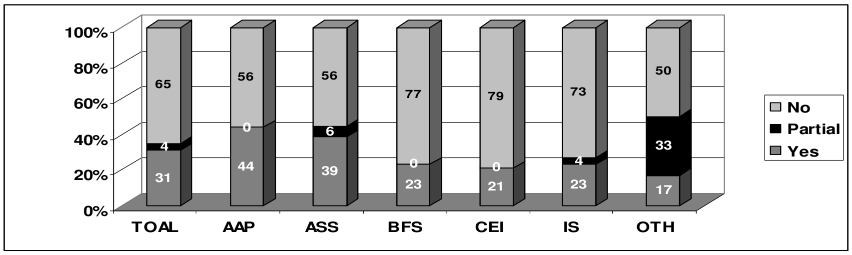
The answers to the ***question 2.2*** whether the proposals in the ED are consistent with and meet the objective stated in the previous question show relatively high differences between the opinions of respondents pertaining to different groups. The agreement percentage at the level of the entire sample is 60%. The Accounting Standards Setter - Group recorded no negative answers: 73% were totally affirmative and 27% were partially affirmative. On the other side the analysis of the Construction and Extractive Industries - Group shows a disagreement of 62%.

Graphic 3: **Answers received for Question 2.2**



Question 3 appears to deal with the thorniest issue of the ED, namely the proposal of elimination the proportionate consolidation method, as it received the highest number of responses (104). On the level of the whole sample, the disagreement percentage (65%) is the highest from all the questions (except Q4.2, which is actually not asking for an agreement or disagreement). On the groups' level, the highest percentages in favor of the proposal pertain to the Accounting Standards Setter – Group (45%) and the Accounting and Audit Profession – Group (44%). However it is remarkable that all Big 4 Audit companies disagree with this proposal. The highest level of disagreement among the analyzed groups has been recorded (not surprisingly) for the Constructions & Extractive Industry – Group.

Graphic 4: **Answers received for Question 3**



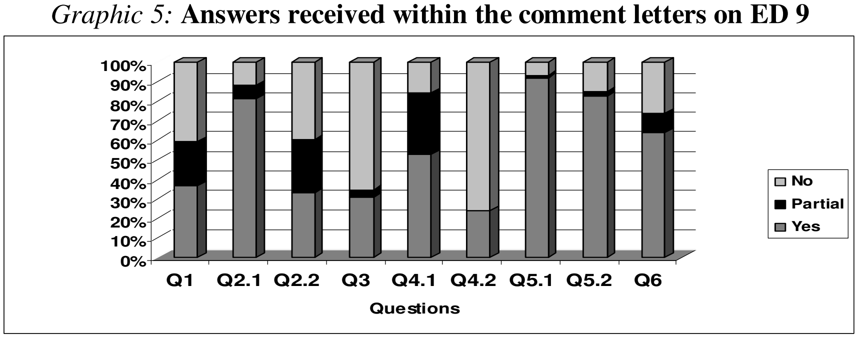
The questions regarding disclosure proposals (***Question 4.1, Question 5.1, Question 5.2 and Question 6***) have generally recorded a high level of total or partial agreement, ranging from 74% (for Q6) to 93% (for Q5.1). The cluster analysis reveals that in case of question 6 regarding the user-usefulness of a split between current and non-current assets and liabilities of associates, the Banking and Financial Services - Group and the Construction and Extractive Industries – Group record significant levels of disagreement (50% respectively 45%).

Table 2 and graphic 5 summarize the number (and percentage) of the 3 standardized types of answers received to each question (out of the nine).

Table 2: **Answers received within the comment letters on ED 9**

		Q1	Q2.1	Q2.2	Q3	Q4.1	Q4.2	Q5.1	Q5.2	Q6
Absolute	**Yes**	36	70	26	32	47	21	81	71	58
	Partial	22	6	21	4	28	0	1	2	9
	No	40	10	31	68	14	67	6	13	24
	TOTAL	**98**	**86**	**78**	**104**	**89**	**88**	**88**	**86**	**91**
Relative (%)	**Yes**	37	81	33	31	53	24	92	83	64
	Partial	22	7	27	4	31	0	1	2	10
	No	41	12	40	65	16	76	7	15	26
	TOTAL	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Graphic 5: **Answers received within the comment letters on ED 9**



4.2 Qualitative Analysis

As previously mentioned, besides the quantitative approach of our research a qualitative analysis of the answers was also needed in order to reach relevant conclusions, taking also into consideration IASB's statement that it would base its conclusions on the merits of the arguments for and against each alternative and not on the number of responses supporting each alternative. We focused the qualitative analysis on the answers received on two core questions (Question 2 and Question 3), and tried to acknowledge the most frequent arguments for or against the issue raised, namely whether a party to a joint arrangement should recognize its contractual rights and obligations relating to the arrangement (and the proposals in the draft meet this objective) and whether proportionate consolidation should be eliminated.

