UNIVERSITY OF TAMPERE
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ACCOUNTING FOR JOINT VENTURES AND JOINT ARRANGEMENTS IN FINLAND

AUDITORS' PERCEPTIONS OF TRUE AND FAIR VIEW

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ABSTRACT

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The current business environment is getting more and more complicated, as well as experiencing great changes while firms pursue competitive advantage through collaborative alliances and partnerships. Consequently, also reporting of inter-firm relationships is now transforming, posing new challenges to managers, accountants, and auditors. This study concentrates on accounting for joint ventures according to Finnish practices and joint arrangements as defined by IFRS 11, which have not been combined in terms of previous research.

In the light of the above, the precise purpose of this study is to understand auditors' perceptions of true and fair view as regards the classification and accounting for joint ventures and joint arrangements. The theoretical framework builds around the research question to what extent management exercises judgment in the classification of joint ventures and joint arrangements, and what consequences does this have for accounting. The academics are then put in a context of audit practice, particularly addressing how auditors assess that a true and fair view of a group's financial performance and position is given when reporting these undertakings.

The study is conducted as a qualitative research, where evidence is gathered from semi-structured interviews with professionals from audit firms, laying emphasis on three aspects: the nature of joint ventures and joint arrangements, accounting for them, and disclosures provided. As research examines Finnish companies that participate in joint ventures and joint arrangements, three of the specialists were Finnish auditors from Big Four firms. The fourth interviewee, CPA auditor, brought an international viewpoint to the research in order to take IFRS and cooperative arrangements beyond domestic borders more comprehensively into consideration.

The results of the study suggest that the decision of management to enter into a joint venture or a joint arrangement is chiefly driven by business aspects, rather than desired reporting outcomes. If the classification of the investment requires a lot of judgment, it would be recommendable to take counsel from an auditor or other adviser. The study also brings forward a fresh insight to the discussion of the appropriate accounting method for joint investments. Although equity method has faced critique among researchers due to the presentation that does not display line items of balance sheet, such as debt, separately, it appeared preferable to proportionate consolidation due to its technical simplicity that may prevent accounting errors, and familiar accounting that is the same for associate companies. True and fair view of the profit and state of affairs is overall assessed through explanatory disclosure of demarcations, rights and obligations.

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Nykyinen liiketoimintaympäristö tulee yhä monimutkaisemmaksi sekä kokee suuria muutoksia yritysten pyrkiessä saavuttamaan enemmän kilpailuetua erilaisten yhteistyöliittoutumien ja -kumppanuuksien kautta. Tämän vuoksi myös näiden suhteiden raportointi on viime aikoina muuttunut, asettaen uusia haasteita johdolle, laskentahenkilöstölle ja tilintarkastajille. Aiemmin toteutetuista laskentatoimen tutkimuksista poiketen tämä tutkielma keskittyy yhteisyrityksiin suomalaisen tilinpäätöskäytännön mukaan ja yhteisjärjestelyihin IFRS 11 -standardin määritteleminä.

Edelliseen perustuen tutkimuksen tarkoituksena on ymmärtää tilintarkastajien näkemyksiä oikean ja riittävän kuvan toteutumisesta liittyen yhteisyrityksiin ja yhteisjärjestelyihin konsernitilinpäätöksessä. Teoreettinen viitekehys rakentuu tutkimuskysymyksen varaan, missä määrin johto käyttää harkintaa yhteisyritysten ja yhteisjärjestelyjen luokittelussa, ja mitä seuraamuksia tällä on laskentaan. Akateemista osuutta täydentää tilintarkastuksen käytännön näkökulma, tarkemmin ottaen kuinka tilintarkastajat määrittävät, että oikea ja riittävä kuva konsernin taloudellisesta tuloksesta ja asemasta on annettu yhteisyrityksistä ja -järjestelyistä raportoitaessa.

Tutkielma on toteutettu kvalitatiivisena, missä tutkimusmateriaalia hankittiin puolistrukturoiduin asiantuntijahaastatteluin kolmeen näkökulmaan keskittyen: yhteisyritysten ja -järjestelyjen luonne, niiden laskenta, ja raportoitavat tiedot. Tutkimuskohteena on suomalaiskonsernien yhteisyritykset ja -järjestelyt, joten kolme neljästä asiantuntijasta oli Suomen Big Four -yhteisöjen tilintarkastajia. Neljäs haastateltava, CPA-tilintarkastaja, toi tutkimukseen kansainvälistä näkökulmaa, jotta IFRS ja kansallisten rajojen ulkopuolelle ulottuvat yhteistyöjärjestelyt pystyttiin ottamaan kattavammin huomioon tutkimustuloksissa.

Tutkimuksen tulosten perusteella päätös osallistua yhteisyrityksiin ja -järjestelyihin pohjautuu ensisijaisesti liiketoiminnallisiin tekijöihin laskennallisten vaikutusten sijaan. Mikäli yhteisen sijoituksen luokittelu vaatii paljon harkintaa, voi johtoa suositella kuulemaan tilintarkastajan tai muun neuvonantajan näkemys. Tutkielma tuo esiin tuoreen näkökulman keskusteluun koskien soveltuvinta laskentamenetelmää yhteisille sijoituksille. Vaikka pääomaosuusmenetelmää onkin tutkimuksissa kritisoitu erityisesti siitä, että se ei esitä taseen eriä kuten velkoja erikseen, se koettiin parempana suhteelliseen yhdistelyyn verrattuna johtuen sen teknisestä yksinkertaisuudesta, mikä ehkäisee virheiden syntymistä, sekä tutusta laskennasta, joka on sama osakkuusyhtiöille. Oikea ja riittävä kuva määrittyy lopulta liitetietoinformaatioon perustuen yhteisyrityksen tai yhteisjärjestelyn luonteesta, sekä olennaisista oikeuksista ja velvoitteista.

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1 INTRODUCTION

1.1 Describing the Research Area

> *Businesses used to grow in one of two ways: from grassroots up or by acquisition. In both cases, the manager had control. Today businesses grow through alliances, all kinds of dangerous liaisons and joint ventures, which, by the way, very few people understand.*
> (Peter F. Drucker, 1909–2005)[1]

Different forms of cooperative strategies in business have gained more general knowledge owing to the spreading use of company partnerships. Joint ventures and looser alliances have been mentioned essential to achieve success in rivalry both in current societal debate (Harvard Business Review 2015; The Economist 2015), and in the academic world. Ever emerging willingness to gain competitive advantage in domestic and international markets carries the topic into timely discussion.

Although macroeconomic uncertainty and weak global growth put a heavy burden on business activity and anticipations of fortunate future prospects, an analysis of large joint ventures[2] has estimated that the volume of them has even increased more than threefold worldwide since the recession in the beginning of 21st century (BusinessWeek 2010). According to a survey conducted by KPMG (2009), joint venture activity has continually increased despite the turbulent times, which means the trend of forming inter-firm partnerships has endured also the financial crisis that hit the global economy in 2007–2009. Moreover, McKinsey & Company (2014) that is considered a highly prestigious management consultancy estimates that nearly 70 % of executives expect the joint venture activity to increase in the coming years[3].

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[1] The quote is an abstract of an interview, published in Harvard Business Review (Harris 1993), with Peter F. Drucker who was an Austrian-born educator and consultant to senior managers in business, also known as the father of modern management.
[2] "Large" refers here to more than USD 500 million (about EUR 440 million) in revenues or assets.
[3] Conclusion is based on a survey conducted in 2014 covering 1263 responses representing a full range of regions, industries, and company sizes. To adjust the differences in response rates, the overall research data was weighed by the contribution of each respondent's nation to global gross domestic product.

As Peter F. Drucker depicted, businesses grow through complex arrangements in the modern society (Harris 1993). Hence, seeking clarity and making the dynamic world more understandable emphasises the meaning of pursuing harmony. This is also the aim of IASB[4] that develops internationally applicable standards (Jarva & Lantto 2012, 141), from which the newest ones are in fact related to accounting for inter-corporation investments. In particular, *IFRS[5] 11 Joint Arrangements* addresses classification and accounting for interests in joint ventures and joint operations, and has its mandatory effective date for annual periods beginning on or after 1 January 2014 in the member states of the European Union. Some previous research has been conducted referring to the preceding regulation of IAS 31[6] (Baker & Hayes 2004; Graham, King & Morrill 2003; Lourenço & Curto 2010; Soonawalla 2006; Stoltzfus & Epps 2005), whereas only a few studies have observed the new standard IFRS 11 so far (e.g. Leitner-Hanetseder & Stockinger 2014; Schmachtenberg 2014). This indicates that a new phenomenon of what has earlier aroused interest among academic scholars has currently arisen, and is ripe for fresh inquiry with updated knowledge.

Management has a great stake in the financial reporting environment and plays an important role in the preparation of the financial statements and as a supplier of financial information (Beaver 1981, 15). Since many managers have the goal of continuous business growth, there is an increasing pressure of capital markets on companies to show growing revenues and profitability (Schmachtenberg 2014, 1), which may trigger management's incentives to disclose information selectively (Jankensgård 2015, 5). Nevertheless, the purpose of financial reporting is to give an understanding, which is not misleading, of the underlying economics of an enterprise (Alexander & Jermakowicz 2006, 161). Additionally, Morgan (1988, 477) states that accountants have the opportunity to construct, "read", and probe reality, which means that financial reporting can be viewed as built on many subjective perceptions. To overcome the disparities in professional judgments, accounting standards give guidance so that accountants and auditors with a unified knowledge base and a common set of assumptions would have similar values attached to the reported information (Mala &

[4] International Accounting Standards Board
[5] International Financial Reporting Standards
[6] IFRS 11 Joint Arrangements replaces *IAS 31 Interests in Joint Ventures* and *SIC-13 Jointly Controlled Entities – Non-monetary Contributions by Venturers* (IFRS 11.C15). IAS stands for International Accounting Standards, and SIC Standing Interpretations Committee.

Chand 2014, 267). However, the evidence according to which auditors only secure that accounting standards are followed, is too limited. Auditors can influence, inter alia, the consolidation process and accounting choices made both at the investment and the group levels, because auditors also serve as accounting experts. (Fagerström 2002, 163)

Conclusively, the formation of alliances and partnerships rests largely on hopes and dreams – what might be possible if certain opportunities are pursued (Kanter 1994, 99). The main reasons that partners generally enter into joint ventures are gaining access to markets in the same industry or new markets in foreign countries, reducing costs or risks, developing new technologies or advanced skills, and even promoting brands (KPMG 2009, 4). As markets have become more competitive and globalised, it has become increasingly difficult for any single company to excel in all aspects of business. Nonetheless, management of joint undertakings is difficult, because no party has total control. (Groot & Merchant 2000, 579–580; Ozorhon, Arditi, Dikmen & Birgonul 2007, 799; Tsamenyi, Qureshi & Yazdifar 2013, 182). Although inter-corporate investments' use is argued to be continually growing (Graham et al. 2003, 124), there is still no international consensus on the appropriate accounting method for them (Lourenço & Curto 2010, 739). The nature and reporting of joint undertakings is dynamic and changing over time, so to be able to modify and renew the view, practitioners and academics must understand how they evolve also in the contemporary world of accounting and auditing, based on the prominent principle of true and fair view.

1.2 Academic Relevance of the Study

Existing research has discovered many aspects of joint ventures and joint arrangements, but some areas are yet waiting for further examination. Hoque (2010, 385) states that a researcher does not start with a fixed set of ideas, but examines the field to develop ideas that seem fruitful. Likewise, Eriksson and Kovalainen (2008, 287) state that crafting a strong theoretical reasoning is partly achieved by carefully situating one's own arguments within the prevailing research literature. Based on the former accounting inquiries, reasons that support the academic relevance of this study are introduced in the following paragraphs.

First of all, the globalised nature of today's business has arisen many questions to be examined in the academic world and practice. Correspondingly, research interest in joint ventures and strategic alliances has followed a substantive increase worldwide, attracting diverse approaches from scholars (Kobernyuk, Stiles & Ellson 2014, 471), and joint ventures are considered highly relevant also in practice due to their relatively large use among European companies currently (Leitner-Hanetseder & Stockinger 2014, 15). Joint partnerships also seem to be on a constant rise worldwide (e.g. KPMG 2009; McKinsey & Company 2014), primarily due to their desired collaborative advantage (Kanter 1994). Researchers have highlighted the importance of enhanced understanding considering structures of organisational forms and dynamic relationships between mutual partners, as well as problems in exercising management control in different settings (Caglio & Ditillo 2008, 894; Moskalev & Swensen 2007, 65; Van der Meer-Kooistra & Kamminga 2015, 38). This is why the nature of joint ventures and joint arrangements forms the first essential component of this study, and is necessary for determining the applicable accounting treatment.

Second, accounting for jointly managed arrangements alters greatly according to diverse accounting standards in different countries and jurisdictions. Richardson, Roubi and Soonawalla (2012, 389) mention that selecting an appropriate method of accounting for joint ventures has been a long debated issue, and new standards will have widespread implications. Alternative methods across the world and harmonisation have greatly influenced the current debate and researchers have called for studies to investigate the impact of varying corporate accounting policies. (Bauman 2007, 496; Kothavala 2003, 518; Lourenço & Curto 2010, 739; Stoltzfus & Epps 2005, 172) Some scholars (Fields, Lys & Vincent 2001, 256) have considered managerial intent being a key factor affecting the accounting choice, which means that mitigating freedom by harmonised guidelines also develops into an interesting research area. Fagerström (2002, 11) states that normative guidelines can be applied in different and flexible ways and besides, only limited research can be found on group accounting across borders so far. Consequently, another important part of this study is to concentrate on accounting for joint ventures according to FAS[7], and on the other hand reporting on joint arrangements when preparing consolidated financial statements in accordance with IFRS.

[7] Finnish Accounting Standards, Finnish GAAP (Generally Accepted Accounting Principles)

Third, in addition to financial statements, decision-useful information is delivered in the notes (Badenhorst, Brümmer & De Wet 2015, 1). Financial reporting and disclosures are important means for management to communicate firm performance and governance to external stakeholders, and are thus continuing to be a rich field of empirical enquiry (Healy & Palepu 2001, 405–407). The question whether the existence of different accounting and disclosure requirements for different classes of investees may have influenced managers' choices, with regard to how investments are structured, is introduced by O'Hanlon and Taylor (2007, 283) as a worthy subject for supplementary examination. Furthermore, Psaros and Trotman (2004, 91) suggest that managers use flexibility in accounting rules to make disclosure favouring their incentives and judgments generally consistent with their motives. Disclosures build the third relevant part of this study, as it compiles information about the decision-making behind the classification of joint ventures and joint arrangements, and their accounting.

Fourth, research focusing on joint ventures by firms from smaller developed economies like Nordic countries, has been extremely limited up to now (Zheng & Larimo 2010, 300), although Finland is considered one of the most competitive countries in the world (Jarva & Lantto 2012, 149). Researchers have underlined that cooperative arrangements are widely used in capital-intensive industries such as chemicals, mining, metal processing and maritime industry (Moskalev & Swensen 2007, 41; Soonawalla 2006, 405). Finland has a long tradition in previously mentioned sectors, which stresses the meaning of research in this national setting. In line with the shift from industrial to information society, also other industries like ICT have recently become more acquainted with business partnerships[8]. Finland has also been increasingly interested in growth opportunities in emerging markets such as China. Besides, business collaboration generally plays a common role in reaching developing countries (The Economist 2015), joint ventures being sometimes one of the few options for market entry due to restrictions that the government imposes on foreign investment in order to enhance progress of national infrastructure (Moskalev & Swensen 2007, 56). Moreover, cooperative arrangements are common in construction and real estate (PwC 2011, 21).

[8] See for instance news about the preliminary agreement of forming a joint venture between Nokia, a Finnish telecommunications corporation, and China Huaxin (Thomson Reuters 2015). Moskalev and Swensen (2007, 41) have also ranked telecommunications to top ten industries using joint ventures, and BDO (2013, 2) mentions that joint arrangements are very common in technology because projects require collaboration among investors to share expertise and resources. ICT means Information and Communication Technology.

Fifth, true and fair view as a research area is of major topical importance (Alexander & Jermakowicz 2006, 132–133). Studies need to address the practice and effects of feedback on the judgments made, as well as guidance on different accounting standards as a decision aid in order to enhance the accuracy of assessment (Mala & Chand 2014, 284). There is also a need to study a much wider range of preparers' judgments considering financial statements (Psaros & Trotman 2004, 92). Arnold (2009, 807) highlights that particularly auditors serve an important function in assuring third parties that the financial statements present a true and fair picture of the conditions of an enterprise. What causes managers to misstate their financial statements, and how auditors detect misstatements are of critical significance to the efficient functioning of capital markets (Dechow, Ge, Larson & Sloan 2011, 17). Management has a position of superior information compared to investors, which is why a demand for research remains in auditing services (Beaver 1981, 48–49). However, operation of audit craft has neither been the subject of serious description nor a more critical examination, and auditing in practice is thus essential for further research (Hopwood 2009, 797–798).

1.3 Objective of the Study and Problem Setting

The purpose of this study is to understand auditors' perceptions of true and fair view as regards the classification and accounting for joint ventures and joint arrangements. In order to achieve this, the research is divided into following subsections:

1. To what extent management exercises judgment in the classification of joint ventures and joint arrangements, and what consequences does this have for accounting?
2. How auditors assess that a true and fair view of group's financial performance and position is given when reporting these undertakings?

The study comprehends Finnish firms that participate in a joint venture or a joint arrangement. A literature review aims to cover the first research question and synthesise the theoretical framework, surveying literary articles in addition to normative references that compile laws, standards and regulations. In turn, the other question originates principally from ISA 315, which addresses "Identifying and Assessing the Risks of

Material Misstatement through Understanding the Entity and Its Environment"[9]. Whereas the theoretical framework lays the groundwork for understanding the entity and its environment, assessment of true and fair view is further confronted in the empirical section. The latter inquiry therefore combines the academic study and audit practice, as interviews with auditors complement the scholarly background.

The research concentrates on consolidated financial statements according to FAS and IFRS, that is individual and separate financial statements are not included in the study. Like in other member states of the EU[10], also Finnish firms are required to apply IFRS for consolidated financial statements of companies whose securities are traded in a regulated market (Accounting Act 7a:4), which is NASDAQ OMX Helsinki in Finland. In the light of the previous, the focus on these two standards is rationalised, consequently excluding other GAAP frameworks. Another issue that the study does not comprehend concerns unit trusts, venture capital organisations, and similar entities, since they are exceptional cases that have an option to use fair values (BDO 2013, 49).

Since study is a conducted by using qualitative methodology, it does not aim at generalisation (Eriksson & Kovalainen 2008, 51). It does, however, provide a richer *understanding* of joint ventures and joint arrangements in consolidated financial statements. There are doubtless several thousands of groups in Finland, but their accounting regulation has only begun to develop after 1980s (Englund, Prepula, Riistama & Tuokko 2005, 13). The needs of group accounting have been a major focus especially since the number of cross-border groups has increased (Fagerström 2002, 24). Hence, the meaning of consolidated financial statements is on the rise due to goals related to business growth, especially when aiming for overseas expansion, which is also why some authors (e.g. Mäkelä, Reponen, Pohjonen & Honkamäki 2012, 5) state that challenging questions arisen from group accounting are eternal. In terms of advancing the theoretical knowledge, comparative perspectives are needed, and there is thus a reason for a heterogeneous approach to study international arrangements in addition to domestic ventures (Volchek 2013, 62).

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[9] Generally, audits shall be conducted according to ISAs and relevant ethical requirements (ISA 200.3). Understanding the nature of an entity enables the auditor to gain better comprehension of complex structures, for example division into multiple locations, which often introduces issues that may give rise to risks of material misstatement. This also means the risks related to accounting for joint ventures and other arrangements. (ISA 315.A23) ISA stands for International Standards on Auditing.

[10] European Union

When an entity is required to disclose the rationale it has made in determining how far does its control reach, it is interesting to see to what extent management will bring forth its significant judgments and assumptions regarding investment classification. These are, namely, principally based on future strategic plans and expected synergies, information that historically has not been shared outside of the circle of board members and executive management. (Schmachtenberg 2014, 147) Besides, preparation of group financial statements is often compound, because the consolidation process involves assembling financial information that is separately prepared by components that may even operate in dissimilar industries, jurisdictions and cultures (Stewart 2012, 7). In particular, what makes the demarcation of joint undertakings difficult is that the exact nature of them can differ significantly depending on industrial concentration and geography (BDO 2013, 2). As the definition of joint control and jointly managed arrangements may have various different meanings depending on context (Moskalev & Swensen 2007, 30; Soonawalla 2006, 398), this study is focused on determination of joint ventures consistent with Finnish conventions and joint arrangements as defined by IFRS[11]. Thus, other cooperative business relationships are left out of the study.

1.4 Structure of the Study

This paper is organised in the following way. The main structure is divided into five chapters altogether. Chapters 1 and 2 are introductory chapters, presenting background information, stating aim of the thesis, and synthesising the theoretical framework. They outline both academic and normative issues related to the preparation and presentation of consolidated financial statements, and introduce their connection to auditing. Chapter 3 clarifies the research philosophy and strategy. Chapter 4 is empirical chapter, combining the collected interview data with the research that scholars formerly have conducted. More precisely, this presents auditors' perceptions of true and fair view as regards accounting for joint ventures and joint arrangements. Chapter 5 is the discussion and conclusions chapter, summarising and critiquing the thesis, as well as assessing contribution of the study and introducing further research possibilities.

