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

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methods for joint ventures. Therefore, our results have particular relevance for

evaluating the IASB's proposed change. Specifically, we investigate whether firms that use EM between 1985 and 1994 experience a decline in value relevance of key balance sheet amounts such as total assets and liabilities when forced to use PC from 1995 onwards. Since 1995 firms are also required to provide footnote disclosures on their share of joint venture assets and liabilities in addition to revenues, expenses and cash flows. Using these disclosures, we investigate whether disaggregate joint venture assets and liabilities are incrementally and overall value relevant. We find that firms that are forced to switch from EM to PC experience a decline in value relevance of reported assets and liabilities. The firms that use PC for the entire sample period experience no such decline. We also find that joint venture assets and liabilities are incrementally and overall value relevant when disclosures are mandatory from 1995 onwards. Our results show that the removal of choice of financial reporting method does have value-relevance implications, something that is of importance to users. We also find that the requirement of additional disclosure of joint venture assets and liabilities is value relevant, which may offset, to some extent, the costs of the reduction in choice. Our inferences may have implications for a number of jurisdictions across Europe and beyond that are affected by a similar reduction of accounting choice proposed by the IASB.

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All EU listed firms were required to adopt IFRS in 2005, so IAS 31 automatically became the standard for listed UK firms from 2005 onwards.

Under the gross equity method disaggregate shares of joint venture revenues, earnings, assets and liabilities are disclosed on the face of the financial statement in addition to equity method recognition.

For example, Canada is in the process of adopting IFRS in full by 2011 (CICA, 2007), and in 2007, the Australian Accounting Standards Board modified their accounting standards so that they are identical to IFRS as issued by the IASB.

Joint ventures are jointly controlled by co-venturer firms where joint control is the sharing of power between venturer firms. No single firm unilaterally controls the joint ventures, and joint consent of all venturers is required for major operating and financing policy decisions.

The cost method, which reports only dividends received as income, was recommended in cases where the equity from the joint venture was not likely to accrue to the co-venturer or there had been a loss of joint control.

Revised CICA 3055 defines a joint venture as ‘an economic activity resulting from a contractual arrangement whereby two or more venturers jointly control the economic activity’

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Rather than trying to investigate how value relevance for firms in general changes over time our study examines how value relevance changes for the same firms over time.

Because the original Section 3055 allowed a choice between EM and PC, we need not be concerned with the issue of early adopters. This conclusion is reinforced by the fact that there was a relatively short time between the release of the exposure draft (June 1993) and finalisation of the revised Section 3055 (October 1994).

The proportion of firm-years in each time period is close to the proportion of number of years in each 10-year time period: 50.3% for 1985–94 and 49.7% for 1995–2003.

These pre-1995 amounts are not used in the regression analysis and are hence untabulated. We believe the pre-1995 set of firms disclosing share of joint venture assets and liabilities is too small to perform any rigorous and conclusive analysis.

Untabulated statistics show that for each year in 1985–94, when choice was permitted, PC was by far the method of choice. On average PC was chosen 68.7% of the time compared to 31% for EM. Untabulated statistical tests show that the PC to EM distribution rejects the assumption of a 50:50 distribution at the 1% level for each of the 10 years in the sample.

For example, suppose a company's primary business is low risk but it has large joint
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Investigating each of these possibilities is beyond the scope of this study. However, they stand as reasonable explanations for the decline in value relevance of accounting amounts experienced by firms that chose EM in the former period.

In further specifications, O'Hanlon and Taylor (2007) distinguish between associate and joint venture liability disclosures incremental to assets and liabilities reported under EM. These additional aspects are beyond the scope of our study.

Bauman (2003) includes indicator variables for investor guaranteed and non-guaranteed debt. However, this is beyond the scope of our data and analysis.

Additional information

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The impact of the adoption of IFRS 11 on the comparability of accounting information

Raquel Wille Sarquis et al.
Accounting and Business Research
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