Regarding ***Question 2*** (Q 2.1 and Q 2.2) we realized that those respondents who were *in favor* of the proposal (thus responding affirmatively to both sub-questions Q 2.1 and Q 2.2) generally did not bring arguments in support of their position, but just stated their agreement. The only argument brought by a few respondents was that accounting for a joint arrangement should be based on substance rather than the form of the arrangement.

The arguments most frequently encountered *against* the Board's proposal can be summarized as follows:

- The core principle and the potential implications raise a number of *concerns regarding the definition of an asset, the unit of account, the specific accounting consequences and the practicability*. Some respondents argue that splitting up assets into their related rights and their separate recognition does not comply with the current Framework and will cause a lot of complex issues on initial accounting and even more so on subsequent accounting. Those respondents were concerned that the recognition of parts of assets as the unit of account under the proposed Standard may be difficult to apply in practice and may also set precedent in other areas.

- Other respondents consider that the exposure draft lacks clarity and seems *internally inconsistent* in explaining the application of the rights and obligations model. A specific example of this inconsistency often mentioned is in respect of the accounting for joint assets, namely the recognition of the right to use the joint asset versus recognition of the share of the joint asset. Some respondents argue that recognizing a share of a joint asset would not be consistent with the Framework definition of an asset because the party does not unilaterally control the joint asset.

- Some opponents of the proposal consider that the general principle of recognizing 'contractual rights and obligations' would indicate that *the main driver in determining the method of accounting for a joint arrangement is still the legal form of the arrangement*. They argue that an entity should consider the underlying economic substance of a joint arrangement in order to determine how it should be accounted for, to best reflect the underlying substance. The use of the term 'contractual rights' would thus suggest that an entity can only have control of an asset through a contract which conflicts with the definition of an asset in the Framework which states that 'an item may satisfy the definition of an asset even when there is no legal control.'

- Not few were the comment letters where respondents believed that *ED 9 would anticipate the outcome of the Phase B of the Framework Project*. In this respect they noted that the approach of ED 9 – to recognize rights to assets – is not only a matter of ED 9. Rather, it represents a fundamental change in accounting principles that would have to be codified in the Framework rather than in ED9. Subsequently, as long as *Phase B* of the *Framework Project* has not been finalized the principles of ED 9 lack a sound foundation and will cause unavoidable problems in their application.

- Many respondents also argued that the exposure draft addresses *areas where more guidance is required* such as changes in ownership interests in joint ventures without losing joint control, transactions between parties to a joint venture. Some of them also raised concerns regarding the illustrative examples.

The most controversial question which the IASB addressed is ***Question 3*** regarding the proposal to eliminate proportional consolidation. As the quantitative analysis showed, it received the highest number of answers within the comment letters (104). It is worth mentioning that those respondents who *agreed* with the proposal, generally, brought few (if any) arguments to sustain their decision. The following list summarizes those arguments:

- The most frequent argument is that *proportionate consolidation leads to assets and liabilities being recognized that do not meet the definitions of assets and liabilities* that are contained in the IASB's Framework. Some respondents consider that it should be eliminated as it inappropriately implies that the reporting entity has direct control over its proportionate share of the individual assets (eg. cash) or a direct share in the revenue streams of the joint venture, resulting in amounts being recognized as assets and liabilities that are not regarded as a faithful representation of an entity's assets and liabilities.

- Many respondents believe that continuing to allow *proportionate consolidation on a line by line basis may reduce comparability* between companies in the same industry due to the effect the different methods have on the margins and ratios that would be reported by parties to a joint venture.

- Some respondents also argue that the *use of the equity method is more supportable, and it would reflect the substance of the situation rather than its legal form* compared to the proportionate consolidation which would reflect the form rather than the substance.

- A few respondents believe that proportionate consolidation should be eliminated for interests in joint ventures merely *for the sake of the IFRS – US GAAP (short term) convergence*, as the US GAAP (APB 18) generally allows only the equity method.

- Some organizations who answered in favor of the elimination argue that this would be *consistent with the IASB's policy of removing choices of accounting policy* within IFRS.

Usually those respondents who *disagreed* with the proposal for eliminating proportionate consolidation sustained their position through relatively long narrative responses, presenting several arguments in this respect. The most encountered arguments are presented below.