[11] Joint arrangement (joint venture or joint operation) is a concept used in IFRS 11, whereas FAS does not distinguish joint operations. Finnish accounting regulations however understand joint ventures, which are types of associate companies that are jointly managed. (Halonen, Jalkanen-Steiner, Johansson, Kyrölä, Nurmo, Pyykönen, Sundvik, Suomela, Tolvanen, Torkkel, Torniainen, Tuomala & Vesikukka 2013, 283)

2 JOINT VENTURES AND JOINT ARRANGEMENTS IN THE WORLD OF ACCOUNTING AND AUDITING

2.1 Concept of True and Fair View from Group Audit Perspective

> *The accounts shall give right and sufficient information on the reporting entity's result and on its financial position.*
> (Accounting Act 3:2.1)

> *The auditor's report shall contain an opinion on: whether the financial statements and the annual report give a true and fair view, in accordance with the applicable financial reporting framework, of the result of operations and the financial position of the corporation or foundation.*
> (Auditing Act 3:15.1 §)

As seen in the excerpts above, true and fair view is an expression used in both accounting and auditing. To be more precise, right and sufficient picture is considered to be a translation of the English term, true and fair view, from the EU Fourth Directive that has been implemented into the national laws of member states such as Finland (Aisbitt & Nobes 2001, 86). Economic reality lays the basis for true and fair view concept, but these kinds of general principles are often not described in detail and give room for elasticity, which is linked to accounting rules, practice, or overall judgment (Fagerström 2002, 33–34). Accordingly, Alexander and Jermakowicz (2006, 136) argue that the essence of reality in the context of financial reporting is, at its best, a generally agreed and inter-subjective human construction, aiming at giving a perception of the underlying economics of an enterprise. Mala and Chand (2014, 267) on their behalf stress that to overcome differences in judgments, accounting standards give directions so that accountants and auditors with a mutual knowledge base would have similar values tied up with the reported information. After all, variation in interpretation and understanding of true and fair view within and between countries, as well as over time, has demonstrated some vagueness considering the expression itself (Aisbitt & Nobes 2001, 83–84), which is why this chapter addresses its conceptualisation in group audit.

Consolidated reports, similarly to separate financial statements, should give a true and fair view of group's financial performance and position (Englund et al. 2005, 70). To prepare consolidated statements, group management must aggregate information about components [12] that often operate in dissimilar industries, cultures, accounting frameworks, and jurisdictions with different statutory audit requirements (Stewart & Kinney 2013, 708). Groups are dominant in global capital markets and their audited financial statements are a central source of information for investment, corporate governance, and regulation. The role of the group auditor is to assess the risk of material misstatement for the group, which encompasses evaluation of findings about specific components, audit of the consolidation process, and establishment of an opinion on the group financial statements. (Stewart 2012, 7) Subsequently, regarding audits of group financial statements in particular, literature emphasises three major objects (Riistama 1999, 227), which are presented below under the headline of auditing (Figure 1).

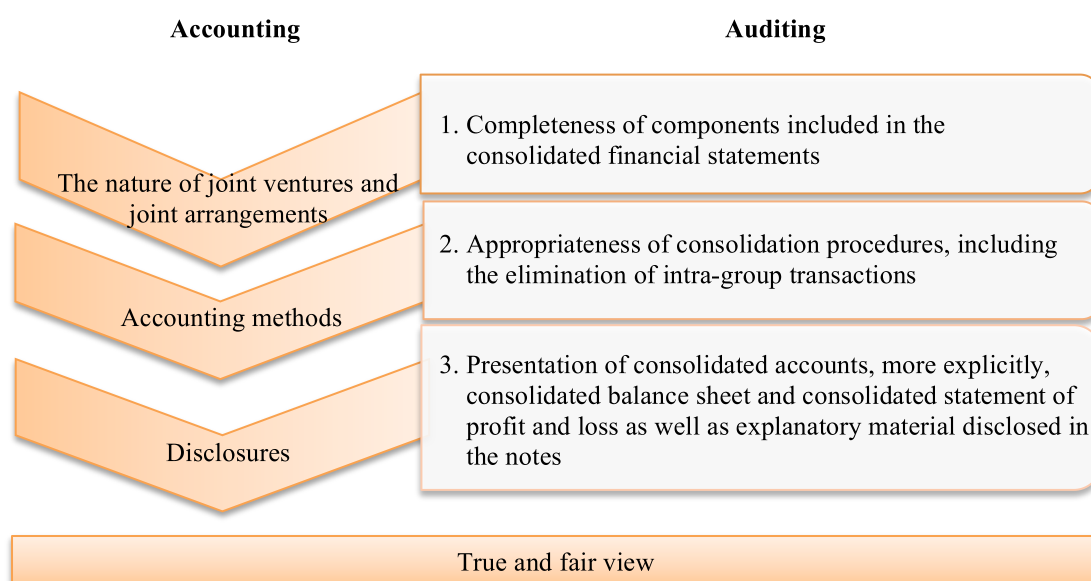

Figure 1. Joint undertakings in the group audit

[12] *Material misstatement* means that financial statements do not present a true and fair view of an entity. Misstatements, including omissions, are considered to be *material* if individually or combined they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. (ISA 200.6) These material misstatements may derive either from error or fraud (ISA 200.13(i)). Moreover, *component* is defined as an entity or business activity for which group or component management prepares financial information that should be included in the group financial statements (ISA 600.9(a)). Much of the information obtained by the auditor is indeed obtained from management and those responsible for financial reporting, but even inquiries directed toward in-house legal counsel or comparable adviser may provide adequate evidence about arrangements, such as joint ventures, with business partners and the meaning of contract terms (ISA 315.A6).

First, *completeness of components included in the consolidated reports* is associated with the nature of joint ventures and joint arrangements. Understanding the scope of consolidated financial statements is a crucial starting point for the audit, especially the arguments for not including certain investments in these accounts (Riistama 1999, 229). Due to financial crises reporting requirements governing off-balance-sheet investments has concerned the world of accounting and auditing remarkably (Arnold 2009, 803; Mantecon, Conover, Altintig & Song 2012, 1010). Control[13] of an investee is the central issue regulating whether an investor company reports consolidated accounts at all (Stoltzfus & Epps 2005, 171). In other words, group relationship between parent company and subsidiary means the obligation to draw up consolidated financial statements apart from some exceptions[14] (Mäkelä et al. 2012, 381). Group reporting system may be based on organisational structure that provides information to be prepared by a parent and one or more subsidiaries, joint ventures, and investees accounted for using equity method (Stewart 2012, 8). Nobes (2002, 27) states that the definition of an associate is a much vaguer concept, and more difficult to audit, than control that is the basis for a subsidiary in many jurisdictions. Zack (2012, 157) also claims that the determination of which units comprise the consolidated reporting entity is a matter involving interpretation of accounting standards. According to Fagerström (2002, 191), group structure affects how components are identified, and consolidation methods derive from the choice of the accounting unit and the level of specification.

Second, *appropriateness of consolidation procedures* refers more precisely to accounting methods in this thesis. In addition to the nature of different components in the group, a group auditor should understand their relationships (Riistama 1999, 232). The fundamental idea of group accounting is to consolidate a group of companies as if

[13] For instance, according to FAS control that constitutes a group relationship exists when the parent corporation holds more than half of the subsidiary's voting rights arising from shares or similar interests, or it has the right to appoint more than half of the members of the subsidiary's board of directors or a comparable body or the members of a body that has the right to do this (Accounting Act 1:5).

[14] A parent company is exempt from the requirement to prepare group accounts, if a group is qualified as *small*. Thus, in both the current and preceding financial year, the group is allowed to exceed only one of the following conditions: turnover EUR 7,3 million, balance sheet total EUR 3,65 million, and average number of employees 50 (Accounting Act 3:9.2). Moreover, an exemption occurs when a Finnish parent company is at least 90 % owned by an entity governed by the law of European Economic Area member state, and the annual accounts of this parent company together with its subsidiaries are consolidated into the accounts of that entity. If the parent company has minority owners, their unanimous approval for not preparing consolidated accounts must be received. (Accounting Act 6:1) However, the previous exceptions do not apply if the parent company distributes assets to the shareholders, or if it is a public company (Limited Liability Companies Act 8:9).

they were one single unit. This means that the consolidated reports should only reflect economic transactions between the group and external parties. The data used for these reports is the profit and loss accounts, balance sheets and notes from the companies within the group. To consolidate is in this sense to aggregate all reports and make needed adjustments for internal transactions. (Fagerström 2002, 196) Group audits reflect the complexity of the accounting process, and the possible participation of multiple audit firms or teams further complicates it, as component audits have to be planned so that conclusions about separately prepared and audited information can be aggregated to achieve reliable group accounts (Stewart 2012, 7). Moreover, Zack (2013, 191) claims that transactions with related parties such as joint ventures are often susceptible to misstatement, which might however be mitigated by the fact that these affairs primarily require separate disclosure in the notes.

Third, *presentation of consolidated accounts and explanatory material disclosed in the notes* are addressed merely as disclosures of joint undertakings in this study. For instance changes in group structure, which have a material effect on the comparability of the consolidated financial statements of the preceding accounting period, shall be disclosed. Moreover, alterations in accounting principles, and their impact on the group's financial performance and position have to be included in the notes. Disclosures in the notes require use of judgment, because they are mainly expressed in words instead of numerals. (Riistama 1999, 238–239) Financial accounting and auditing have an essential role to play by ensuring that relevant and reliable information is disclosed to investors (Arnold 2009, 807). According to Zack (2013, 189), misstatements may be classified as omissions, incomplete reports, misrepresentations of information presented in the notes, and confusing disclosures. For example, omissions consist of failures to disclose information required by an accounting standard, and most commonly involve a negative piece of information such as a pending litigation against a company, which would cast an adverse light on the entity. Correspondingly, Dechow et al. (2011, 77) found that managers of misstating firms desire to maintain high stock market valuations, and misstatements usually tend to be made with the objective of covering up a slowdown in financial performance. This reflects the uttered conflict between the manager who wants to maximise investors' perceived value of the firm and the auditor who desires to minimise investors' valuation errors (Fields et al. 2001, 297–298).

2.2 Nature of Joint Ventures and Joint Arrangements

2.2.1 Academic Discussion of Inter-firm Collaboration

A firm usually has different choices to expand its boundaries. It can enter in arm's length contracts with a third party, share ownership of the new assets with a partner, or assume full control over new operations. (Lourenço & Curto 2010, 745; Mantecon, et al. 2012, 1012) Different partnerships between firms have become crucial components of the pursuit of competitive advantage as market complexity is growing and globalisation is increasing (Ozorhon et al. 2007, 799). In spite of the benefits that joint ventures and different forms of collaborative alliances provide, there is a considerable failure rate of them, which particularly has led to an increase in interest in understanding the managerial problems of these types of business relations (Tsamenyi et al. 2013, 182). Although relationships are expected to change throughout their life cycle, leading to other paths even though the starting point may have been the same (Caglio & Ditillo 2008, 894–895), less attention has been paid to the dynamics of joint venture relationships so far (Van der Meer-Kooistra & Kamminga 2015, 24).

Optimal *ownership* allocation has been examined extensively considering joint ventures, indicating generally that it should be asymmetric (Moskalev & Swensen 2007, 31). Some scholars (Groot & Merchant 2000, 606) argue that unequal ownership shares may have a meaningful impact on decision-making and on conflict resolution practices. Former academic studies have also proposed that larger firms, and partners that invest more in research, development and expertise may generally prefer greater ownership over their joint ventures (Nguyen 2009, 19). Besides, it has been stated that the greater the influence one part has, which initially derives from the partner's bargaining power, the higher share of ownership that part can obtain (Zheng & Larimo 2010, 295). In an equal ownership between partners influence and control are strongly affected by who accepts administration of operational management. (Kobernyuk et al. 2014, 475)

Another major strand of academic literature on joint ventures investigates the distribution of *control* in collaborative arrangements between separate firms (Moskalev & Swensen 2007, 31). As indicated similarly in the previous paragraph, Hannula and Kari (2007, 79) assert that the capability of the partner to control the operating decisions

improves its bargaining power. Zheng and Larimo (2010, 295) define control as the management process by which a parent's interests are protected. When compared with controlling a single business venture, sharing management involves an obvious, extra dimension of complexity (Van der Meer-Kooistra & Kamminga 2015, 24). At least joint venture agreements and board of directors play an important role in controlling a common relationship successfully. Contracts state the venture's objectives, prohibit partners from performing some actions, contain pricing of services or other agreements, as well as declare obligations of the partners such as conflict resolution processes. Boards, in turn, approve all major investment, financing, and personnel decisions, aside from monitoring the venture's performance reports, as well as administering rewards and punishments. (Groot & Merchant 2000, 599–600)

Additionally, international joint ventures have been widely studied, particularly the contrasting relationship between western economies and their eastern counterparts. For instance, previous research has been carried out on Russia (Kobernyuk et al. 2014; Volchek 2013), the United Arab Emirates (Tsamenyi et al. 2013), China (Zheng & Larimo 2010) and other Asian regions (Van der Meer-Kooistra & Kamminga 2015). Traditional research has examined foreign investment regulations, which earlier imposed some restrictions on contractual freedom concerning ownership and control issues. For example, prior studies have shown that multinational executives choose local partners to be able to satisfy government requirements for local ownership or to avoid political intervention (Nguyen 2009, 15). Although there have been liberalisations of government policies that have been designed to promote shared ownership with local firms and restrict control by foreign investors (Moskalev & Swensen 2007, 32), firms still face a high level of uncertainty in international markets (Ozorhon et al. 2007, 800). Given former research, conflict may arise through cultural dissimilarities between partners, because culture shapes the behaviour of managers (Kobernyuk et al. 2014, 472), which is why many management studies addressing cross-cultural joint ventures rely notably on the widely accepted *cultural dimensions theory* by Hofstede (1991)[15].

[15] People from cultures very dissimilar on the national culture dimensions of power distance, individualism, masculinity, uncertainty avoidance, and long-term orientation are able to cooperate fruitfully. Yet, people from some cultures will collaborate more easily with foreigners than others. For example, most problematic are nations, which score high on uncertainty avoidance, and thus feel "what is different, is dangerous". (Hofstede 1991, 237)

2.2.2 Defining Joint Ventures and Joint Arrangements

Briefly, the foundation of joint venture classification in FAS rests generally on the legal structure. As a joint venture is considered to be one particular type of an associated company, a presumption of significant influence occurs with 20–50 % voting rights in the investment. Besides, FAS does not distinguish joint operations. IFRS divides joint arrangements into joint ventures and joint operations, where the focus is particularly on the rights and obligations of the parties, instead of legal form, as central criteria for demarcation. Hereafter these issues will be defined more thoroughly.

2.2.2.1 Joint Ventures According to FAS

FAS comprehends a *joint venture* as a special case of an associated undertaking, although Accounting Act does not provide a precise definition for it (Halonen et al. 2013, 283). The distinction is however important to rationalise, since the classification determines the accounting method. Specifically, the annual accounts of an associate company are allowed to be proportionally consolidated in the group's reporting, if an undertaking consolidated in the group financial statements (parent company or one of its subsidiaries) manages another undertaking (joint venture) jointly with one or more undertakings not consolidated in the group financial statements[16]. In other cases, they shall be included in the consolidated accounts similarly as other associated undertakings, using equity method, since they do not meet the characteristics of a joint venture. It is notable that only one undertaking belonging to a group can be an owner in the joint venture, although it otherwise can have several owners. Additionally, joint ventures may take the form of diverse legal structures such as limited liability company, cooperative, limited partnership, or general partnership. (Englund et al. 2005, 380–381)

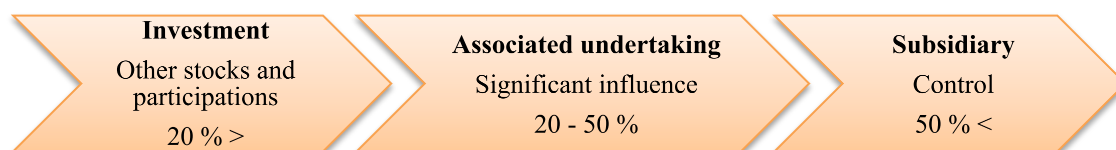

Figure 2. Presumption of group structure in FAS based on shares

[16] This originates from the general guidelines issued by the Finnish Accounting Board (7.11.2006), that is "kirjanpitolautakunnan (KILA) yleisohje". In comparison to IFRS, FAS does not include so detailed regulations considering the principles of consolidation. (Halonen et al. 2013, 283)

In contrast to IFRS, FAS might lean primarily on legal form (Jarva & Lantto 2012, 157; Halonen et al. 2013, 273), due to its requirement of a significant ownership percentage in addition to significant influence and, in that sense, indeed differs from IFRS regulation (Haaramo, Palmuaro & Peill 2015, Chapter 11). Respectively, *associated undertaking* is defined as a participating interest, where an undertaking consolidated in the group financial statements holds 20 per cent or more, however less than 50 per cent, of the voting rights in another undertaking (Figure 2). Thus it shall be assumed to exercise a significant influence over its operating and financial policy unless the contrary is shown. *Participating interest* itself is defined as an interest held by one undertaking in the equity shares of another undertaking, which it holds on a long term basis for the purpose of securing contribution to that undertaking's own activities by the exercise of control or influence arising from or related to that interest. (Accounting Act 1:7–8) These kinds of presumptions have their base on the principle of "one share – one vote"[17]. Apparently, if the joint management is lost, entity shall not anymore consolidate it proportionally in the group financial statements. If it nevertheless satisfies the criteria of an associated undertaking, equity method is still an appropriate accounting technique. (Englund et al. 2005, 382)

2.2.2.2 Joint Arrangements According to IFRS

Contrary to IAS 31, in which the legal form of the arrangement was the primary determinant for the classification, IFRS 11 defines rights and obligations of the involved parties as the central criteria (Leitner-Hanetseder & Stockinger 2014, 2)[18]. There are two types of *joint arrangements* distinguished: joint ventures and joint operations. *Joint venture* is "a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement", whereas *joint operation* is "a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement". (IFRS 11:15–16)

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[17] Principally, all shares shall carry equal rights in the company. One share shall carry one vote in all matters dealt by the General Meeting. However, it may be that the company has or may have shares that differ from each other as regards the rights or obligations they carry, and different shares may carry different voting rights. (Limited Liability Companies Act 3:1–3)

[18] IAS 31 identified three forms of joint ventures where there is joint control (jointly controlled operations, jointly controlled assets, and jointly controlled entities), whereas IFRS 11 addresses only two types of joint arrangements (EY 2011).

In evaluating whether all participants in a joint arrangement exercise joint control, or does one party have the control itself, requires assessment (Halonen et al. 2013, 274)[19]. Significant judgment is also required considering the classification of a joint arrangement, when it has been structured through a separate vehicle (BDO 2013, 63), which makes the determination of the type of an investment more complex (PwC 2011, 8). Accordingly, Haaramo et al. (2015, Chapter 11) state that vital assumptions and conclusions regarding the type of joint arrangement have to be brought out when the investment is carried out through a separate vehicle. Thus, when evaluating whether a joint arrangement is a joint venture or a joint operation, one should first assess whether there is a separate vehicle, because a joint arrangement without such is automatically a joint operation. Term *separate vehicle* is broader than just legal entity, and is defined in IFRS 11 as "a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality". Subsequently, if a separate vehicle exists, the following additional factors need to be considered: the legal form of the separate vehicle, terms of contractual arrangement, and also other facts and circumstances when relevant (IFRS 11.B15).

Assessment of *legal form* often reveals the rights and obligations related to the arrangement. *Terms of the contractual arrangement* are usually in line with the rights and obligations, but may distinct some specific debts and guarantees. When evaluating *other facts and circumstances*, an example of how joint operation is formed is that it primarily aims to provide the parties with an output. (Haaramo et al. 2015, Chapter 11) Namely, when activities of an arrangement are mainly designed for production to the involved parties and the vehicle does not sell a significant portion of its output to third parties, it should primarily be classified as joint operation (Schmachtenberg 2014, 113). For instance, it is typical among Finnish companies, which operate in forest or energy industry, to follow the so-called Mankala Principle. This means that the shares entitle an owner to the produced goods by the investee at a cost price, and each shareholder is also obligated to pay for the expenses arising from the investee's operations relative to ownership, so that no profit and no loss occur. (Halonen et al. 2013, 281) The process of distinguishing joint ventures from joint operations is shown on the next page (Figure 3).

[19] An example of improper application of the accounting standards governing consolidation is the case of Koninklijke Ahold N.V., a publicly held international supermarket operator organised in the Netherlands. "Royal Ahold" was charged with improperly consolidating several joint ventures, the use of which was a significant part of the company's growth strategy beginning in the 1990s. (Zack 2013, 161–162)

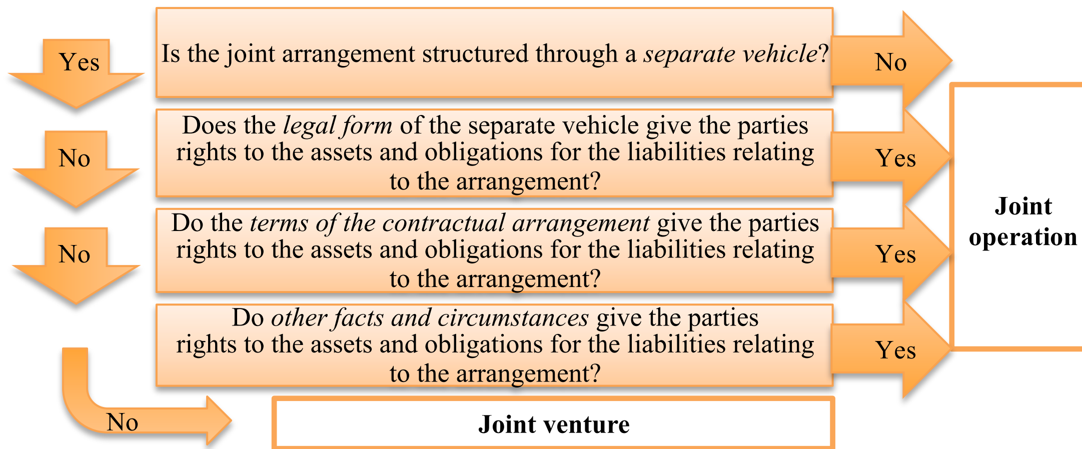

Figure 3. Determining the classification of joint arrangements under IFRS 11 (adapted from PwC 2011, 8)

When assessing the rights and obligations of the parties, there is a difference between limited liability companies and general partnerships in Finland[20]. The belongings of the parties are separate between a limited liability company and its shareholders, whereas owners are all personally liable for any legal actions and debts the company may face relating a general partnership. Consequently, when there are no other factors considering terms of contractual arrangement or other facts and circumstances, a joint arrangement can be classified as joint venture (limited liability company) or joint operation (general partnership). (Haaramo et al. 2015, Chapter 11) It is important to note that the factors need to be considered in aggregate, because although one aspect provides an indicator of a joint venture or a joint operation, it can be overridden by other elements. For example, a contractual arrangement between the parties may reverse or modify the rights and obligations conferred by the legal form of the vehicle. (Schmachtenberg 2014, 113) There is also a requirement of continuous assessment in IFRS 11, which means that if facts and circumstances change an entity shall reassess whether it still has joint control of the arrangement, and if this yet exists, whether the type of the arrangement in which it is involved has changed (PwC 2011, 9).