- Many respondents consider that *proportionate consolidation better meets the information needs of users* of financial statements by providing through disaggregated information a better representation of the performance of an entity's management. Consistent with this argument some respondents argue that one of the main consequences of the proposal is that all the key operating information on the joint venture activities, assets and liabilities would not be presented in the primary financial statements. Therefore, the primary financial statements would be less relevant for users, and groups will be obliged to compensate in the notes. This can lead to undue costs and efforts for entities currently applying proportionate consolidation: these entities would need to develop specific information for primary financial statements while maintaining current consolidation procedures for internal reporting and relevant information in the notes.

- Also numerous respondents argue that proportional consolidation reflects the substance and economic reality of a joint arrangement and believe that the rationale in favor of proportionate consolidation provided in IAS 31.32 is still valid and expedient: "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 using […] proportionate consolidation".

- Another common argument was the fact that *joint ventures and associates represent different degrees of ability to exercise influence* and therefore it would be both questionable and inappropriate to account for them using the same method. Many respondents underlined the difference between joint control and significant influence and suggested that such different economic arrangements would merit different accounting treatment.

- Many opponents of the proposal consider that *the differences between equity accounting and proportionate consolidation have not been fully explored* and believe that the IASB has not demonstrated that the equity method would be the appropriate accounting treatment. They argued that resorting to the use of the equity method for a residual interest in a joint venture would not provide information that is more relevant. Some respondents identified conceptual concerns with equity accounting and argued that there would be also practical difficulties with its application that tend not to arise in proportionate consolidation, such as accounting for net liabilities or accounting for upstream transactions. Moreover equity accounting is considered by some respondents to effectively be a one-line consolidation that in substance largely adopts a proportionate consolidation approach, but presents the outcome as a single amount in the balance sheet and income statement.

- Interestingly, not few respondents believe that by eliminating proportionate consolidation, *full convergence (IFRS – US GAAP) will not be achieved* since for some companies (e.g. from the oil and gas exploring and construction industry) according to AIN 2 to APB 18 and EITF 00-1 proportionate (or pro rata) consolidation is still allowed within US-GAAP. The elimination of proportionate consolidation within IFRS would, in some cases, rather foreclose than contribute to a further convergence with US-GAAP since under IAS 31 entities are enabled to achieve convergence on a voluntary basis.

CONCLUSION

Our study complements the literature on accounting for joint ventures, especially concerning the comparison between applying the proportionate consolidation and the equity method by analyzing the standpoints of organizations relative to the IASB's proposed changes within ED 9 Joint Arrangements. For this purpose we conducted a quantitative and qualitative examination of the answers received by the IASB within the 114 comment letters regarding the exposure draft.

Generally, the results regarding the six questions (which we transformed into nine research questions) show that there is a high dispersal of percentiles (for yes, partial or no answers) among the questions. The thorniest (most controversial) questions were those related to terminology and the accounting for joint arrangements. The own interest of respondents concerning the debated issues could be generally observed. For instance, the elimination of proportionate consolidation has found the strongest opposition within the Constructions and Extractive Industry – Group, as it is current practice for such organizations to account for joint ventures by applying the proportionate consolidation. However this proposal encountered relatively strong opposition within all the analyzed clusters. At the same time findings suggest that while organizations usually agree with the recognition of contractual rights and obligations – approach, many of them especially pertaining to the banking or the two industries – groups raise numerous concerns regarding the consistency of IASB's proposal regarding this approach. As opposed to this conclusion, we observed that questions on disclosure proposals generally encountered only week opposition, except the one regarding the current – non current assets – split, which seemed to be sensitive for the Banking and the Constructions and Extractive Industries groups.

Our analysis suggests that many respondents do not welcome change. We also observed that an important change from current practice (such as the removal of proportionate consolidation) was more likely to be criticized than retaining current practice. However many respondents sustained their position relative to the elimination of proportionate consolidation with solid arguments. Based on our analysis we incline to predict that the IASB will not proceed with its proposal to remove proportionate consolidation, at least not within the short term project. Our prediction is also taking into consideration the case when the IASB proposed the full goodwill method within the revision of IFRS 3 Business Combinations but abandoned the proposal as a response to numerous concerns raised by respondents.

The study is subject to several limitations which should be considered. Such limitations arise when regarding the fact that our quantitative analysis is based on a *convenience sample* as the respondents submitted voluntarily the comment letters, no sampling method being employed, thus raising the problem of representativeness of the sample (and subsequently the reliability of the quantitative results). Another limitation might also be the reduced number of responses to some questions or the risk to have misinterpreted the answers when standardizing them.

It is obvious that accounting for joint ventures (arrangements) is not straightforward. Future research is undoubtedly needed on issues related to this topic, especially regarding the differences between equity accounting and proportionate consolidation as well as the recognition of contractual rights and obligations – approach. Further attention may be also directed to study practices of accounting for the different types of joint arrangements around the world.

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