[20] A limited liability company in Finland is most commonly known as “osakeyhtiö (Oy)”. A general partnership, in turn, is usually called “avoin yhtiö (Ay)”.

2.2.3 Joint Management and Joint Control

Joint control between investors appears as joint management in an undertaking in FAS, and the relationship is usually formalised by drawing up a written shareholders' agreement. Besides, every owner has to have their own representative in the unit with administrative responsibilities of the joint venture. According to IFRS joint control derives from a contractually agreed sharing of control of the arrangement, which only exists when decisions about the relevant activities require unanimous consent of the parties sharing control. These are addressed next in more detail.

2.2.3.1 Joint Management According to FAS

If proportional consolidation is chosen, the factors on which joint management is based must be rationalised (Accounting Ordinance 4:3.1). Joint ventures are subject to sharing of control, which basically means that no single party can decide on its own, and therefore they initially do not belong to any group. Regarding *joint management*, FAS provides some criteria how it shall be distinguished (Englund et al. 2005, 381–382):

- Joint management is factual, covering the relevant decisions considering business like investment choices, financing, and personnel policies.
- Joint management has to be exercised actively by venturers in practice.
- Joint management is permanent, not temporary, by its nature.
- Every owner must have their own representative in the administrative bodies of the joint venture.

Joint management is often agreed in written form, although oral agreement[21] is also valid. Strategists who are working closely with business structuring, have noticed that dividing the share of ownership in a joint venture or joint arrangement into unequal proportions makes it easier for partners to agree upon decisions (BusinessWeek 2010), and Finnish companies in fact also use this kind of arrangement when forming joint

[21] This may be very rare in practice. As Caglio and Ditillo (2008, 895) express, when initiating a relationship, firms that are unaccustomed to each other may experience some trust issues. Based on this perspective, they could decide either not to formalise their agreement to stay flexible and have the possibility of exiting the relationship, or to engage immediately in a formal contract that insures them against opportunistic behaviour.

ventures, expressly with foreign partners (Thomson Reuters 2015). Academics argue similarly, stating that unequal ownership shares may have significant effects on decision-making styles and dispute resolution processes (Groot & Merchant 2000, 606).

In other words, ownership does not have to divide equally in order to control an undertaking jointly with one or several other firms. Joint management may be based on Articles of Association or other similar regulations, or on a shareholders' agreement[22]. (Englund et al. 2005, 495) Joint ventures tend to be very challenging, because investors may have contradictory interests, which arise from conflicting strategic objectives and benefits among partners. Therefore, in order to formalise the terms of a joint venture, the parties most likely enter into a shareholders' agreement, which is defined as an arrangement among company's owners describing how the undertaking should be operated, and what are shareholders' rights and obligations. (Hannula & Kari 2007, 59)

2.2.3.2 Joint Control According to IFRS

IFRS 11:7 defines *joint control* as "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"[23]. This definition is in accordance with the characterisation of control in *IFRS 10 Consolidated Financial Statements* (IFRS 11:B5). Therefore, the key elements of joint control are the following features:

- Contractually shared agreement.
- Determination of relevant activities and who has the rights to direct them.
- Determination of whether unanimous consent is needed for the decisions about the relevant activities.

The *contractual agreement* sets out the terms upon which the parties participate in the arrangement[24]. Just because parties may have equal ownership, it does not mean joint

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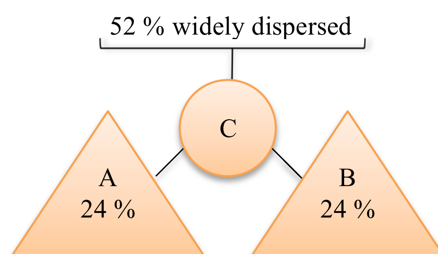
[22] This originates from the general guidelines issued by the Finnish Accounting Board (7.11.2006).
[23] Mäkelä et al. (2012, 20) have suggested that it would be desirable to adopt the definition of control under IFRS to Finnish conventions as well. Additionally, see the study of Baker and Hayes (2004, 783).
[24] These terms generally address matters such as the objective and duration of a joint arrangement, specific activities undertaken by the joint arrangement, how the members of the governing body are appointed and how decisions are made, capital and other contributions required of the parties, and how parties will share assets, liabilities, revenues, expenses, or profits or losses (PwC 2011, 2–3).

control exists, because based on the contractual arrangement only one party may have rights to direct the relevant activities and thus has the control. Regarding the determination of the *relevant activities* and who makes the decisions about them, guidance in IFRS 11 is consistent with that in IFRS 10, that is the activities that significantly affect the returns of the arrangement. Judgment is required when assessing what constitutes relevant activities (PwC 2011, 6), and examples of them are selling and purchasing goods, acquiring and disposing assets, and researching and developing new products or processes (IFRS 10:B11). IFRS 11:B9 notes that *unanimous consent* means that any party with joint control of the arrangement by not agreeing or participating in the decision-making can prevent the other parties from making decisions about the relevant activities. With this definition, it is clear that control and joint control are mutually exclusive, meaning that if it is determined that one party has control, there cannot be joint control, and vice versa. (Schmachtenberg 2011, 110)

Subsequently, it is not necessary for every party to the arrangement to agree to have unanimous consent, but only those parties that collectively control the arrangement must have a common approval (EY 2011, 13). When parties agree on relevant activities based on joint de facto control, IFRS requires greater use of judgment. Regarding de facto control, investor should consider economic dependency, the size of its shareholding in comparison to other holdings, and voting patterns at shareholder meetings. (Zack 2013, 161) *Joint de facto control* according to IFRS 11 exists when a large block of voting power is held by a number of investors that have a contractual agreement to always vote together concerning the relevant activities of the investee, and the remaining shares are held by other small and dispersed independent investors (BDO 2013, 26). An example of this is illustrated below (Figure 4).



A and B have an arrangement in which they each have a 24 % voting interest of C. Decisions about the relevant activities require a majority of the voting rights. The remaining 52 % is widely dispersed. A and B have an agreement that they will agree on decisions about relevant activities. Collectively, A and B have joint de facto control due to the contractual agreement, although they have no majority of voting rights.

Figure 4. Joint de facto control (adapted from EY 2011, 15)

2.3 Accounting Methods

2.3.1 Prior Research on Accounting for Joint Undertakings

There is no international consensus on the appropriate reporting method for interests in joint investments, including however primarily equity method and proportionate consolidation as alternatives (Lourenço & Curto 2010, 739; Richardson et al. 2012, 374). Although both academics and practitioners have been discussing the impact of joint ventures on financial statements and alternative accounting treatments since the sixties (Kothavala 2003, 518), contemporary debate still focuses on identifying the appropriate method of reporting joint undertakings (Stoltzfus & Epps 2005, 172). Through IFRS 11 European companies have recently been facing new challenges in identification, classification, and accounting requirements for joint arrangements (Leitner-Hanetseder & Stockinger 2014, 1–2). Briefly, how to report liabilities for equity accounted investees has been examined, as such commitments may represent hidden obligations of the reporting entity (Bauman 2003; O'Hanlon & Taylor 2007). Earlier studies provide evidence particularly of the incremental usefulness of proportionate consolidation (Bauman 2007; Graham et al. 2003; Stoltzfus & Epps 2005) and of the significance of additional information provided by venturers about their interests in joint ventures (Kothavala 2003; Lim et al. 2003; Soonawalla 2006).

Equity method has faced critique by several scholars who have examined the risks that applying one-line consolidation approach hides. According to Badenhorst et al. (2015, 2), a debate about the appropriateness of equity accounting is ongoing. For example, academics opposing the method have claimed that it reduces information quality (Graham et al. 2003; Soonawalla 2006). Researchers also state that the reported net investment, using equity accounting, masks the magnitude of the debt of joint ventures (Stoltzfus & Epps 2005, 173), and may serve as an opportunity to facilitate off-balance-sheet activities concealing the level of group gearing (O'Hanlon & Taylor 2007, 267), as well as potentially hinder financial analysis (Bauman 2007, 497). Moreover, Kothavala (2003, 519) mentions that joint ventures are often formed to engage in uncertain and risky projects, and the details are thus not enough appearing when applying the equity method. Soonawalla (2006, 405) emphasises that capital-intensive businesses in particular tend to carry out a large amount of their activities through

cooperative arrangements, indicating that for these firms a material amount of their earnings and investments are in them. A summary of previous research regarding accounting for joint ventures, and partly associated companies that are equity accounted investees too, is displayed below alphabetically by the last name of scholars (Table 1).

Table 1. Summary of previous research regarding accounting for joint ventures

Citation	Key findings
Bauman (2003)	The study focuses on off-balance-sheet activities concealed by equity method of accounting, and suggests that market participants find disclosures of equity-accounted investees useful.
Bauman (2007)	The use of proportionate consolidation has greater value relevance than equity method for explaining bond ratings.
Graham, King and Morrill (2003)	Proportionate consolidation is the best representation method, because it provides better predictions of future return on equity than equity method.
Kothavala (2003)	Whereas proportionally consolidated financial statements are more risk relevant for explaining price volatility, equity method for joint venture investments is surprisingly more risk relevant for explaining bond ratings.
Leitner-Hanetseder and Stockinger (2014)	Equity method has generally been preferred to proportionate consolidation as an accounting method for joint ventures in Europe. Findings also show that liabilities, sales, and EBIT[25] are all influenced materially when applying IFRS 11 for the first time, although having no material impact on total assets.
Lim, Yeo and Liu (2003)	Equity method provides relevant information for users, when additional information is disclosed in the notes.
Lourenço and Curto (2010)	The study concludes that the type of a jointly controlled entity plays an important role in the management's choice to report interests in them using alternative methods. The contribution suggests that requiring all ventures to be reported using one technique, like only equity method, reduces the reliability of financial statements not representing the substance of jointly controlled entity.
Nobes (2002)	The study examines the development of equity method across time and space, and criticises several past applications of the method.
O'Hanlon and Taylor (2007)	Disclosed liabilities of equity accounted investees are value-relevant especially in the case of joint ventures.
Soonawalla (2006)	The findings show that aggregated joint venture accounting amounts masks information that financial statement users could use to predict future earnings and explain share prices.
Stoltzfus and Epps (2005)	When compared to equity method, the results suggest that proportionate consolidation numbers provide more value-relevant information to creditors when companies guarantee the debt of the joint venture.

In comparison to equity method, many academics prefer proportionate consolidation since it reflects substance while equity method gives a legal view (Stoltzfus & Epps 2005), it represents better the liabilities of investees (Lourenço & Curto 2010), and gives superior predictions of future return on equity (Graham et al. 2003). However, accounting researchers critique also proportionate consolidation, because a single venturer cannot control its pro rata share of joint venture assets. Therefore, it also should not reflect a proportional debt that is not a present obligation of the venturer.

[25] Earnings Before Interest and Taxes

This is argued as inappropriate, leading to presentation of a misleading image of the venturer's financial performance and position. (Richardson et al. 2012, 377) Critics have also argued that proportionate consolidation weakens comparability between reports when it is an additional alternative to equity method, and that it contravenes the economic unity concept (Leitner-Hanetseder & Stockinger 2014, 5).

2.3.2 Theories Related to Classification and Accounting for Group's Interests

Investee's accounting treatment in the consolidated statements is determined by its characterisation. Similarly, distinction between a joint venture and a joint operation is important, since accounting for these arrangements is different, and therefore under IFRS 11 originates from the classification (Leitner-Hanetseder & Stockinger 2014, 4; Schmachtenberg 2014, 114). Psaros and Trotman (2004, 81) examined consolidation judgment, and assert that accountants may take an extreme interpretation of accounting standards, which can be reached by exploiting the possibly existing discretion that supports the preferred reporting position. Also O'Hanlon and Taylor (2007, 283) claim that the issue whether accounting and disclosure requirements for diverse investees have affected managers' choices concerning how they are structured is worth a consideration. The picture below exhibits the relationship between control or influence over the investee, which is at the core of demarcation and accounting method (Figure 5).

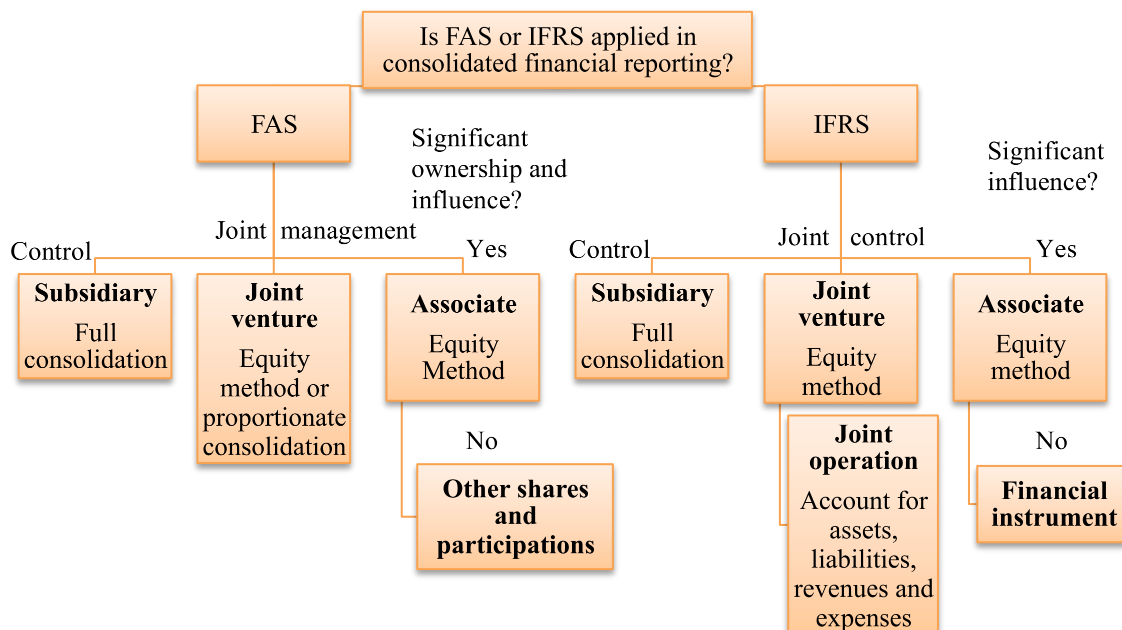


Figure 5. Connection between classification of investment and accounting method

One of the underlying theories related to research that supports the theoretical base of this study is Paton's (1922) *entity theory* (as cited in Fagerström 2002, 189), which was applied precisely on group accounting later by Moonitz (1944). It has been vital in the discussion among researchers regarding consolidated statements, since traditionally a group has been described as an economic or business entity that composes legally-separate units subject to control based primarily upon powers conferred by share ownership (Moonitz 1944, 13). Central to this theory are the group management and reporting to outsiders. Consequently, group accounting begins with defining the entity so as to decide the scope of consolidation. Group accounting theory is thus based on the entity postulate, which provides guidance on the demarcation of the group. When this categorisation is decided, methods such as the full consolidation, equity method, and proportional consolidation follow. (Fagerström 2002, 186–189)

Another strand of research, *positive accounting theory* by Watts and Zimmerman (1986), has provided motivation for many studies when examining managers' incentives to choose among accounting methods to achieve desired financial reporting objectives. Indeed, several researchers (e.g. Dhaliwal 1988; Fields et al. 2001; Healy & Palepu 2001; Healy & Wahlen 1999; Mantecon et al. 2012) have cited the theory while examining management's reporting and disclosure decisions. With respect to inter-firm collaboration in particular, Lourenço and Curto (2010), found that the type of a jointly controlled entity plays an important role in the management choice to report interests in them using the equity method or proportionate consolidation. Leitner-Hanetseder and Stockinger (2014, 6) cite that equity method is preferred among the automobile and transportation firms, whereas construction tends to prefer proportionate consolidation. Also Fagerström (2002, 160) brings out that industry has been used in previous financial reporting research as one explanatory variable for accounting method choices.

A prevalent theory in accounting research also addresses how firms report revenues and expenses being an object of both management and manipulation. This means *earnings management*, which is defined as follows: "managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers" (Healy & Wahlen 1999, 368). Fields et al. (2001) acknowledge both approaches, since choosing

the accounting method may be either economically efficient as flexibility in reporting enhances transparency and mitigates information asymmetry, but also opportunistic so as to maximise managers' own utility. Given prior research, Badenhorst et al. (2015, 3) suggest that aggregation conceals information that investors use about the profit and loss of equity accounted investees such as joint ventures. Besides, Mantecon et al. (2012, 1010) claim that single-line reporting provides co-owners with leeway to manage earnings, and even mentions one extreme example of the implications of such equity method reporting, which includes the use of off-balance-sheet investments by Enron's management to keep debt off its balance sheet and recognise higher profits.

2.3.3 Accounting for Joint Ventures and Joint Arrangements

Many national accounting standards such as FAS permit proportionate consolidation as an alternative to equity method when reporting interests in joint ventures. Due to the rather recent issuance of IFRS 11 the existing choice of proportionate consolidation of joint ventures got eliminated[26]. IFRS 11 however introduces a separate accounting for joint operations, which closely resembles proportionate consolidation. Hereupon examples of the presentation of these "one-line" and "line-by-line" reporting methods, and accounting for joint arrangements according to IFRS are presented.

2.3.3.1 Accounting for Joint Ventures as Defined by FAS

Since joint ventures according to Finnish law fulfil the requirements of an associate company, they may be accounted for using either equity method or proportionate consolidation, but the method shall be used consistently once chosen (Halonen et al. 2013, 283). Moreover, it is permitted to use both methods at the same time for different joint ventures. It is preferable to use equity method instead of proportionate consolidation if the venture's field of operation differs from the group's other operations, in a way that has an impact on giving a true and fair view of the group's overall financial performance and position. (Englund et al. 2005, 382–384)

[26] In IFRS, the accounting option for joint ventures has been eliminated to reduce the differences between IFRS and US-GAAP (United States-Generally Accepted Accounting Principles) and to improve comparability (Leitner-Hanetseder & Stockinger 2014, 2), which means that only equity method is now permitted for these investments.

Equity method, also known as one-line consolidation, is a technique of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets of the investee. To the extent that the investor receives dividends from the investee, these are accounted for as a reduction of the investment in the investee. Similarly, proportional payments decrease the investment. (Englund et al. 2005, 354) The illustrative example below provides a comprehension of the presentation of group figures, when a 40 % acquired joint venture is included in the consolidated balance sheet using the equity method. For example, the proportion of unallocated group goodwill and deferred tax liability are included in the carrying amount of the investment, because the investment is presented on a one-line basis. There are also no elimination entries at the point of acquisition. (Figure 6)

Balance sheet	Joint venture (book value)	(fair value)
Intangible rights	1 000	
Buildings	500	700
Land areas	500	
Investments	150	
Other assets	1 390	
Total assets	3 540	
Shareholders' equity	3 000	
Other liabilities	540	
Shareholders' equity and liabilities	3 540	

Calculating group goodwill		
Acquisition cost	1 300	
Group's interest in joint venture	1 200	(3 000 * 40 %)
Consolidation difference	100	
Allocation to buildings	80	(200 * 40 %)
Deferred tax liability	21	(80 * 26 % tax)
Group goodwill	41	(100 - [80 - 21])

Equity method

Balance sheet	Investor company	Joint venture	Eliminations	Group
Investments in associated companies and joint ventures	1 300			1 300
Other assets	1 700			1 700
Total assets	3 000	-	-	3 000
Shareholders' equity	1 700			1 700
Other liabilities	1 300			1 300
Shareholders' equity and liabilities	3 000	-	-	3 000

Figure 6. Equity method in consolidated balance sheet presentation (adapted from Mäkelä et al. 2012, 97–98)

Proportionate consolidation, on the other hand, is a method representing items of assets, liabilities, income and expense in proportion to the firm's percentage of participation in the jointly managed undertaking. Minority interest is not presented separately, because the investment has been consolidated proportionally. (Mäkelä et al. 2012, 98) As proportionate consolidation discloses separately items, like debts, related

to joint venture, it has been extensively discussed among researchers internationally. For instance Bauman (2003), Mantecon et al. (2012), as well as O'Hanlon and Taylor (2007) have expressed their concern about the opportunity to exploit off-balance-sheet activities, which may be concealed by equity method. In comparison to the presentation of equity method, an illustration is presented below when a joint venture is included in the consolidated financial statements in proportion to acquired 40 % interest (Figure 7).

Proportionate consolidation						
Balance sheet	Investor company	(Joint venture 100 %)	Joint venture 40 %	Total	Eliminations	Group
Buildings		(500)	200	200	80	280
Investments in joint ventures	1 300			1 300	-1 300	0
Group goodwill					41	41
Other assets		(2 500)	1 000	1 000		1 000
Total assets	1 300	(3 000)	1 200	2 500	-1 179	1 321
Shareholders' equity	1 300	(3 000)	1 200	2 500	-1 200	1 300
Deferred tax liability					21	21
Shareholders' equity and liabilities	1 300	(3 000)	1 200	2 500	- 1 179	1 321

Figure 7. Proportionate consolidation in consolidated balance sheet presentation (adapted from Mäkelä et al. 2012, 101–102)[27]

Past equity method is applied when joint ventures are included in the consolidated financial statements. When the acquisition cost for the investment exceeds the pro rata portion of investee's equity, the investor calculates a consolidation difference that is allocated to applicable assets and liabilities of the joint venture. The proportion of this difference, which cannot be allocated, is recognised as *group goodwill* in the consolidated financial statements. Vice versa, a negative consolidation difference, which cannot be allocated to appropriate assets and liabilities, will be recognised as *group reserve*. Whereas group goodwill shall be amortised periodically over five to 20 years in order to reflect the useful economic life, group reserve may be transferred to the consolidated profit and loss account as future losses or expenses occur, or as it corresponds to a realised gain. (Englund et al. 2005, 385) Under equity method the group's interest in a joint venture is carried in the consolidated accounts of financial position at an amount that reflects its share of the net assets of the investee together with group goodwill on acquisition, whereas under proportionate consolidation the group goodwill is separately disclosed in the balance sheet (Mäkelä et al. 2012, 99).

[27] Group goodwill here is calculated similarly as in the equity method example (see Figure 6).

2.3.3.2 Accounting for Joint Ventures and Joint Operations as Defined by IFRS

As described by Schmachtenberg (2014, 114), the distinction between a joint venture and a joint operation is important, because the accounting for the two types of joint arrangements is different. A joint venturer recognises its interest in a joint venture as an investment, and account for this using the equity method as defined in IAS 28, which is the same accounting as for significant influence investments or associates (IFRS 11:24)[28]. In *accounting for joint operations* the parties recognise their assets, liabilities, revenues, and expenses relating to their involvement in accordance with the IFRS-standards applicable to these particular account types. Accounting for joint operations resembles highly proportionate consolidation, but one main distinction is however that IFRS 11 requires an entity to recognise its assets, liabilities, revenues and expenses as determined in the contractual arrangement, rather than basing this on ownership shares. (EY 2011, 28) Hence, it can be possible that investor does not recognise debt of joint operations in its balance sheet at all, because the entity may not be responsible for any obligation regarding them (Halonen et al. 2013, 282).

One of the key differences when accounting for joint ventures versus joint operations is that the liability under the arrangement for parties engaged in joint ventures is limited to their respective investments in the arrangement, whereas in a joint operation there is no liability limitation, that is, all parties are jointly and severally liable for the obligations of the arrangement (Schmachtenberg 2014, 114). In other words, for a joint venture a party has an interest in the net assets and that party's loss is limited to its investment, and such losses are not recognised unless the party has a legal or constructive obligation to make payments on behalf of the joint venture. In contrast, for a joint operation the assets and obligations are recognised without limitation, even if that results in the liabilities exceeding assets. When a joint operator is required to recognise 100 % of a liability, because it is responsible for the entire balance of the obligation, also key figures like the leverage or gearing will be negatively affected. (EY 2011, 18)

[28] This is a significant change from the previous regulation of IAS 31, which gave venturers a choice of proportionate consolidation or equity accounting for their interest. The joint venturer does not have rights to individual assets or obligations for individual liabilities of the joint venture, and does not therefore reflect these in its financial statements. (PwC 2011, 13) When using equity method, the investment is initially recognised at cost, then adjusted for the post-acquisition change in the investor's share of net assets of the joint venture. Presentation is a one-line entry in the profit and loss statement *investor's share of the joint venture's profit or loss* and a separate line item for other comprehensive income, as well as a one-line item in the statement of financial position *investment in joint venture*. (IAS 28:3)

The concepts underlying the procedures used in accounting for the acquisitions of a subsidiary are also applied regarding joint ventures. On acquisition of a joint venture, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for either as *goodwill* if positive (included in the carrying amount of the investment) or as gain if negative (IAS 28:26–32). Any *negative goodwill*, or badwill, should be recognised in the profit or loss account as a profit all at once (Mäkelä et al. 2012, 343). If impairment is indicated, the amount of impairment loss is calculated by reference to IAS 36 Impairment of Assets. Thus, the entire carrying amount of the investment is tested for impairment as a single asset, that is, goodwill is not tested separately. (IAS 28:40–43) The acquirer of an interest in a joint operation in which the activity constitutes a business as defined in IFRS 3 Business Combinations is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRS with the exception of those principles that conflict with the guidance in IFRS 11 (IFRS 11:21A).

2.4 Disclosures

2.4.1 Literature Review on Disclosures

The meaning of financial accounting is to create and record useful information for investors, creditors, and other decision-makers outside the business entity. Decision-useful information can be conveyed in reporting by either recognising an accounting amount in financial statements or by disclosing information in the notes. (Badenhorst et al. 2015) The requisite for financial reporting and disclosure arises from information asymmetry and interest divergence between managers and outside shareholders, which is why corporate releases are critical for the functioning of an efficient capital market. (Healy & Palepu 2001, 406) Jensen and Meckling (1976) is one of the classics in accounting literature. Their remarkably cited paper is known for *agency theory*, highlighting the conflict of interests between principals and agents, which means the relationship between managers and the outside equity and debt owners. Their theory helps to explain, inter alia, why accounting reports would be provided voluntarily to stockholders and creditors (Jensen & Meckling 1976, 306).

Related to economic theory, Beaver (1981, 48) has examined one specific type of information asymmetry, namely *moral hazard*, and points out that it is a problem of the agent possessing superior information and thus having the opportunity to use it self-interestedly at the expense of the principal. Some studies reflect the assumption that managers of firms choose accounting methods to maximise their own welfare (Dhaliwal 1988, 289). Information asymmetry explains the demand for audit services, because audit reduces managers' chances to withhold material information from the shareholders, and thus enhances the credibility of management disclosures (Halonen & Steiner 2009, 15; Healy & Palepu 2001, 406; Riistama 1999, 27). Subsequently, voluntary disclosure has been a subject of an extensive literature. Given prior research, managers have an informational advantage over outside investors regarding the firm's profitability and value, and have incentives to maximise the worth of the business firm in the eyes of stakeholders. To that end, managers have purposes to strategically and selectively disclose information. (Jankensgård 2015, 5–6) The role of auditing in the functioning of capital markets is displayed below (Figure 8).

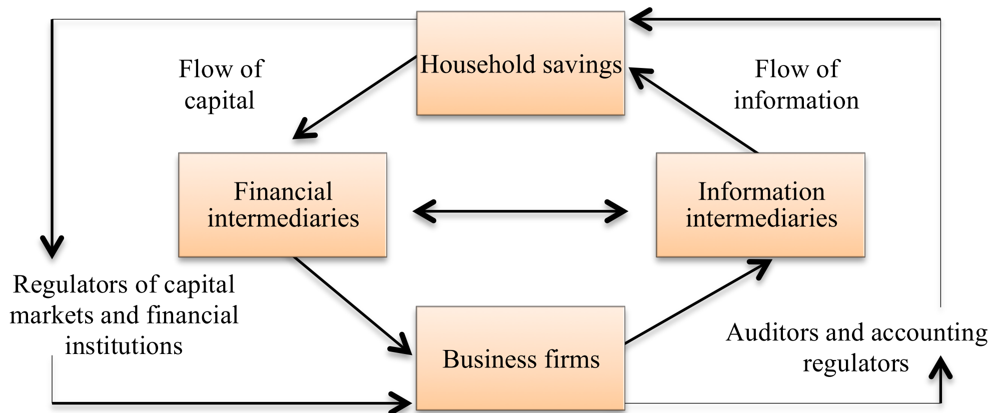


Figure 8. Financial and information flows in a capital market economy (Healy & Palepu 2001, 408)

Prior to reading any financial statements, readers should always consider the valuable information provided in the notes to the financial statements (Zack 2013, 187). Regarding disclosed information of the nature of investments, Psaros and Trotman (2004, 91) examined preparers' consolidation judgment, and additionally found evidence that managers use flexibility in accounting rules to make disclosure favouring their incentives. The term judgment itself typically refers to forming an opinion about a

phenomenon, and it tends to take a form of an evaluation of a current state of affairs or predictions about the future (Bonner 1999, 385), which is why judgment and decision-making are considered to be critical activities in all organisations (Mala & Chand 2014, 264). Accounting and reporting standards require firms to reveal information to some degree about judgment concerning how an investment is categorised and correspondingly consolidated (Accounting Ordinance 4:3.1; IFRS 12.1), although joint venture agreements contain elements to a large extent that are not intended for general distribution (Groot & Merchant 2000, 606; Schmachtenberg 2014, 147).

When it comes to reporting joint undertakings, findings of the study by Soonawalla (2006) evidenced that the separate recognition of the disclosure of joint ventures and associate companies provides value relevance. Similarly, O'Hanlon and Taylor (2007) find an increase in the significance of accounting information following a regulation that requires more disclosures for joint ventures. Previous research indeed suggests that a failure to disclose separate joint venture accounting amounts masks information that could help market participants assess risks more accurately (Stoltzfus & Epps 2005), and supplementary information of joint ventures is associated with a decline in information asymmetry (Lim et al. 2003). Additionally, findings of Richardson et al. (2012) indicate that liability disclosures of equity accounted investees are value relevant. Mantecon et al. (2012) complete this by asserting that at the core of disclosure requirements related to joint ventures are the needs to provide adequate information to protect investors from potential abuses. This may be especially important to acknowledge when contemplating jointly managed and risky arrangements, as some researchers (Healy & Palepu 2001, 421) claim that firms use disclosures strategically to optimise their financing strategies, which other researchers (Jankensgård 2015, 23) support by asserting that businesses aim at obtaining favourable outcomes in connection with changes in their financial structure.

2.4.2 Disclosures of Interests in Joint Ventures and Joint Arrangements

FAS emphasises that the base of joint management shall be disclosed in the notes to the consolidated statements, as described later. IFRS requires entities to disclose significant judgment and assumptions made in determining both joint control and the type of a joint arrangement, which means demarcation between joint ventures and joint operations.

2.4.2.1 Disclosures of Joint Ventures Under FAS

In relation to each joint venture proportionately consolidated, there shall be stated the nature of the joint management arrangement. In other words, the following information shall be included in the notes to the consolidated financial statements:

> *If the annual accounts of an associated undertaking are included in the consolidated accounts according to chapter 6, section 15, of the Accounting Act, information on the nature of the joint management of the associated undertaking.* (Accounting Ordinance 4:3.1)

Investee is possible to be interpreted as a joint undertaking, when the owners exercise management together, for example based on a shareholders' agreement. This classification is the requirement for applying the proportionate consolidation instead of equity method that is used in the case of associate companies. (Mäkelä et al. 2012, 98) Additionally, average number of staff in the joint ventures that have been incorporated in the consolidated accounts in the manner described in chapter 6, section 15, of the Accounting Act (i.e. proportionate consolidation), shall be included in the notes to the consolidated profit and loss account and balance sheet (Accounting Ordinance 4:4.6).

In some cases it is permitted not to include a joint venture in the balance sheet and profit and loss account of the group. Specifically this means there is no need to comply with consolidation requirements when the amounts involved are not material for the purpose of giving a true and fair view of the group. Furthermore, the same regulation refers to exemptions according to which subsidiaries are excluded from the consolidation. (Englund et al. 2005, 384) The previous expressly states that the financial data of a subsidiary does not have to be included in the consolidated financial statements if its shares are held only with a view to subsequent sale, if information on that investment cannot be obtained without unjustifiable delay or disproportionate expense, or if serious and permanent restrictions have a substantial effect of the parent company's control over that subsidiary (Accounting Act 6:3).

2.4.2.2 Disclosures of Joint Arrangements Under IFRS

A reporting entity is required to disclose information that helps users of financial statements understand the nature of the arrangement, and the contractual relationships with other participants. It also has to inform about the risks related to the investment, and how these risks have changed. In order to achieve this, an entity has to give specified information about every material joint arrangement, and obligations related to the investment. (Haaramo et al. 2015, Chapter 11) Therefore, an entity must communicate significant judgments and assumptions it has made in determining joint control of an arrangement, as well as the type of a joint arrangement (joint venture or joint operation) when it has been structured through a separate vehicle. Management will need to use judgment to meet the disclosure objectives of IFRS 12. Notwithstanding the specific requirements, an entity might also have to disclose additional information. (EY 2011, 39)

As a brief recap of chapter 2.2 of this study, when assessing existence of joint control an entity needs to define what constitutes relevant activities, and do the decisions about them demand unanimous consent (IFRS 11:7). The type of joint arrangement that an entity is party to, in turn, depends upon the rights and obligations that arise from the contractual arrangement. Besides, the use of a separate vehicle makes the determination more difficult, because without it the arrangement is inevitably a joint operation. (PwC 2011, 6–8) Additionally, considering the nature of all material joint arrangements, IFRS 12:21–22 requires following qualitative disclosures: name of the joint arrangement, nature of the investor’s relationship with the joint arrangement (description of the activities of the joint arrangement and whether they are strategic to the entity’s activities), place of business, the proportion owned and, if different, the proportion of voting rights held (BDO 2013, 64).

2.4.3 Disclosures of Financial Performance and Financial Position

In brief, there are some accounting guidelines for joint ventures described, which according to FAS shall also be disclosed in the notes to consolidated statements. IFRS requires an entity to disclose information about the risks and financial effects in relation to its participation in joint arrangements in particular, as seen in subsequent sections.

2.4.3.1 Disclosures of Accounting for Joint Ventures Under FAS

The accounting principles applied to the consolidated financial statements are included in the notes (Accounting Ordinance 4:2). In general, financial statements according to Finnish GAAP require significantly fewer notes than IFRS (Halonen et al. 2013, 47). Nonetheless, where appropriate, accounting for joint ventures follows regulations in Accounting Act chapter 6 article 4, and articles 6–8 (Englund et al. 2005, 495). Based on these instructions, the following bullet points highlight the major guidelines that shall be applied when accounting for joint ventures (e.g. Mäkelä et al. 2012, 400):

- Consistent accounting policies and practices in accordance with the principles used to draw up consolidated accounts from one financial year to the next.
- Where the financial statements of a joint venture have been prepared according to accounting rules differing from those used by the parent company or group, they shall be adjusted so as to accord with the principles used for the parent company or group financial statements.
- Principles applied in the translation into Finnish currency of items in the annual accounts of foreign subsidiary or foreign associated undertaking, and information on how the conversion differences arising from the translation of such items into Finnish currency have been treated in the consolidated profit and loss account and balance sheet[29].
- Income and expenditure, debts and claims, and profits and losses resulting from transactions between the undertakings in the consolidation included in the book values of assets, shall be eliminated in the preparation of group accounts.
- Proportion of accumulated depreciation difference and voluntary provisions recognised under equity.
- Disclosure of the amount and recognition of equity at the time of acquisition.

Joint ventures are considered related parties, and they are defined in FAS the same way as in IFRS, more specifically IAS 24 Related Party Disclosures. Therefore, a company shall be considered *related party* if one controls the other or if one otherwise has

[29] The balance sheet shall be translated using the current exchange rate prevailing at the end of the reporting period, whereas income statement items are translated using the average exchange rate for the period (Accounting Act 6:4). The Finnish currency is euro at the moment.

significant influence in the financial and business decision-making of the other. The annual report shall contain separate information on loans, liabilities and commitments to related parties and on the main terms thereof, if the sum of them exceeds 20 000 euros or five per cent of the equity of the company, as it appears on the balance sheet. (Limited Liability Companies Act 8:6) Reporting entity is required to disclose any material transactions that are not carried out under normal commercial conditions. It is vital to include in the annual account a note on deals with related parties, stating the amount of such transactions, nature of the related party relationship, and other information about the affairs necessary for an understanding of the financial position of the company. (Accounting Ordinance 2:7b)

2.4.3.2 Disclosures of Accounting for Joint Arrangements Under IFRS

The disclosure requirements of accounting for joint arrangements are incorporated within *IFRS 12 Disclosures of Interests in Other Entities*. Consequently, an entity shall disclose the description, extent, and financial effects in relation to its involvement with joint arrangements (PwC 2011, 18). This encompasses information that enables users of financial statements to evaluate the following aspects in making decisions about providing resources to the entity (IFRS 12:1):

- The nature of, and risks associated with, its interests in other entities, including the contractual relationship with the other parties that have joint control.
- The effects of those interests on its financial position, financial performance and cash flows.

First objective relates to the nature, and changes in, risks related to a joint venture. To meet this purpose, a joint venturer is required to disclose commitments that it has relating to its joint ventures separately from the amount of other commitments, and contingent liabilities incurred relating to its interests in joint ventures separately from the amount of other contingent liabilities. (PwC 2011, 23) Entity is required to disclose accounting policy and financial information for each joint venture that is material to the entity, and summarised information in the aggregate for individually immaterial joint ventures. Evaluating which information may be useful to users of financial statements will however, once again, require judgment. (EY 2011, 40–41)

2.5 Synthesis of the Theoretical Framework

The theoretical framework of this study is divided into three parts that derive from previous research on classification and accounting for joint ventures and joint arrangements. Previously in this study a literature review has been introduced in order to explore, compare, summarise and critically analyse what other researchers have written about the topic of the research (Eriksson & Kovalainen 2008, 44). In fact, more meaningful results can be provided when a wider explanation of a single phenomenon is built by taking into consideration several perspectives and theories that complement each other (Hoque 2010, 481). Synthesis of the theoretical framework is exhibited below (Figure 9).

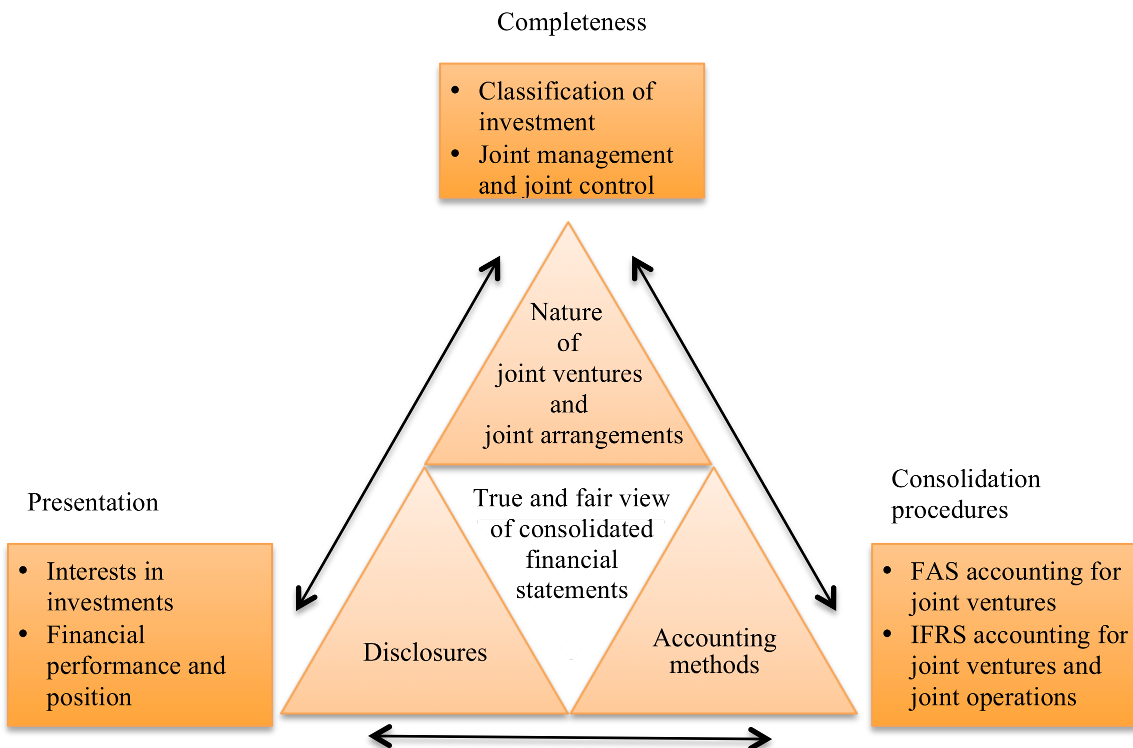


Figure 9. Synthesis of the theoretical framework

The previous literature about joint ventures and joint arrangements highlights three dimensions. First, the *nature* of these kinds of investments is of importance to the scope of group accounts. Second, the determined classification of undertakings concludes the applicable *accounting* methods, and is essential considering the reported values in consolidated profit and loss statement and balance sheet. Third, *disclosures* contained mainly in notes exhibits the agreed collaborative relationship between partners, and the

state of affairs and transactions in these inter-firm investments. When these three pieces are therefore extended further to group audit, they comprise the three principal objects of review: *completeness* of components included in the consolidated financial statements, appropriateness of *consolidation procedures*, and *presentation* of the group figures including explanatory information disclosed in the notes (Riistama 1999, 227). Subsequently, the three dimensions form the essence of true and fair view of consolidated financial statements, when a firm participates in joint undertakings.

The rightful categorisation of investments is important, because it determines the accounting method. Healy and Wahlen (1999, 369) claim that managers must decide how to arrange corporate transactions, for example equity investments can be structured so as to avoid or require consolidation. Also Psaros and Trotman (2004) have examined preparers' consolidation judgment with emphasis on interpretation of accounting standards. The number of parties included in inter-organisational agreements differentiates between bilateral and multilateral arrangements, which in the environment of increasing globalisation make the joint relationships more and more complex when firms pursue competitive advantage (Ozorhon et al. 2007; Van der Meer-Kooistra & Kamminga 2015). The managerial issues of joint undertakings have been studied especially from the viewpoints of ownership allocation, and shared control (Moskalev & Swensen 2007; Nguyen 2009). Besides, international joint ventures have been extensively examined, chiefly from the perspective of western and eastern counterparts (Kobernyuk et al. 2014; Tsamenyi et al. 2013; Volchek 2013; Zheng & Larimo 2010). FAS basically relies on ownership and shareholders' agreements as the foundation for joint management, whereas IFRS arrangements focus primarily on the contractual relationship as well as the rights and obligations rather than legal form.

For joint ventures there is a wide global variation in the accounting treatment now, mainly in terms of requiring or permitting the use of equity method or proportionate consolidation – FAS permitting the use of both methods for joint ventures, IFRS 11 allowing only equity method for joint ventures and introducing another accounting method for joint operations. Earlier research suggests that proportionate consolidation conceives with greater transparency when compared to equity method, because it displays a greater number of accounting information (Bauman 2007; Kothavala 2003; Stoltzfus & Epps 2005). However, empirical evidence about the supremacy of one

method over another is mixed (Graham et al. 2003; Lim et al. 2003; Soonawalla 2006). Mian and Smith (1990, 167) examined consolidation choice and argue that in the same way as firms employ unconsolidated subsidiaries to mislead investors by understating the fixed claims on the firm's balance sheet, companies also use other off-balance-sheet financing methods. Fields et al. (2001, 256) on their behalf claim that managerial intent is the key to the definition of accounting choice, which is the reason why some researchers (e.g. Lourenço & Curto 2010) are motivated to examine for example debt covenants related to management choice to report interests in jointly controlled entities. Correspondingly, scholars such as Bauman (2003), Mantecon et al. (2012), as well as O'Hanlon and Taylor (2007) have examined the opportunity to exploit off-balance-sheet activities, which may be concealed by equity method accounting, as debt related to the interest in joint venture is not disclosed separately in the balance sheet.

Management and stockholders are the ones to whom consolidated statements tend to overshadow single-company reports in importance (Moonitz 1944, 16). Information asymmetry between managers and equity and debt investors explains the demand for audit services, because audit reduces the chances to withhold material information from the shareholders (Healy & Palepu 2001, 406). Since joint cooperation is based on agreements that contain many elements that are not intended for general distribution (Groot & Merchant 2000, 606), and traditionally have not been shared outside the circle of board and executive management, it is interesting to observe to which extent management will reveal judgments concerning investment classification (Schmachtenberg 2014, 147). Academics also suggest that supplementary disclosure related to accounting for joint ventures helps market participants to assess risks more accurately, as well as moderates disproportion of information and potential abuses (Lim et al. 2003; Mantecon et al. 2012; O'Hanlon & Taylor 2007).

3 CONDUCTING THE RESEARCH

This chapter lays a foundation for the empirical part of the thesis. Briefly, the research philosophy of this study can be described from the perspective of constructivism. The study is ontologically relativist, epistemologically subjectivist and methodologically hermeneutic and dialectic. Using qualitative approach and semi-structured interviews, the research strategy is justified through the previously mentioned philosophical assumptions in the following sections in detail.

3.1 Research Philosophy

Knowledge of the philosophical concepts is important to become acquainted with in order to be able to design a solid piece of study that delivers, what it promises. Philosophical concepts also assist in specifying the overall research strategy. Ontology, epistemology and methodology are considered key concepts in the philosophy, while they together relate to each other as a unified view that some researchers call paradigm. (Eriksson & Kovalainen 2008, 11–13) This could be summarised to the beliefs of Hoque (2010, 379), who accentuates that the ability to carry out research successfully lies partly in a familiarity with the philosophical traditions. All in all, awareness of research philosophy supports to defend the chosen methodology (qualitative or quantitative) and identify new or different areas worth of investigation.

3.1.1 Social Constructionist Paradigm

> *Objectivity in accounting is largely a myth.*
> (Morgan 1988, 477)

Paradigm is a term deriving from the history of science, where it was used to describe a cluster of beliefs and dictates that what should be studied, how research should be done, and how results should be interpreted (Bryman & Bell 2015, 726). The concept of paradigm is widely used in social sciences and business research, and means a belief

system or worldview that guides a researcher in their work (Eriksson & Kovalainen 2008, 16). Bryman and Bell (2015, 32) appoint two positions, which question whether the world should be considered as objective entities that have a reality external to social actors (objectivism), or whether it should be examined as social constructions built up from the perceptions of social actors (constructionism). Whereas the first view resembles positivism, which is the belief that propositions about the social world can be unambiguously verified against objective reality (Armstrong 2008, 871), the latterly mentioned defines the paradigm used in this study. Thus, the world is seen as socially constructed, the approach relies on the commonalities of experiences amongst individuals, and aims to make sense of situations and everyday practice (Hoque 2010, 381). The constructivist paradigm assumes relativist ontology, subjectivist epistemology, and a set of methodological procedures related to the natural world (Denzin & Lincoln 2003, 35), which are described next.

3.1.2 Ontological, Epistemological and Methodological Assumptions

Ontology concerns the ideas about the existence of and the relationship between people, society and the world in general as described by Eriksson and Kovalainen (2008, 13). This research sees that perceptions and experiences construct reality that may be different for each person, as well as change over time and according to context. Thus, ontologically this study can be seen as *relativist*. This means that all acceptable statements about existence depend on a worldview, and there are multiple constructed realities (Patton 2002, 97), and thus there is no objective truth (Tuomi & Sarajärvi 2003, 55). After all, human being is not only biologic but also social individual, who lives in interaction with its surroundings (Hirsjärvi & Hurme 2011, 23).

Epistemology defines how knowledge can be produced and argued for (Eriksson & Kovalainen 2008, 13). There is a fundamental difference between the subject of matter of the natural sciences and that of the social sciences, and epistemology is required to reflect and capitalise upon that disparity (Bryman & Bell 2015, 30). Social sciences resemble this study, and the path of having a *subjective* epistemological view is followed. It should be understood so that no access to a world beyond observations and interpretations of people is possible (Eriksson & Kovalainen 2008, 14). According to Bryman and Bell (2015, 35), organisations altogether are seen as socially constructed

products, labels that are used by individuals to make sense of their experience. Also Morgan (1988, 477) claims that epistemology in accounting should be seen as reality construction, people as everyday observers are active producers of what is experienced, and finally all knowledge is a matter of perspective. How epistemology shows in practice, is seen in both data collection and analysis.

Methodology is more practical in nature. It focuses on the specific ways and methods, which can be used in research when trying to understand the world better. (Eriksson & Kovalainen 2008, 15–16) Methodologically this study embodies *hermeneutics*, which focuses on interpretation. Hermeneutic theory pursues understanding with special attention to context (Patton 2002, 114). Consequently, this thesis should be comprehended in its cultural setting paying attention to Finland and in its temporal dimension, when the current standards in accounting are applied. So this research obeys the principles of hermeneutic circle, which Guba and Lincoln (1989, 178–179) define as a continuous interplay of data collection and analysis that occurs when the inquiry proceeds. Internal coherence amongst different levels of theory is continually being renegotiated, since observations made in earlier studies are being reconsidered within new interpretive frameworks (Denzin & Lincoln 2003, 170). However, it is notable to acknowledge the words of Patton (2002, 115) that other researchers using different methods, having different purposes and coming from different backgrounds would likely develop somewhat diverse scenarios. A common construction is made between the researcher and respondents, grounding the findings, via a *dialectic* process. This is in line with Morgan (1988, 484) who argues that accounting indeed should be approached as a dialogue with situations in an interpretive mode.

3.2 Research Strategy

3.2.1 Qualitative Approach

In terms of choosing the most convenient methodology for scholarly studies, Arnold (2009, 804) suggests that one of the greatest challenges for financial accounting research is to reduce its dependence on quantitative databases, and bridge the gap between academic research and the world of accounting in action. In recent years,

businesses have witnessed dramatic changes. The complexity has resulted in an increase in the use of qualitative methodology based on its ability to provide fresh and interesting insights to the way that accounting interacts with its environment. (Hoque 2010, 375) Typical for qualitative research is that it aims at a holistic understanding of the issue studied, and is sensitive to the context of the phenomena. Hence, although there is a long-standing dominance of quantitative research, academics remind that there is no point in claiming that quantitative methodology is the more desirable form and qualitative only a complementary to it. (Eriksson & Kovalainen 2008, 5) As stated by Morgan (1988, 481), an accounting theorist needs to understand the complicated, multi-dimensional and paradoxical aspects of the world around us.

> *Qualitative studies are useful when researchers seek to understand how accounting phenomena are produced, experienced, and interpreted by social actors within complex social world. The multifaceted nature of many accounting practices can only be analysed when qualitative methods are adopted. The roles that accounting plays in the dissolution, reconstruction and operation of new organisational forms, such as networks and inter-firm alliances, for instance, can only be described and understood using a qualitative approach.*
> (Hoque 2010, 377)

The word *qualitative* itself means an emphasis on the nature of entities and on processes and meanings that are not experimentally examined or measured with regard to quantity, amount, intensity or frequency (Denzin & Lincoln 2003, 13). Quantitative inquiry may only be a narrow view of reality in some cases, while qualitative study attempts to overcome the simplified and highly structured explanations in the manifold world of accounting (Hoque 2010, 377). Hence, the decision to use qualitative approach in this study answers to the call of academics (e.g. Hopwood 2009, 798), who have expressed concern that accounting may be drifting away from examining the compound nature of practice, often in the name of theoretical elegance and methodological rigour.

The overall decision whether to use qualitative or quantitative approach depends on its appropriateness in relation to the research aims (Eriksson & Kovalainen 2008, 5). Since the purpose of this study is to understand auditors' perceptions of true and fair view as regards the classification and accounting for joint ventures and joint arrangements, it is

essential to inquire how they assess the risk of material misstatement in the daily practice[30]. Qualitative researchers investigate things in their natural settings, attempting to make sense of, or to interpret, phenomena in terms of the meanings people bring to them (Denzin & Lincoln 2003, 5). Conclusively, any interpretation of a phenomenon is bound by an individual's ability to understand fully the complexities surrounding it, and thus it cannot be represented to be an objective depiction of reality (Hoque 2010, 381).

3.2.2 Semi-structured Interview

Interviews are a relevant way to gather information, when the research area is complex and unknown. In a qualitative research, the choice of methods will be determined by the questions under examination and purposes of the study in order to build a richer description of a phenomenon. (Hoque 2010, 386–387) Hirsjärvi and Hurme (2011, 41) clarify that interviews seek to describe the views, beliefs, experiences and motivations of an individual participant, which Guba and Lincoln (1989, 253) complement by asserting that the research process itself must be pursued in collaborative ways, for, without two-way communication there can be no hope of honouring individual constructions. Researchers have relied on interviews as sources of information with the assumption that interviewing results in true and accurate pictures told by the respondents (Denzin & Lincoln 2003, 62).

Semi-structured techniques are relevant when the intended purpose is to understand the meanings that participants connect with issues and situations, because respondents are encouraged to answer in their own words (Hoque 2010, 387). Distinctive for semi-structured interviews is that they have an outline of topics or issues prepared by the researcher in advance, but there is still an opportunity to vary the wording and order of questions in each interview (Eriksson & Kovalainen 2008, 82). Apparently a semi-structured interview is, as its name suggests, between structured and unstructured interviews. Usually this type of interview also focuses on a combined framework of general themes. (Tuomi & Sarajärvi 2003, 77) In this study, a literature review works as the foundation upon which the research is built, and which synthesised in the beginning of the research process the key themes that are examined further empirically.

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[30] See Appendix for interview questions.

3.2.3 Data Generation

Both accessibility and suitability are essential in terms of a specific research problem, when selecting participants for a qualitative study (Eriksson & Kovalainen 2008, 51). It is important that the interviewees know as much as possible about the research topic or have experience from the issue. Therefore, the selection of contributors that deliver information should not be chosen by coincidence, but to be elected with a certain consideration. (Tuomi & Sarajärvi 2003, 88) When conducting a research that involves participants who are human beings, anonymity and confidentiality are issues to be deliberated (Hoque 2010, 490). Hence, letters from A to D are used for informants to ensure their privacy. Considering other ethical aspects, the participant has the right to know on what they have agreed to commentate, and thus it is justifiable to share the interview questions for review already before the appointment. Besides, researchers get the most informative answers, when the interviewee has had a chance to think the subject of the discussion in advance. (Tuomi & Sarajärvi 2003, 75) The framework of interview questions were sent at least a week before the appointment to the interviewees, who in this study are selected to be audit professionals with practical experience, which is utilised to unravel the research problems.

Table 2. Respondents of the study

Participant	Proficiency	Familiarity with joint ventures and joint arrangements	Interview location	Date	Duration
A	CPA Auditor, 25 years in auditing	Comprehensively experienced in joint ventures, reasonably familiar with joint arrangements	Vienna, Austria	20.11.2015	1 hour 38 minutes
B	KHT Auditor, 20 years in auditing	Both joint ventures and joint arrangements encountered at work	Helsinki, Finland	17.12.2015	57 minutes
C	KHT Auditor, 16 years in auditing	Joint ventures and joint arrangements are met continually among clients	Helsinki, Finland	18.12.2015	1 hour 1 minute
D	KHT Auditor, 18 years in auditing	Some clients are engaged in joint ventures and joint arrangements	Tampere, Finland	29.12.2015	56 minutes

Empirical data collected by researchers themselves is called *primary data*, whereas the name for already existing empirical data is commonly secondary data. Interviews are

one way of gathering primary data, and they often take place face to face. (Eriksson & Kovalainen 2008, 77–78) Also in this study, all interviews were conducted in person. In order to gather empirical evidence, the prior criterion for choosing the participants was that they are audit professionals with expertise and knowledge of group accounting and IFRS. All informants were also inquired about their familiarity with joint ventures and joint arrangements in particular. One of the interviewees brought an international viewpoint to the research in order to take IFRS and cooperative arrangements beyond domestic borders more comprehensively into consideration, as companies more and more operate in multiple national markets. The respondents comprised eventually one CPA auditor, and three KHT auditors working for Big Four audit firms (see Table 2 for further information about the interviews, presented in a chronological sequence)[31].

All interviews were arranged during November and December 2015. The interview in Austria was conducted in English, the other ones in Finnish. The interviews took place at each interviewee's office, or at their workplace. The duration ranged between 56 minutes and one hour and 38 minutes. The interviews were recorded with a digital voice recorder and transcribed either on the same day or in the next couple of days. Hoque (2010, 389) stresses that the recorded interviews indeed should be transcribed verbatim at the nearest opportunity while the interview is still fresh in the researcher's mind so it is possible to add in notes on observations or possible theoretical links. In addition, in the field of business studies, it is most often enough to have a transcription that includes all the words that have been said (Eriksson & Kovalainen 2008, 85).

3.2.4 Data Analysis

In terms of the process of data analysis, qualitative research is often divided into inductive and deductive reasoning. This study follows *inductive reasoning*, which draws more general claims from observed cases, whereas deductive would be concerned with the formulation of hypotheses from which particular phenomena can be explained. (Eriksson & Kovalainen 2008, 21) Bryman and Bell (2015, 20) supplement this with

[31] *CPA* means Certified Public Accountant. *The Big Four* are the four largest international professional services networks offering accounting and auditing services, consulting, corporate reorganisation, as well as tax and legal advising (Arnold 2009, 807), and refers to PwC, Deloitte, EY, and KPMG (Stewart 2012, 3). *KHT* originates from "keskuskauppakamarin hyväksymä tilintarkastaja", who is an auditor authorised by the Auditing Board of the Central Chamber of Commerce in Finland (Auditing Act 2:2.2 §).

notion that qualitative research is used to develop theories further, not to test them like in quantitative studies. According to Tuomi and Sarajärvi (2003, 110–111) inductive reasoning is a common qualitative research approach, and proceeds in an orderly sequence of three steps. First step is to condense the raw textual data into a summary format (observations). Second, establishing similarities and differences deriving from the raw data (pattern). Finally, developing a framework about the underlying structure of experiences, which are apparent from the data (theory).

The data analysis began by reading of transcribed interviews, and finding out the occurring consistencies among transcripts. Every time similarities were recognised, these constructs were gathered into a separate memo, as suggested by Tuomi and Sarajärvi (2003, 94). With four respondents in this study, the saturation point was achieved in a satisfactory manner, since same constructs were occurring in most of the interviews. After no more new constructs emerged, a final list of collective themes based on the uniform constructs was developed. According to Denzin and Lincoln (2003, 275) these themes are abstract constructs that investigators identify before, during, and after data collection. They also add that researchers start with some general themes derived from reading the literature and insert subthemes as they go.

Theory often emerges through induction during the phases of data collection, analysis and writing. Instead of a linear model of research, a realistic picture of the research process is that of circular process, where it is almost necessary to move back and forth during the different phases in the research process (Eriksson & Kovalainen 2008, 31). Using an inductive approach, in some cases also referred as grounded theory, means that a researcher eventually attempts to build up a theory using the materials through careful analysis to identify consequences (Hoque 2010, 390). In order to achieve this, it is essential that researchers relate their own interpretations to other researcher's ideas and findings (Eriksson & Kovalainen 2008, 42–43). Awareness of the previously mentioned is respected in this thesis, as interview data is reflected to previous studies in the following chapter.

4 AUDIT DELIBERATION OF TRUE AND FAIR VIEW

4.1 Unified Perceptions of True and Fair View Regarding Joint Ventures and Joint Arrangements

In research, accounting is often seen as a social construction that reflects the society in which it operates (Fagerström 2002, 1). Generally, the nature of reality in the context of financial reporting is, at best, a commonly agreed, inter-subjective human construction, and the objects of accounting are part of an economic reality that is socially constructed and objectified by virtue of collective intentionality (Alexander & Jermakowicz 2006, 134–136). According to some other academic views, theory is produced in the process of trying to answer a question of what particular people are doing in particular situations. Theory is to be constructed through an iteration in which observations are adjusted, one in the light of the other, so as to achieve a mutual consistency. (Armstrong 2008, 872–876) Having taken all these considerations into account, this chapter introduces the consensus map of auditors' perceptions of factors influencing true and fair view of a group's financial performance and position when joint ventures or joint arrangements are included in the consolidated financial statements.

The consensus map comprises six unified constructs, and linkages between them, shared among auditors. These themes are (1) *presence in the joint relationship*, (2) *equality between partners*, (3) *international dimension*, (4) *appropriateness of accounting method*, (5) *performing the audit engagement*, and (6) *extent of disclosures*. The empirical data, generated by the interviewed auditors, is analysed under each theme, and the similarities are identified and discussed. Each of the themes includes several more detailed subthemes, which form a thematic region. All auditors, to a greater or lesser degree, reflected that they find the right classification of the investment essential, assess the overall meaning of a certain joint undertaking for the whole group's figures, and consider that the users of financial statements get sufficient knowledge related to the arrangement if they utilise information disclosed in the notes. These notions could be reflected to both FAS and IFRS. Additionally, some differences between Finnish GAAP and internationally applied standards could be recognised. For example, IFRS requires

more use of judgment when it comes to the demarcation between two types of joint arrangements, joint ventures and joint operations, which FAS does not separate. In case the categorisation is well rationalised and documented in the notes, auditor has more evidence to get assured that true and fair view of the group is given. The aggregated consensus map, which represents the main themes and perceptions reflected by the auditors in the interviews, is introduced below (Figure 10).

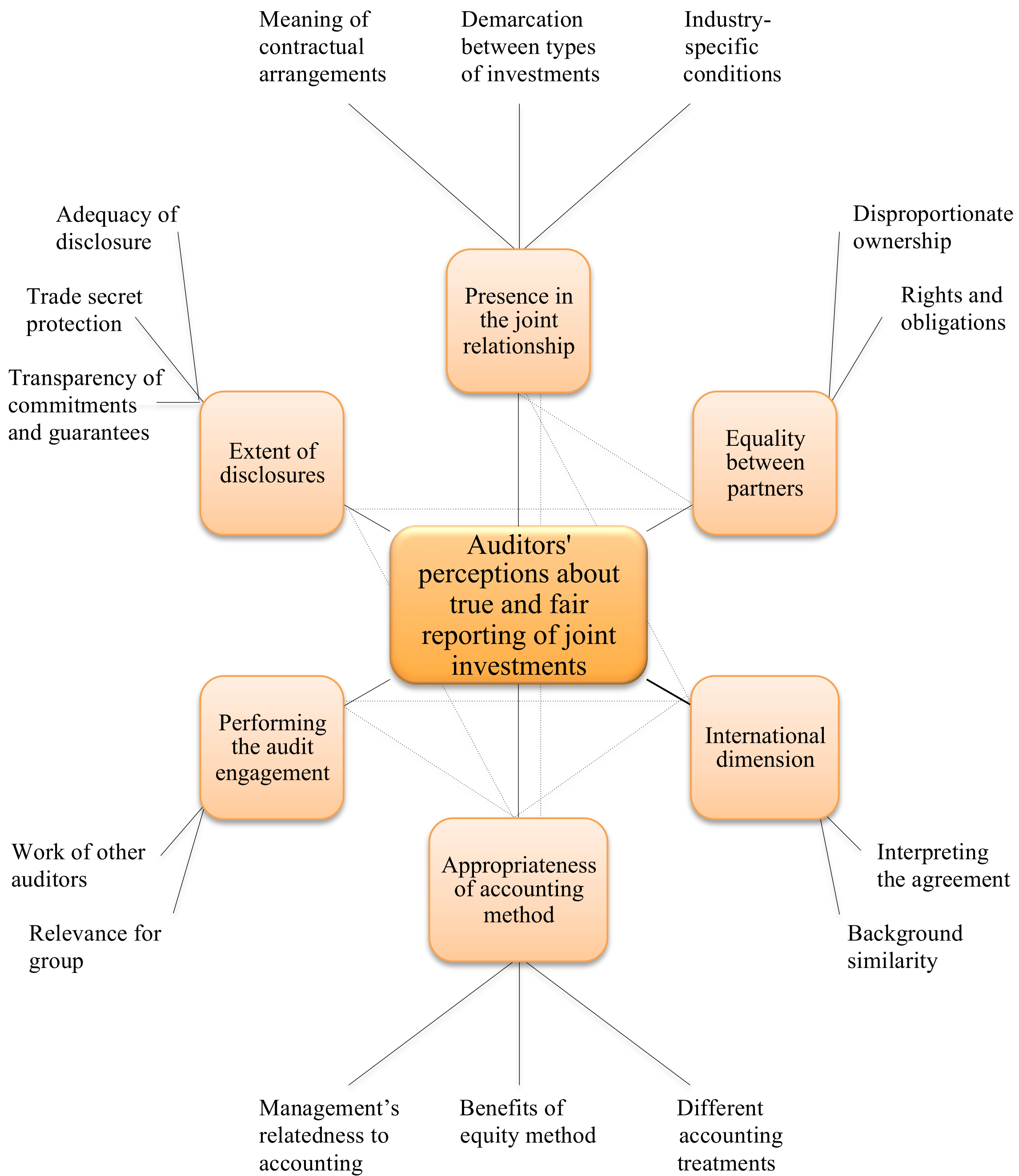

Figure 10. Auditors' unified perceptions of true and fair reporting of joint investments

The connections among different themes are illustrated with dotted lines in the figure on the previous page. For example, presence in the joint relationship and international dimension are related to each other in terms of interpreting the agreement, whereas appropriateness of accounting methods and extent of disclosures are connected. This is because although equity method does not separately show debt in the balance sheet, relevant liabilities still have to be disclosed in the notes to the consolidated financial statements. These are brought out more in detail in the following paragraphs. The constructs are specific to the empirics of this study, but they are analysed together with the already existing research. It is noteworthy that the purpose of the consensus map introduced in this chapter is to serve as a guide to the empirical analysis, not to establish causality among different factors. As the last step, the synthesis of the theoretical framework is re-evaluated and complemented with the novel findings.

4.1.1 Presence in the Joint Relationship

Joint ventures are difficult to manage due to their complex structures involving more than two entities having different and competing objectives and strategies. The complexity is mainly caused by the presence of two or more partner organisations that may be competitors as well as collaborators. (Ozorhon et al. 2007, 799) Similarly, Van der Meer-Kooistra and Kamminga (2015, 24) state that management control is complex as the parent companies share it and have to govern the relationship with each other. Usually joint undertakings are formed when a formal legal contract is signed, stating the endeavour's objectives, describing the obligations of partners, prohibiting some actions such as disclosure of sensitive information, as well as containing other contractual agreements related to pricing of services among others (Groot & Merchant 2000, 600). For the interviewed auditors, contracts form an essential part of audit evidence when assessing whether an investment is classified properly according to either FAS or IFRS.

Particularly respondent A stressed that the starting point is contract that remains the top priority, although sometimes it is difficult to find out if there have been changes after signing the agreement that are not properly documented. A heavier workload for auditors may arise as joint undertakings might include several partners, and agreements may have become more complicated with their terms and conditions, like previous research has also indicated. Accordingly, the response of B highlighted that in

shareholders' agreements or similar arrangements the principles of relationship are established, joint ventures and joint arrangements might be more challenging compared to associate companies and subsidiaries, and contracts are in the key position considering auditing. Auditor D emphasised that contracts are not audited per se, which is why the profession of lawyers exists, but they serve as tools when looking for answers in order to see whether certain criteria of accounting standards are met. Consequently, all the interviewees referred to the *meaning of contractual arrangements* when they talked about the existence of joint relationship, which can be seen in the following responses.

> *Even for real estate joint ventures you get 300 pages of contracts and details, so it's becoming more complex in terms of finding the right solution, or what exactly is the legal contract. My main observation is that the real life still follows what makes sense, but no one bothers adjusting the contracts, and that's pretty tricky. So the contracts are being overruled now and that's one of the challenges that legal departments and accountants are facing. (A)*

> *In the world of IFRS the most important thing is to understand what is it all about – the objective and nature of the arrangement, which build the foundation for everything. What is written in contracts, and which things both parties factually agree, are essential. (C)*

The data uncovers possible ambiguity related to the rightful classification of investments, which is vital in terms of the scope of consolidated financial statements. According to Finnish informants, the separation between control and joint control in FAS has been generally quite straightforward, being typically based on the percentage of shares and voting rights. In IFRS some rare occasions require more judgment so as to attain substance over form, because it focuses largely on rights and obligations rather than legal structure. The wish of auditor C is that Finnish Accounting Act would move towards the interpretation of control under IFRS, which accompanies the viewpoints of Mäkelä et al (2012, 20) as well as some of the key notions in the study of Baker and Hayes (2004, 783). When the judgment behind the decision considering the categorisation of the investee is well disclosed, ensuring true and fair view is simpler, which also applies to the demarcation between joint ventures and joint operations.

Respondents' views resemble the study of Psaros and Trotman (2004, 78) who claim that preparers regularly makes numerous important interpretations of case specific information regarding issues such as what constitutes control for consolidation. O'Hanlon and Taylor (2007, 268) expressly mention that joint venture investees are each subject to an important degree of influence by the investor firm, where the power however falls short of the control that would classify the investment as a subsidiary. This is in line with A, who has experienced more conversation around the distinction between subsidiary and joint investees than joint ventures and joint operations. Hence, *demarcation between types of investments* is fundamental in order to achieve the fair completeness of components included in the consolidated financial statements.

> *I think that, at least from my experience, I have not seen so many discussions around joint ventures and joint operations. What I have seen more is, is it a joint venture or a subsidiary. That's when you get into whether I have control or not. I think that's a more productive area of discussion. (A)*

> *It makes a very essential question in the first place, whether it is a joint arrangement or not. Some firms may prefer consolidating their investment as a subsidiary and thus report higher revenues, whereas others have interest in joint ventures and equity method in order to keep debt off the balance sheet. (C)*

An industry consists of companies that have similar operating activities. Different industries have different levels of complexity, use various accounting methods, and have diverse adjustments in their group accounts. (Fagerström 2002, 160) In case venture's operations differ significantly from the group, proportionate consolidation is not the best method in order to give a true and fair view (Englund et al. 2005, 382–384), which interviewees C and D also brought out. There is a more probable risk of errors when accounts need more adjustments, and also displays less useful information when some transaction that is not common to the group is recorded. In some industries, for instance real estate, joint investees tend to be more common, and their accounting is more familiar for the group. Interviewee A highlighted that the knowledge of accounting personnel, and experience of joint arrangements in general, are key things to review in audit, as it may uncover the probability of errors.

Firms prefer inter-firm cooperation to internal projects when the risk of the activity is greater than the risk of the firm's primary activities (Moskalev & Swensen 2007, 31). For example, joint ventures in the construction industry are commonly considered to be project-based rather than continuous collaborations. Unlike many other industries, construction projects are however subject to more risks than other business activities. (Ozorhon et al. 2007, 800) Regarding *industry-specific conditions* auditor C mentioned it is internationally acknowledged that among construction companies occur more malpractice than other industries, which was accompanied by A. Thus, the risk of material misstatement can arise from variety of sources, including conditions in the companies' industry and environment. Dechow et al. (2011, 34) emphasise that industries characterised by substantial investment in intangible assets tend to be prone to material misstatement, as well as possible overstatement of expectations. This is in line with the response of auditor D in particular, who underlines that accounting estimates may, in general, relate to misstatements.

> *It is easy for me to understand the logic among real estate investment firms that both parties would like to show 50 % of the value of a shopping centre in their balance sheet as assets, and 50 % of the rental income, because it operationally differs only a little from the idea that directly 50 % would be owned. ... Bearing in mind these management and profitability issues, proportionate consolidation would certainly be smart. (C)*

> *When thinking about the industry, it is essential to consider how much it differs from the group's activities, and whether we get some items that otherwise do not exist in the group. ... When we have something based on estimates, it may be wrong. The result is anticipated to be different, which cannot be considered a fraud, because it is not intentional, for instance forecast of project outcome. (D)*

4.1.2 Equality between Partners

Under certain circumstances, joint ventures in developing countries are preferable to wholly-owned subsidiaries as a mode for foreign investment (Moskalev & Swensen 2007, 31), and local partners are chosen to fulfil certain government requirements (Nguyen 2009,15). This got support also from auditor C in particular, who stated that in

some countries yet today remains the norm that a local partner has to have over 50 % of a business in order for a foreign company to get into the market. All in all, the Finnish auditors mostly stressed that the decision of control based on ownership and voting rights has been quite straightforward in the situations they have encountered so far.

Auditor B stressed that FAS still relies largely on the form, and even 19,9 % ownership and two members in the board out of five is presumably not an associate company, which it on the other hand according to IFRS would quite clearly be. However, an auditor might face cases where one party has an outstandingly minor portion in comparison to the other, which may not provide a sufficient rationalisation for the categorisation of a joint undertaking, and give a true and fair view regarding the scope of consolidated financial statements. As auditor C stated, evidently differing ownership percentages do not make sense from the business point of view either, and these kinds of occasions should ring alarm bells. Therefore, *disproportionate ownership* may require more assessment, as regards the classification of the investment. For example, A's answer, shown below, resembles joint facto control (Zack 2013, 161), as IFRS has defined wider principles how to evaluate the existence of control and joint control in comparison to FAS. Despite the disproportionally divided shares, in a joint relationship both partners should be in an equal relationship, as informant D depicted. Additionally, Groot and Merchant (2000, 606) state that unequal ownership shares have a noteworthy impact on decision-making and conflict resolution processes in joint ventures.

> *The more difficult decision is whether you've got control or not – you get 51 % and still be on equal terms, it could be that someone has only 49 % but with all the contractual arrangements has the power to govern. That's tricky, especially in one-on-one situation. If the situation is involving three or more, that's easier until two or three team up. (A)*

> *There may be a situation where I own 30 % and you 70 %, but we are still talking about a joint venture. When I in the notes then disclose that I own 30 %, no one presumes that it is anything else than an associated company. ... So these kinds of exceptional cases, which would be obvious considering other information, have to be disclosed. Why do I have control, or why is it joint control? (B)*

According to Caglio and Ditillo (2008, 895), a proper contract insures the parties of joint relationship against opportunistic behaviour. A formal legal contract describes the obligations of the partners, conflict resolution processes and other agreements (Groot & Merchant 2000, 599). Since joint ventures and joint arrangements have several parties involved, especially respondents C and D emphasised the meaning of equal rights among the partners participating in an arrangement, inter alia, regarding pricing. For example, C stated that an essential object of the audit is that no one is suppressed, meaning also that charging criteria are appropriate and market-based for both parties.

In order to give a true and fair view of group's financial performance and position, interviewed auditors brought out that preparers of consolidated statements will have to remember to take into account both *rights and obligations* resulting from joint ventures and joint arrangements. For example according to the words of auditor D, liabilities arising from a newly established arrangement have to be disclosed, and after having written it out once it similarly follows from year to another in the notes. The key feature in the debate considering accounting for joint ventures altogether is whether the co-venturer is ultimately responsible for the joint liabilities, even if not explicitly stated (Richardson et al. 2012, 374). Moreover, partners may have significantly different opportunities to fund the collaborative business as time goes by. Especially financing questions trigger situations where the venturers might reconsider their participation in the cooperation, or even end up terminating the relationship. (Hannula & Kari 2007, 79) The former idea got support specifically from A, who underscored that financing questions are one of the difficult parts regarding audit, and could affect the classification of the investment, because the party that is financially more stable may finally have to cover costs of joint ventures and joint arrangements, which refers to control. In case control is assumed, the investment should be categorised as subsidiary.

> *Do different arrangements cause challenges? Yes. Besides identifying what it is, a joint venture or a joint operation or anything else, the trickiest part at least from my experience is, if things are going wrong, who absorbs the losses. Who puts up the additional financing, or guarantees the financing? ... Regarding the audit work, that's of course the difficult piece. (A)*

In comparison to a subsidiary, joint ventures and joint arrangements always have a counterpart who takes care that the internal control functions well, or that they have their own opportunity to monitor it, for they are shareholders, they belong to the board or other influential bodies. ... However, they participate in the operations differently compared to associate companies or subsidiaries. (B)

4.1.3 International Dimension

International joint ventures are formed between two or more firms with different organisational and cultural characteristics (Zheng & Larimo 2010, 294). Ozorhon et al. (2007, 799) add that in international joint ventures the partners may in fact be competitors as well as collaborators. Major and fundamental disparities exist between various players on the world regulatory scene. Different players will interpret words, concepts and agreements in different ways, both now and in the future. (Alexander & Jermakowicz 2006, 161) Furthermore, given past research, in some jurisdictions the rules of financial reporting may be identical, or very similar, to the practices, but sometimes a company may depart from those policies (Fagerström 2002, 30).

The response of A was mostly in line with prior research, emphasising the difference between contract and reality, referring also to a current international arrangement met at work[32]. However, among Finnish auditors this did not gain as high emphasis as the CPA auditor A, who was the informant mainly concerning IFRS and multinational undertakings, brought out. For example, D mentioned that at least the contracts of arrangements in a western environment are understandable by both parties, specifying expressly Mankala[33] companies that have been encountered more among clients. The use of contracts to restrict an international joint venture's use of technology or brand name, and access to suppliers and markets, is an important weapon in the battle to control any unexpected behaviour of local partners (Nguyen 2009, 33). Since contracts tend to play a vital role as audit evidence when reviewing whether joint control actually exists and the investment is classified correspondingly, *interpreting the agreement* may be challenging, however as discussed in this paragraph mainly in international cases.

[32] The auditor was discussing a case he was working on at the time of the interview, referring to a joint undertaking in Eastern Europe, a project, between companies of two different Central European countries.
[33] Mankala Principle is described on page 17 of this study. Here the debate concerned energy production.

The biggest thing here is the difference between what it should be according to contracts and what it actually is. ... The contract is fairly clear, but it means a different thing in different countries. (A)

In the past there may have been some cases, but only exceptions, since there are two parties, and both of them hold on to their rights. However, if there is a stalemate, disagreement may occur in terms of how to interpret a certain clause. Because the contract is then not unequivocal, lawyers and others are needed to find out what was the initial purpose when establishing the joint venture. (B)

According to Fagerström (2002, 29), multinational companies face the challenging multiplicity of institutional environments. Besides, the competence of the managers in less developed countries is likely to be relatively low (Groot & Merchant 2000, 606). Despite the benefits associated with international joint ventures, the failure rate of them is higher than those for domestic ones. Many partners must monitor operations in political and legal systems with which they have little familiarity, and they have to cope with geographical separation. (Ozorhon et al. 2007, 800) Answers of the respondents were complementing the previous research, including the same countries and areas that researchers similarly have concentrated on when examining joint investments such as Russia (Kobernyuk et al. 2014; Volchek 2013), the United Arab Emirates (Tsamenyi et al. 2013), and Asian regions (Van der Meer-Kooistra & Kamminga 2015; Zheng & Larimo 2010), as the following paragraph and quotes indicate.

All of the Finnish auditors referred to differences between domestic and Eastern European or Russian counterparts. International joint ventures are high-risk, and macro-contextual trends in Russia have a considerable impact on shaping managerial practices and influencing the accomplishments of the venture (Kobernyuk et al. 2014, 472–475). C mentioned that it might be difficult to audit whether assets like factories that are reported in the balance sheet even exist in areas that are facing crises. According to B, the risk of material misstatement resulting from bookkeeping error is smaller in Anglo-Saxon countries where audit system has existed for a couple of hundred years, and group’s accounting principles are applied in the daily bookkeeping. C added that if the venture operates in a dissimilar culture and business environment, for example Arabia or somewhere in Asia, it is a target of additional attention. Therefore, when it comes to

background similarity, an auditor is interested in the bookkeeping applied in the joint venture and its resemblance to the group accounting, especially in international transactions as stressed by auditor A. All respondents seemed to agree that international arrangements have risks related to the truthfulness and fairness of the provided information compared to the environment that is known for auditors and their clients.

> *The risk of material misstatement is connected with the issue whether IFRS or the national GAAP is applied in the daily bookkeeping. ... From the viewpoint of a group that follows IFRS the risk is related to the topic whether essential monthly, quarterly, yearly, or half-year financial statement reconciliations are done. (B)*

> *Location affects the questions like who executes the audit and where, and according to which GAAP it is done. If it is done somewhere in Romania based on the local accounting legislation ... you have to somehow take a look at whether there are big differences compared with the Finnish one or IFRS. (D)*

4.1.4 Appropriateness of Accounting Method

A relatively strong bargaining power of a parent company strengthens the effects of decisions made on the joint venture relationship (Van der Meer-Kooistra & Kamminga 2015, 27–28). As noted by A, a partner can try to have the accounting principles to be applied in the joint investee with the other counterpart, but it may not be easy. Auditors also stressed that the more similar accounting principles are with the group, the less adjustments have to be made, which lessens the possible errors deriving from them.

According to Groot and Merchant (2000, 601), financial accounting rules seem not to create significant disputes, and the partners seem to be able to adapt reasonably easily to the foreign guidelines applied by an international joint venture. However, as particularly interviewees A and C underlined, if these standards differ notably from the ones applied by the group otherwise, needed additional adjustments result easier in errors. Additionally, respondent D mentioned that today it is commonplace to have a smaller firm preparing group accounts according to FAS and a bigger firm applying IFRS, and these two have joint undertakings together. Moreover, as mentioned by auditor B, errors may occur as a result of deficient guidance of the parent company, since initially the

parent company has to inform all its subsidiaries, joint ventures and also associate companies of its needs when it prepares consolidated financial statements. Nguyen (2009, 36) brings out that foreign parent firms consider it important to focus their control on financial and accounting areas by having their own financial manager in international joint ventures in order to ensure accurate reporting. In line with this, auditor A remarked that a venturer might send an accountant to assert the rules applied in the group. Hence, *different accounting treatments* cause misstatements if many things have to be rewritten and revaluated in the reporting package.

> *You may have underlying substantive differences in terms of how you value inventory, how you do percentage of completion accounting. ... Depreciation, inventory valuation, those kinds of things – so that could happen that there is an underlying accounting implication or concept difference. ... Your way to influence and get judgments and rules on your partner may be a little bit difficult. (A)*

> *If we think we have a joint venture and two partners, each party consolidates it according to their own principles. In that sense, if this joint venture doesn't follow similar guidance of one partner but perhaps the principles of the other party, then of course the adjustments to financial statements requires more work. And the more you have to do these modifications, the more errors may occur. (C)*

Equity method and proportionate consolidation both have their advantages and disadvantages (Leitner-Hanetseder & Stockinger 2014, 5), which was remarked by all of the interviewees. Joint undertakings facilitate risk sharing and market-based coordination of activities that are usually performed internally. It is difficult for financial statements to fully reflect the complex relations and underlying implicit commitments. (Healy & Palepu 2001, 433) There might be a desire to avoid reporting the proportion of the joint venture that is debt financed, which is why equity method is preferred (Moskalev & Swensen 2007, 33). However, it has been argued that it is wrong to reflect a pro rata share of a joint venture's debt that is not an obligation of the venturer, which lead to the assertion that proportionate consolidation would even be inappropriate (Graham et al. 2003, 124). This is particularly in line with the response of auditor B as the quotation on the next page signifies.

Firms' efforts to manage information asymmetries have raised questions whether financial or non-financial disclosure type is the most responsive to financial status and financing events (Jankensgård 2015, 24). Some market participants even develop their own valuation of investments in equity accounted investees (Badenhorst et al. 2015, 2). Interviewee C specifically pointed out this by stating that among clients there have been cases where credit rating agencies have used their own measures based on disclosures instead of purely relying on the information of consolidated balance sheet. Although previous research has mostly favoured proportionate consolidation for several reasons, the respondents found *benefits of equity method*[34]. For instance, it is a common method since it is technically simpler to exercise, it is the same accounting as for associated companies, and relevant debt is anyway disclosed in the notes, based on which some financial statement users may do their own calculations.

> *When you take 50 % of each row according to FAS, it may not be correct. This is because there is most likely something that is more or less mine than yours, and vice versa. There might be joint operations where I purchase 60 % of the outcome and the neighbour buys 40 %, but I anyway own 50 % of shares – so then I just can't take that 50 %. It is challenging as regards the bookkeeping technique, but it's about the capability of accounting software to process it. (B)*

> *I know a company where a significant joint arrangement, joint venture, is accounted for using the equity method, but the credit rating agencies consolidate it line-by-line in relation to the ownership in their own calculations. ... The risk of error is often bigger concerning proportionate consolidation, because the systems don't support it as good as equity method regarding calculation technique. (C)*

In a 1990 survey, around 70 % answered that the chairman of the board at group level was little involved in decisions about accounting principles, which was also extended to the parent company's managing director in a study conducted almost ten years later (Fagerström 2002, 163). Respondent A emphasised that decisions on managerial level do not always go through the company to accounting, and they are often performed separately. Additionally, auditor A stated that IFRS 10 and IFRS 11 are not historic

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[34]A summary of previous research regarding accounting for joint ventures is introduced on page 23 of this study, including pros and cons of both equity method and proportionate consolidation.

things but they have just have been changed, which emphasises the need for accountants to get engaged in the business in order to know what to account for. This part of the study answers to the call of O'Hanlon and Taylor (2007, 283), investigating whether diverse accounting and disclosure requirements for different classes of investee have influenced managers' choices with regard to how they are structured. It also debates with the research of Lourenço and Curto (2010, 739) who examined determinants of the accounting choice between alternative reporting methods for interests in jointly controlled entities and provide evidence that supports the importance of debt covenants in the decision. The question around this issue builds the foundation for a suggestion, according to which the accounting consequences of different structures should be deliberated already when negotiating contracts, ideally including auditors' or other advisers' counsel as suggested by informants C and D.

With the increasing demand on keeping up with changing accounting guidance, managers might find themselves in a dilemma where deals that are very attractive from a business perspective are entered into, but afterwards when they are accounted for, result in accounting that comes as a surprise to them (Schmachtenberg 2014, 3). Thus, in some cases it is observed that *management's relatedness to accounting* may not be close, which stems from the business mindset that overrides the presentation of financial reports, rather than the other way round when investment decisions would be determined based on desired reporting outcomes.

> *Let's say that often, or I am not sure if actually often, but it happens that top management may not know the rules of IFRS to the same extent as the auditor of the corporation or its special advisers. ... There are of course firms that do not use much consultancy. Usually bigger companies do, because they know the value that external professionals are able to bring. (B)*

> *Management or chief executive officer, they don't know it, it's the accounting personnel. Accountants sometimes discuss with the auditor, and if it comes to a very grey area, additional advice may be asked from some third party. ... What gives the most grey hairs is that management draws up the joint arrangement or shareholders' agreement, but the awareness of the contract and how it is going to be consolidated is reviewed after the deal is already signed and closed. (C)*

4.1.5 Performing the Audit Engagement

In accounting, the principle of materiality must be applied – if an investment is small, it does not matter remarkably how accounting is adjusted. The size of the group increases the complexity, which has an influence on the adjustments in the group accounting. (Fagerström 2002, 161) As Stewart and Kinney (2013, 708) explain, component materiality has important consequences for auditors, those charged with governance, investors, as well as other users of audited group financial statements. If the materiality amounts are too large only scarce work will be performed to achieve the group audit objective and audit is ineffective, but in case they are too small more work will be performed than is necessary and audit will be inefficient (Stewart 2012, 1). Particularly auditor A emphasised that materiality is a significant topic also in the context of conceptual framework, and D believes that exactly true and fair view has the meaning.

The informants stressed the *relevance for group* when speaking of jointly managed investments. When performing group audits, components have to be distinguished between relevant and non-significant, as well as outline the type of work to be performed in each case. In auditor A's core competency, financial industry, joint arrangements are common, however often being small and not highly relevant to the groups. Auditors overall seemed to agree that materiality is merely a standard procedure, concentrating on the hit to certain benchmarks regardless of their relatedness to profit or equity. Auditor B additionally mentioned an example of Carlsberg, a Danish brewing company, which has its associate companies spread out in the areas of the former Soviet Union after having acquired Baltic Beverages. Since these companies altogether comprise a relevant part of the operational business, they are accounted for using equity method, and they are included in the composition of operating profit instead of below this line in the profit and loss statement.

> *Initially joint ventures that have been accounted for using the equity method are shown below the line of operating profit, but according to IAS 1 that addresses the presentation of financial statements it is not a prerequisite. Thus, an investment accounted for using the equity method can be moved so as to display it above the operating profit, if its result is essentially generated by the normal operations of the business. (B)*

Changes in the group structure always have to be considered in relation to the impact – which are more or less relevant. Of course a change itself is an important object of audit, because alterations in the group structure and the entries resulting from them may often go wrong. No one encounters them on a daily basis. ... Of course when it comes to a minor joint venture, not much time is used to it by management – or time otherwise either. (C)

Component audits ought to be planned so that conclusions about separately prepared, and audited, information can be aggregated to achieve reliable group financial statements. Participation of multiple audit teams or firms complicates group audits. (Stewart 2012, 7) This definition is strictly in line with the responses of auditors C and D, who stress that assuring true and fair view of consolidated financial statements that include joint undertakings is easier accomplished when the auditor himself or herself participates in the audit of the venture. Nonetheless, auditor A also adds that it is better to have different auditors for the partners of the same venture, based on the experience around a current case at work, since so the outcome usually gets easier close to the respective client's expectations.

Reliance on the *work of other auditors* was a topic that came up strongly during the interviews, and is especially worth of consideration if the audit of the venture is performed abroad. Already Hofstede (1991, 237) stated that it is natural to encounter difference with some uncertainty. As auditor B tells, Anglo-Saxon nations have a more familiar environment regarding accounting and auditing for Finns, which is why the audits performed in these countries are easier to assess in order to get assured of the group accounts as a whole. However, given the limited prior studies, as well as diverse nature and multinational operations of enterprises today, Stewart and Kinney (2013, 708) bring out that research in the area of multi-location audits is needed to close prevalent research gaps and strengthen current knowledge.

The role of the auditor is related to the relevance of the joint venture. If it is significant, the risk from the viewpoint of auditor decreases when he or she participates in the audit of the venture. However, this is not always the case. ... Another thing that increases the risk from auditor's viewpoint is that the same audit firm cannot audit the venture, as considering international occasions. (C)

If we are getting a new essential company to the group, we have to think who is going to audit it, where it will be audited, and is its audit good enough for us – especially concerning foreign ventures. But this mainly applies to the planning and execution of the audit. Of course another thing is that when we get some significant business, we have to think whether new risks occur due to this. (D)

4.1.6 Extent of Disclosures

Information asymmetries are generally associated with the relation between managers and investors (Fields et al. 2001, 257). Managers have an informational advantage over outside investors regarding firm's profitability and value, and have incentives to maximise the worth of the business in the eyes of stakeholders. Thus, managers have purposes to disclose information selectively. (Jankensgård 2015, 5–6) Commitments in general refer to the extent to which the partners are bound to the stability and success of the joint relationship (Zheng & Larimo 2010, 295). Moskalev and Swensen (2007, 33) review the reluctance to report the amount of liabilities used to finance the deal, and thus apply equity method so as to avoid disclosing the portion of the joint venture that is debt financed. It has also been argued that joint venture debt is often the responsibility of the investor, and equity accounting offers firms an opportunity to use these investments as a means of off-balance-sheet financing (Kothavala 2003, 519).

Although *transparency of commitments and guarantees* has troubled accounting researchers (e.g. Mantecon et al. 2012; O'Hanlon & Taylor 2007) that have studied the opportunity to exploit off-balance-sheet activities, which may be concealed by the equity method, respondents of this study reminded that related party transactions will reveal significant liabilities anyway in the notes, and some stakeholders even use their own measures to assess the amount of debt relevant to the group based on the information in disclosures. Also the findings of Bauman (2003, 313) show that market participants value off-balance-sheet liabilities supported by guarantees similar to reported ones, which indicates that financial statement users usually consider the disclosure of these activities useful. However, although disclosures provide essential information, Beaver (1981, 9) stresses that investors are a heterogeneous group that differ with respect to beliefs and skill in interpreting financial information. This might be identified in the following comment of D as well.

Covenants may be a little bit trickier. If I'm trying to disguise or hide something that's effectively liability, by using the equity method, that's something I can see that people want to expand. ... But it's fairly short, given the disclosures you have to make. Every bank will realise there is something else, and stop eating it up. (A)

Disclosure requirements under IFRS are so comprehensive that you should be able to read them. As mentioned previously, also under FAS relevant off-balance-sheet liabilities should be written out. ... Hopefully balance sheet isn't the only thing well-informed readers view, but I'm not always so convinced about it. (D)

A prime responsibility of management is financial reporting, which can help to evaluate the managerial stewardship (Beaver 1981, 14–15). As regards joint ventures it has also been asserted that provision of supplementary information about them could reduce information asymmetry among market participants (Lim et al. 2003, 23), and that supplementary disclosure of expressly equity-accounted investees is indeed considered valuable (Bauman 2003, 304). However, some joint venture agreements contain elements that make them highly confidential, which is why firms tend to be very cautious about what they want to reveal to external parties (Groot & Merchant 2000, 606). Schmachtenberg (2014, 147) claims that an entity is required to disclose significant judgments and assumptions it has made in determining control issues, which are based on forthcoming strategic plans and anticipated synergies, information that traditionally has not been shared with outside parties. In line with the prior research, the interviewed auditors emphasised that accounting regulations usually prescribe minimum disclosure requirements, but management is also expected to take reasonable precautions to secure the information's secrecy.

Trade secret protection was a topic related to the extent of disclosures commonly shared in the responses of interviewees. Although IFRS 11 and IFRS 12 require a wide range of disclosures about entities' interests in joint arrangements, and about the significant judgments and assumptions they have made, auditors seem to aim at a balance between clients' internal information and the remaining disclosure to the public. This can be seen in FAS as well as auditor D stated, although Finnish accounting regulation has fewer disclosure requirements. Thus, companies may only describe briefly that joint management builds around a contract.

I think the reporting as it stands now in IFRS, and US GAAP, is probably quite ok. But you always have the trade-off – how much detail can, and should, you disclose to the public at large and to your competitors and to others compared to giving an investor a perspective. And of course an investor in a company may be excited about what the actual arrangements are, but is it ok to disclose, there's always that border line how much disclosure you want. (A)

IFRS does not provide an easement that if any issue is a trade secret you wouldn't have to tell it. Everything has to be disclosed, which is relevant and necessary in giving a true and fair view. But I don't think that anyone explains more than joint management is based on a common contract. ... The issues that are decided in administrative bodies no one tells, and nobody requires revealing them. (B)

Informational perspective can be better understood in the light of the financial reporting environment, which consists of various constituencies such as management, investors, and auditors (Beaver 1981, 8–9). The level and detail of disclosure is developed in accounting standards (Fagerström 2002, 36). For example, Jarva and Lantto (2012, 154) point out that national accounting standards in some institutional environments such as Finland may not have as precise requirements as IFRS. The Finnish auditors agreed that FAS does not have as extensive requirements of disclosure as IFRS. However, B emphasised that there is a considerably large span among Finnish companies considering the amount of pages included in the notes to the consolidated financial statements, mentioning as examples firms such as Wärtsilä, Kone, Stora Enso, and Fortum. Informant B continued by saying that mainly bigger companies in Finland produce better financial statements than smaller ones, due to the lack of resources that small and medium-sized as well as big family enterprises are facing. This is also natural, as minor firms do not have such a need for reputation as the larger ones have.

Mala and Chand (2014, 267) propose that it is difficult to implement one single set of standards in different countries and on companies that vary in size, complexity level, types of business ownership, culture and financial reporting, unless additional guidance on these standards is provided. However, when harmonisation of accounting standards is pursued, one of the expected benefits is increased consistency (Jarva & Lantto 2012, 174). For instance, auditor A emphasised this point of view, stating that the results

reported from fiscal years are comparable with other consolidated financial statements. *Adequacy of disclosure* was another common issue that was pondered among auditors when discussing the material misstatements. C highlighted that the rightful demarcation between types of investments is easier to assess when a sufficient degree of disclosure is provided. Although the realisation of true and fair view may be simpler to assess regarding joint investments when a comprehensive extent of disclosure is provided, it may be however harmed by the fact that the greater amount of pages in the notes may even easier include errors, as brought out clearly by auditors A and C.

> *If you have a very specific kind of cookbook, it leads to error, because you may just take a wrong decision. However, if you have less guidance, less cookbook type of approach, then decisions may be taken differently. I don't want to say that the rules create more error, potentially yes, but in terms of consistency of solutions it's probably not a bad thing. (A)*

> *When we absolutely disagree, usually as qualified audit report is issued, the situation concerns overall problematic cases. ... Let's say that the company hasn't been able to, or wanted to, or understood to convince the auditor of its own interpretations and their validity. (D)*

4.2 Re-evaluation of the Theoretical Framework

This chapter provides a reconsideration of the empirical findings of the study. These newly discovered results are compared to the priori themes that were recognised in chapter two, where a theoretical framework was developed to constitute a skeletal structure to guide the empirical work. Based on the previous research, three dimensions were originally identified: *nature of joint ventures and joint arrangements*, their *accounting methods*, and supplementary *disclosures*, which were closely attached to auditing in terms of *completeness*, *consolidation procedures* and *presentation* (see e.g. the three distinct objects of group audit by Riistama 1999, 227). By taking all these aspects into account, a contemporary understanding regarding true and fair view of groups' joint investments in Finland could be achieved.

Meaning of contractual arrangements, demarcation between investments and industry-specific conditions formed the subthemes of presence in the joint relationship. *Meaning of contractual arrangements* was familiar in the case studies of Van der Meer-Kooistra and Kamminga (2015), who used accessible contracts in the examination of joint venture relationship, and Groot and Merchant (2000), where all ventures examined were formed when a formal legal contract was signed. In addition to academics, contractual arrangements were highly important in practice for auditors as the leading evidence in assuring the applicable classification of investment and joint relationship. Also *demarcation between investments* could be recognised both from previous research and the data. Psaros and Trotman (2004) found in their study regarding preparers' consolidation judgment that when both test groups had the incentive not to consolidate, substance-over-form standards such as IFRS may have an effective impact in stopping biased financial reporting. Data supported this subtheme as well. When the judgment and assumptions behind a decision of the classification of a certain investment is enough rationalised in the disclosures, auditors' assessment of true and fair view reporting becomes simpler, preventing possible unexplained and inappropriate biases that management might provide. *Industry-specific conditions* was present in the study of Ozorhon et al. (2007), which stated that construction projects are more prone to many types of risks than other business activities. Also the data referred to this, and among construction companies may additionally occur more malpractice than other industries.

Interpreting the agreement and background similarity had unified features under the theme international dimension. In the study of Zheng and Larimo (2010), international joint ventures were studied from the perspective of Finnish firms in China, and foreign companies' uncertainty in economic behaviours when entering emerging markets was declared. Above all, *interpreting the agreement* was emphasised in international arrangements, as the *background similarity* makes it easier to comprehend agreements likewise. For example, in case the venture is established in an area confronted by crises, there might be even uncertainty whether plants there exist anymore or whether they are demolished, and assessing the true and fair view is challenging. Otherwise international undertakings seem to be more prone to material misstatements, since accounting adjustments cause errors between different standards. This discovery supports the findings of Fagerström (2002), who studied group accounting across borders.

Both literature and data had similarities in terms of different accounting treatments, benefits of equity method and management's relatedness to accounting regarding appropriateness of accounting method. In order to ensure accurate reporting, parent firms consider it important to have their own financial manager in the joint venture (Nguyen 2009). Among informants this insight was also developed around the area of *different accounting treatments*. O'Hanlon and Taylor (2007) claim that the removal of proportionate consolidation option does not significantly reduce the quality of information regarding the liabilities of joint ventures, which indicates the *benefits of equity method*. The fact that the informants of this study gave special attention to explanatory disclosures of liabilities in addition to balance sheet presentation, support the work of Lim et al. (2003) and Richardson et al. (2012), although proportionate consolidation has been conclusively preferred in many studies such as those of Stoltzfus and Epps (2005), Lourenço and Curto (2010), and Graham et al. (2003). The results of this study are also consistent with the findings of Kothavala (2003), which suggest that different market participants use financial statement information diversely. Moreover, this research complemented the findings of Schmachtenberg (2014) in terms of *management's relatedness to accounting*, as many deals may in some cases even turn out to have surprising accounting outcomes for managers.

Transparency of commitments and guarantees, *trade secret protection* and *adequacy of disclosure* were discovered as subthemes related to the extent of disclosures. The findings of Bauman (2003) provided that market participants find the disclosure of off-balance-sheet liabilities useful. This result was confirmed in the data, when informants described that some financial information users, like credit rating agencies, use this explanatory material in their own valuations, and so *transparency of commitments and guarantees* is also reflected in equity method. *Trade secret protection* was evidently mentioned in the studies of Schmachtenberg (2014) and Groot and Merchant (2000), and the data of this study finds similar evidence. In their study concerning Finland, Jarva and Lantto (2012) referred to *adequacy of disclosure*, which also according to data serve as a tool for auditors in practice to finally assess true and fair view.

Disproportionate ownership as well as *rights and obligations* were examined under the theme equality between partners. These were rather new areas emerging from the data, not yet well covered in academic research. One of the reasons for this may be the new

regulation of IFRS 11, which concentrates more on rights and obligations instead of the legal form that might have prevailed as a basic presumption in accounting research traditionally. Only a few studies (e.g. Leitner-Hanetseder & Stockinger 2014; Schmachtenberg 2014) have reviewed IFRS 11 to date. *Relevance for group* and *work of other auditors* were other strands under performing the audit engagement that got only little support from the existing research, some of the major notions being suggested in the research of Stewart (2012) on group audits. Also the study of Stewart and Kinney (2013) indeed suggest that examination in the area of multi-location audits is only developing, and there is a call for further research.

Conclusively, when the thematic orientations were examined further, it was recognised that four of the themes got more support from previous studies. *Presence in the joint relationship*, *international dimension*, *appropriateness of accounting methods* and *extent of disclosures* are extensively identified in the literature. However, *equality between partners* and *performing the audit engagement* included areas that have not yet been examined so comprehensively. The reason for this may lay on the fact that IFRS 11 provides a new orientation for accounting studies, and as Stewart (2012, 2) stated, research in the area of group audits is still continuing to advance given the today's trend of diverse nature and multinational operations of enterprises. When comparing the findings to the priori dimensions set in the theoretical framework, significant similarities emerge. Although all of the themes that arose from the data were well connected to each other, they could only roughly be placed under each dimension deriving from the theoretical framework. Besides, it became apparent that the themes were considering both FAS and IFRS more or less, so their separation in the analysis would not have given a coherent picture of the study, and thus the highlights are presented collectively. A refined theoretical framework for the assurance of true and fair view of consolidated financial statements, which include joint undertakings, is presented on the next page (Figure 11).

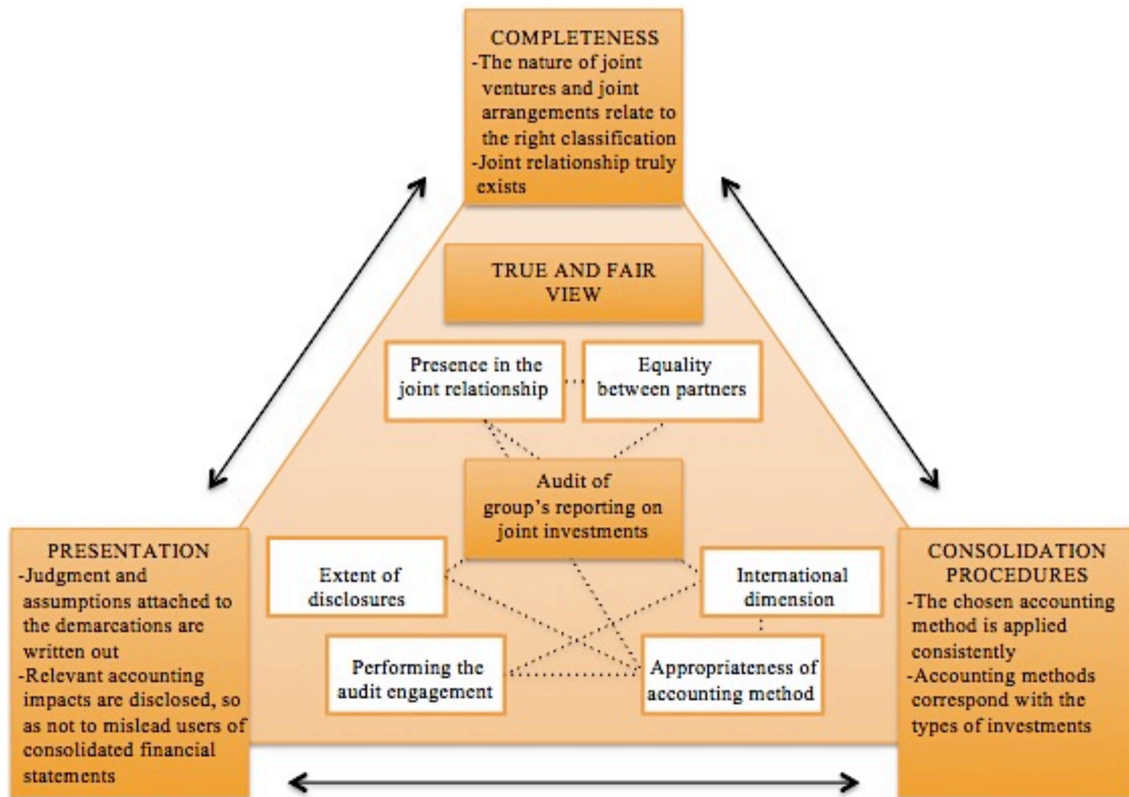

Figure 11. Re-evaluation of the theoretical framework

5 DISCUSSION AND CONCLUSIONS

5.1 Summary of the Research

Joint ventures and joint arrangements, which involve autonomous firms collaborating towards some common objective, are becoming more and more prominent due to the globalisation of business and competition. They are becoming an increasingly common way to combine assets and capabilities, as well as conquer new markets. Whether or not joint undertakings are determined, accounted, and reported appropriately has been under debate for decades. As auditors play an important role in ensuring that the capital market economy functions without severe outages, as well as contribute to the development of accounting, their assessment of true and fair reporting on joint investments at the time of fresh regulation of IFRS is vital. True and fair view in auditing means that financial statements are free from material misstatements, whether due to error or fraud, and faithfully represent the financial performance and position of the entity, which has been the common thread throughout this study.

Briefly, philosophically this study was conducted from a constructivist perspective, being ontologically relativist, epistemologically subjectivist and methodologically hermeneutic and dialectic. The study was carried out with regard to the view of accounting academics, who stress that qualitative methodology in accounting research closes the gap between academic studies and practice.

The purpose of this study was to understand auditors' perceptions of true and fair view as regards the classification and accounting for joint ventures and joint arrangements. In order to achieve this, the research was divided into following subsections:

1. To what extent management exercises judgment in the classification of joint ventures and joint arrangements, and what consequences does this have for accounting?
2. How auditors assess that a true and fair view of a group's financial performance and position is given when reporting these undertakings?

To what extent management exercises judgment in the classification of joint ventures and joint arrangements, and what consequences does this have for accounting? The first research question built its aim on a foundation deriving from prior literature. For instance, the question whether the existence of different accounting and disclosure requirements for different types of investments may have had an impact on managers' choices, with regard to how these investees are structured, has been mentioned to be a subject of fruitful enquiry. Previous research has also examined the incentives to choose between equity method and proportionate consolidation, as these are the prevalent methods in accounting for joint ventures, and their presentations in the consolidated financial statements differ. Demarcation between classes of investments and group accounting are based on entity theory, whereas positive accounting theory has been prevalent in examining managers' motivations to achieve a desired financial reporting objective, which have guided the work of many accounting researchers before. Conclusively, the theoretical framework comprised altogether of three dimensions: nature of joint ventures and joint arrangements, accounting methods, and disclosures.

Through the harmonisation with IFRS and US-GAAP European companies, Finland amongst them, are facing new challenges in accounting for joint arrangements. With the goal of enhancing the quality of financial reporting, the new standard IFRS 11 concentrates on two aspects. First, the classification and accounting requirements now focus on the rights and obligations of the parties as the central criteria for demarcation. Second, the accounting option for joint ventures has been eliminated to reduce the dissimilarities between accounting standards and to improve the comparability of IFRS reports. Therefore, proportionate consolidation method for joint ventures is prohibited, and all joint ventures have to be included in the consolidated financial statements using the equity method. FAS as Finland's own national GAAP still permits the choice between equity method and proportionate consolidation, and the method selected has to be consistently applied throughout the fiscal years.

The major differences between the two accounting methods include the reporting of joint investment assets and liabilities on the consolidated balance sheet and the level of detail presented in the group income statement. Proportionate consolidation reports the venturer's portion of the joint venture assets, liabilities, income and expenses line by line, and therefore moves the entity's share of the joint venture debt onto the balance

sheet. Although previous research has claimed that joint ventures are often formed to embark on uncertain and risky projects, and include features, which do not appear under the equity method, this study on its behalf gave support for the decision of IASB to eliminate the proportionate consolidation method, as brought out later when summarising the empirical analysis.

All things considered, management exercises judgment in the classification of joint ventures and joint arrangements when evaluating whether joint management or joint control exists, which determines the demarcation of the investment. This appears more clearly in principle-based IFRS that concentrates on rights and obligations when dividing joint arrangements into joint ventures and joint operations, compared to FAS that highly relies on the amount of shares and voting rights. However, both standards require that the decision behind the categorisation is rationalised in the notes to the consolidated financial statements. In some occasions the decision may even have unexpected consequences for accounting, because entering into joint undertakings might be overruled by business reasons rather than reporting outcomes that management brings out to investors. This introduces a viewpoint into discussion that is contrary to some previous research, namely, to what extent biased or aggressive reporting overall concerns joint investments that would harm true and fair view, as well as result in misleading reporting and a situation that auditors disagree with the management.

How auditors assess that a true and fair view of a group's financial performance and position is given when reporting these undertakings? As the second research question initially originated from the International Standards on Auditing, the response derives predominantly from the gathered empirical data of semi-structured interviews with four auditors, who served as subject matter specialists. One of the informants, a CPA auditor, gave valuable insights about IFRS and international arrangements that according to current references are on the rise today, whereas three Finnish KHT auditors from Big Four firms shared their perceptions in relation to their experience.

In the theoretical framework, three main objects of group audit were selected from preceding literature: completeness, consolidation procedures, and presentation. Based on this background, six unified themes were identified from the data: presence in the joint relationship, equality between partners, international dimension, appropriateness of

accounting method, performing the audit engagement, and extent of disclosures. Four of the themes got widely support from earlier research, whereas equality between partners and performing the audit engagement had subthemes that predominantly emerged from the data, revealing new paths for future studies to consider. Although many researchers have underlined proportionate consolidation, this study has given some support to the counterpart, stating the benefits of equity method. The reason for achieving contrary findings compared to the past may result from the research methods that previously might have taken a too narrow approach, neglecting the holistic view.

Although six unified themes were identified and titled independently, they do not exclude one another. Vice versa, these themes have connections with each other, as interviews revealed[35]. For instance, appropriateness of accounting method is linked with extent of disclosures in terms of additional information provided in the notes to the consolidated financial statements, especially liabilities that are not seen from the group balance sheet. International dimension, on its behalf, is attached to performing the audit engagement. Group audits seem to be encountering more and more situations today, where the joint investment is located abroad, in a foreign accounting environment, or even in an uncertain economy. Moreover, equality between partners and extent of disclosures appeared to accompany each other, because both the prior research and data uncovered management's possible unwillingness of disclosing certain information about the joint relationship. IFRS underlines rights and obligations instead of legal form, and requires firms to disclose information of their interests in investments, as well as their financial implications. However, data stressed that with respect to the client, no sensitive information is required to be written out. Especially in FAS it might be enough only to bring out that the relationship is based on contract without declaring any details.

The main differences between FAS and IFRS considering the classification and accounting for joint investments are that FAS does not include the concept of joint operation, and only distinguishes joint ventures. FAS also permits the use of two alternative accounting methods for joint ventures, whereas IFRS 11 Joint Arrangements requires equity method for joint ventures and provides guidance also in the accounting for joint operations, which resembles proportionate consolidation to a large extent. In

[35] See re-evaluation of the theoretical framework on page 73.

this study, the two standards were however finally treated collectively, since separation of those would not have complemented the analysis of the empirical results. In the course of the study it also became evident that literature tends to stress different issues than what is more commonly seen in practice. Frauds as material misstatements seem to have aroused more interest among researchers, although these tend to occur rather rarely in comparison to errors. Enron was a known case concerning misleading accounting practices in relation to off-balance-sheet financing, revenue recognition, and financial statement disclosures. Nevertheless, it is only one extreme example[36]. Additionally, accounting for joint operations under IFRS was considered superior to traditional proportionate consolidation, as this method does not include every line item in relation to owned shares in the consolidated financial statements, but consolidates the rights and obligations that actually concern the reporting entity.

To sum things up regarding the second research question, auditors assess that a true and fair view of a group's financial performance and position is given when the nature of joint ventures and joint arrangements relate to the right demarcation between classes of investees, and joint relationship truly exists. In other words, auditors evaluate the rationalisation behind classification of investment presented by the management, and review whether the rights and obligations of the investor in the joint relationship do not make the investment fall into control or significant influence. It is also important for auditors to review that the partners are in equal terms considering the management and output of the joint undertaking. Moreover, auditors assess that the chosen accounting method that derives from the demarcation of an investment is applied consistently from fiscal year to another, and accounting methods correspond with the types of investments. This means ensuring that adjustments are recorded correctly, which may have been made for example when a joint undertaking is located in a dissimilar accounting culture. Finally, management has to provide an adequate extent of disclosures in order to give true and fair view, which is finally assessed when performing the audit engagement. This means that the probable judgment and assumptions attached to the classification are written out, and relevant accounting impacts are disclosed, so as not to mislead users of consolidated financial statements.

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[36] Enron entered into a joint venture arrangement, but since it held less than majority of voting rights it avoided consolidating the partnership. It was however obvious that Enron controlled the investment. (Baker & Hayes 2004, 772) See more of the case also on page 26 of this study.

As a final conclusion, the theoretical framework was revisited and re-evaluated, and a figure for the audit of group's reporting on joint investments was introduced. To ensure the thesis would be relevant for practitioners, it aimed at going beyond the theoretical analysis of accounting literature and guidance, and therefore had the complementary empirical analysis. The data was collected in face-to-face interviews with subject matter specialists as a confirmation of prior research results, to discover areas not yet thoroughly confronted, and to understand the topic more comprehensively in practice. Consequently, there were altogether six collective themes that emerged from the conducted interviews as regards auditors' perceptions of true and fair view related to the classification and accounting for joint ventures and joint arrangements. Figure 12 below presents the key factors of the theoretical framework, as well as the themes and subthemes emerged from the data in this study, all combined together.

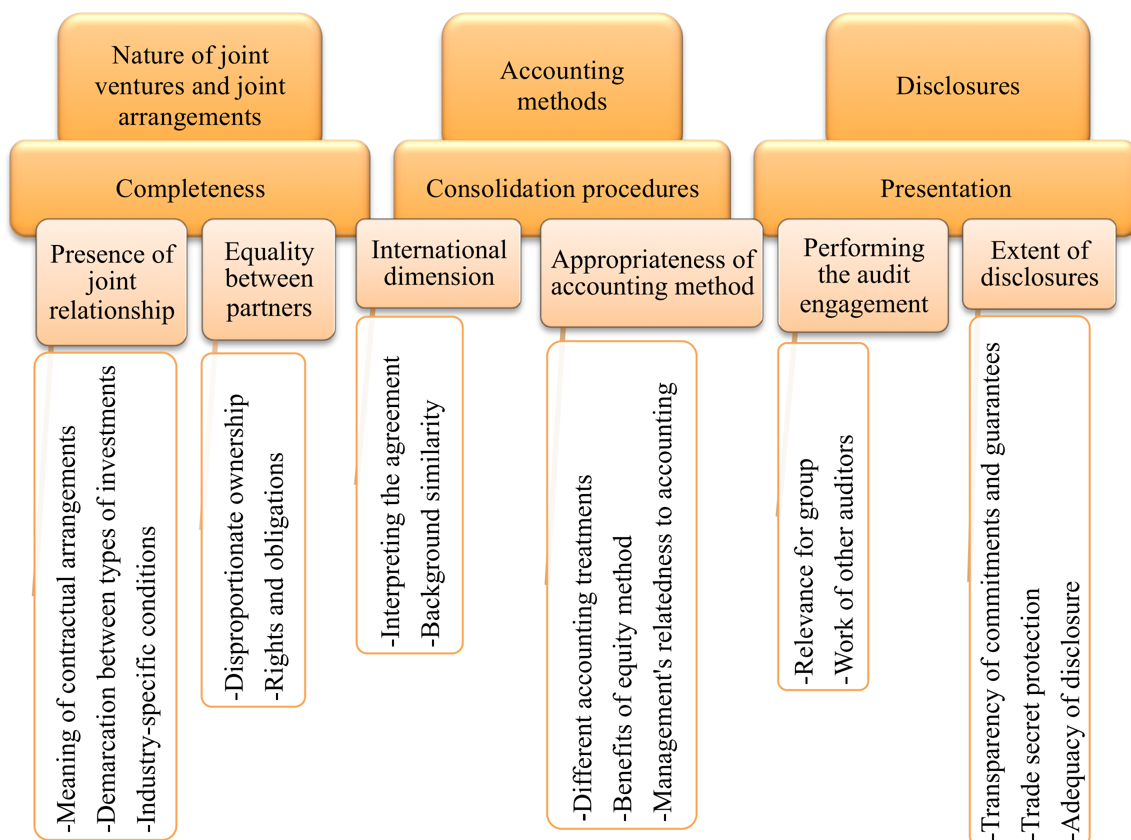

Figure 12. Collective themes

The most important findings of this study suggest that the decision to enter into a joint investment is predominantly driven by business aspects rather than desired reporting outcomes, which was emphasised in the interviews carried out with auditors. The study

also brings forward a fresh comprehension to the debate of the appropriate accounting method for joint investments. Equity method turned out to be preferred due to its technical simplicity as the investment is possible to include in the consolidated financial statements as a rather uncomplicated entry, whereas accounting software usually does not seem to support the line-by-line technique of proportionate consolidation. This notion may result in decrease of accounting errors, which might have caused material misstatement if certain benchmarks are exceeded. Besides, equity method is simpler to comprehend, because it is the same method as used in accounting for more familiar associate companies in Finland, both under FAS and IFRS. Although equity method has faced critiqued among researchers due to the presentation that does not display line items, such as debt, separately in the consolidated balance sheet, true and fair view of the profit and state of affairs is overall assessed through supplementary disclosure of the decision behind the demarcation between types of investments as well as rights and obligations emerging from the joint relationship.

5.2 Contribution of the Research

In the following paragraphs the contribution to accounting knowledge has been contemplated taking into account the *theoretical*, *methodological* and *practical* aspects. They correspond to the previous chapters 2, 3 and 4 of this study, where the theoretical framework was introduced, the description of how the research was conducted got clarified, and the insights that the gathered empirical data brought to understanding of the research topic in practice were noted.

This study contributes to the existing literature due to its explicit focus on accounting for joint ventures and joint arrangements in a Nordic country, Finland, in contrast to prior research (e.g. Bauman 2003; Mantecon et al. 2012; Richardson et al. 2012; Stoltzfus & Epps 2005; Soonawalla 2006), which has mainly been conducted from the viewpoint of bigger western economies, Anglo-Saxon nations, like the United States or Canada. Eriksson and Kovalainen (2008, 262) state that showing gaps in the previous knowledge achieved, and concentrating on niches, is a possibility for new knowledge. Academics O'Hanlon and Taylor (2007, 283) suggested that the issue whether diverse accounting and disclosure requirements for different types of investments may have

influenced managers' choices with regard to how they are structured should be further addressed. This study answers that request on its behalf, calling attention to the external reporting consequences of investment categorisation with respect to managerial judgment. The research also deals with the most recent standards that are not yet well-covered, and enhances understanding of the accounting outcomes resulting from different investment structures and degrees of influence and control, complementing this way the dissertation of Schmachtenberg (2014). Finally, the study contributes to the accounting literature as regards the disclosure requirements, an important area that needs up-to-date investigation.

Interpretive research has a great deal to contribute to the understanding of how accounting is actually performed, for example in terms of how standards and reporting conventions are used in practice (Armstrong 2008, 878). Some researchers strongly advocate qualitative methodology in accounting research and claim this strategy can make substantial contributions to the study of how accounting interacts with its environment (Hoque 2012, 375). So far, research has made limited progress in expanding understanding due to unambitious attempts to examine difficult phenomena, and because of focus on replication rather than extension of current knowledge (Fields et al. 2001, 299). Thus, most of the previous work done in accounting for inter-company arrangements may have focused on narrow causality, as well as the objective to generalise and predict. Positivist research has faced critique of being insufficient in explaining the complicated world (Arnold 2009, 804), and not providing practitioners guidance. With respect to the call of enhancing knowledge by comprehending a more holistic approach, this study has used qualitative methodology and thus pursued to bridge the gap between theory and practice (Hoque 2010, 378). This study has also built its theory and methodology on acknowledged and cited references and approaches. Moreover, having an interview with a foreign CPA auditor brought additional contribution and valuable insights for the study in terms of understanding joint arrangements under IFRS and international arrangements, since nowadays more and more ventures are established with foreign partners beyond national borders.

In addition to theoretical implications, the study offers insights for accounting and auditing practitioners. A part of the endorsement of intellectual output is in the hands of professional managers and accountants – a validation that has so far not been

forthcoming (Armstrong 2008, 870), mainly due to strong focus on purely theoretical elegance and advancement (Hopwood 2009, 798). From a practical point of view, it is suggested that management considers the implications on accounting already when negotiating the contracts of joint undertakings. Particularly managers' discussion with auditor or adviser lessens the disagreements considering applicable reporting and true and fair view of the group as a whole. Given to the gathered interviews, management should be closely involved with accounting personnel, as diverse accounting techniques may have considerably differing impacts on reported performance metrics and debt covenants, which is also corresponding to the study of Schmachtenberg (2014). Some cases related to the demarcation between investments may even require input from legal counsel, and entities might wish to bring in their auditors to discuss areas of material judgment. Additionally, this study recommends to examine the possibility of implementing similar reporting practices from IFRS to FAS, as this may lead to faster accounting and reporting, fewer adjustments and thus a smaller occurrence of errors.

5.3 Evaluating the Research Quality of the Study

Research quality is usually assessed with the concepts of *validity* (the research has studied what had been promised to study) and *reliability* (the repeatability of the research results). In qualitative studies, the usage of these concepts has faced critique because they are mainly corresponding to the desires of quantitative approach. (Tuomi & Sarajärvi 2003, 133) Thus, the usual positivist criteria of validity and reliability are replaced in this study by *trustworthiness*, which is divided into four categories: credibility, transferability, dependability and confirmability (Guba & Lincoln 1989). These criteria are more suitable for research philosophy that reflects constructivism, and are used to evaluate trustworthiness hereafter.

Credibility evaluates research quality by asking, whether the researcher is familiar with the topic and whether the data is sufficient to merit the claims. This means ensuring that any other researcher would be able to, on the basis of the materials, come relatively close to the interpretations made. (Eriksson & Kovalainen 2008, 294) As the interviews were recorded, the specific quotes could be used in the write up to improve the

credibility of inferences drawn (Hoque 2010, 389). The participants were informed about the discussed topics before interviews, which enhances credibility while the researcher obeys good scientific practice, and respects ethical perspectives (Tuomi & Sarajärvi 2003, 131). Having linked the research questions, findings and discussion to existing literature was an important way of demonstrating the credibility of the research and the contribution it is making (Bryman & Bell 2015, 9).

Eriksson and Kovalainen (2008, 292–293) assert that there are several techniques for increasing credibility, for example *triangulation*, which is a process of using multiple viewpoints to refine and clarify the findings of the research. There were four participants in this study, so several sources of information were used, which embodies triangulation of data. Besides, triangulation of theories was applied, since an understanding to the research questions was pursued basing on a variety of theoretical discussions. In fact, the most prevalent attempt in theoretical triangulation is in efforts to integrate different perspectives into the study of the same phenomenon, which enriches the understanding of everyday accounting practice (Hoque 2010, 479).

Transferability is concerned with the researcher's responsibility to show the degree of similarity between the conducted study, or parts of it, and other research, in order to establish a connection between the research and previous results (Eriksson & Kovalainen 2008, 294). A strong frame of reference has been maintained throughout the research highlighting the connections to existing literature, unravelling simultaneously the problems of a new phenomenon that has not been examined in the same scope and context before. Transferability refers to the degree to which the results of qualitative research can be shifted to other settings (Tuomi & Sarajärvi 2003, 136). The results of this study could be generalised, but only to some extent, to nations with similar economic, institutional, and accounting environments, namely to other Scandinavian countries (Jarva & Lantto 2012, 175).

Dependability evaluates the stability of data over time. It underlines the technique for documenting the logic of research process and method decisions. (Guba & Lincoln 1989, 242) Also Eriksson and Kovalainen (2008, 294) emphasise that dependability is enhanced when offering information to reader, meaning careful documentation of the proceeding so that it comes through as consistent and traceable. However, one of the

weaknesses may be found in the interpretive perspective of the study, because implicit in this view is the assumption that the researcher is never entirely sure that the views of the respondents is entirely acquired (Hoque 2010, 380). It may also be difficult for the interviewees to rate their own performance in general (Bonner 1999, 394). Major audit firms rarely have allowed studying, what they actually do (Hopwood 2009, 798), since they are relatively reluctant to provide research access in terms of securing confidential client data. The limitations were unveiled in this section, because as declared by Tuomi and Sarajärvi (2003, 136), the researcher should be aware of the factors that originate from the investigated phenomenon itself in order to evaluate dependability.

Confirmability may be thought as a parallel to the conventional criterion of objectivity (Guba & Lincoln 1989, 242). However, all knowledge can be seen always somehow subjective, because an academic decides the whole research setting according to his or her own consideration (Tuomi & Sarajärvi 2003, 19). Also Morgan (1988, 482) support this by asserting that accounting can never be truly objective, because accountants are really trying to persuade others that his or her concepts, or latest set of figures, give a true and fair view, when in reality this interpretation is as partial as any other. Therefore, findings and interpretations should be strongly linked to the data in ways that are easily understood by others. These linkages exemplify the extent to which the outcomes are shaped by the respondents and not by the imagination of the researcher. (Eriksson & Kovalainen 2008, 294) Consistency in presenting quotations from the gathered empirical evidence has been maintained in order to establish that all findings can be traced back to the data.

5.4 Concluding Remarks and Further Research Directions

The recent trend in globalisation and international business increases the motivation to understand joint ventures and joint arrangements, because they allow firms to perform complex mutual tasks without acquiring one another. Some academics argue that accounting should not be analysed in isolation overlooking its multidimensional nature, which is claimed to be more of a social phenomenon, "inherently complex, multi-dimensional and paradoxical". Although the debate of appropriate accounting method for joint investments has been going on for decades, this study provided a fresh insight

to the discussion that has extensively questioned researchers from different viewpoints. Bringing the perceptions of auditors to the conversation, benefits of equity method could be brought out, as technically proportionate consolidation may not get support from the used software, and the method is easier to understand due to the same accounting applied in the case of associate companies that are more usually occurring in group financial statements. Moreover, as this study took into account disclosures, it was able to discover that relevant debt related to the joint investment have to be disclosed specifically in the notes to the consolidated financial statements, which is why it should not be entirely condemned that equity method would hide liabilities as they are not displayed separately in the balance sheet.

Based on the interviews with audit professionals, there seems to be some aspirations that FAS, when renewed, would permit more alternatives to apply the accounting principles of IFRS in Finnish firms, since this leads to fewer adjustments and misstatements. There is a certain degree when firms enter into cooperative arrangements, and the regulations concern only a limited set of companies, which is why the specialisation of the issue seems to be rather narrow so far. Therefore, knowledgeable experts may be difficult to access, and every respondent of this study provided cherished information. The observation also emphasises the importance to deepen the knowledge among professionals, and supplementary studies might advance the insights on any unresolved issues. To date, only little research exists on accounting for joint investees particularly related to the Finnish context. A combination of legislative and accounting research provide intriguing topics to discover further, also considering the increasing internationalisation. For instance, the latest standards, IFRS 14 Regulatory Deferral Accounts, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases provide interesting avenues of research. Further research could also bring forward the Finnish accounting legislation with regard to the refreshed regulation of IFRS, possibly examining whether the principles of IFRS 11 could be implemented to FAS as an alternative or wholly correspondingly. After all, accounting for joint ventures and joint arrangements is likely to improve in the future because of learning effects among managers, accountants, and auditors.

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APPENDIX

Appendix. Interview Questions

Background Information

- Work experience and position
- Experience and knowledge of group accounts
- Experience and knowledge of IFRS
- Familiarity with joint ventures and arrangements

Common Questions Related to the Study

- Do you believe that joint ventures and joint arrangements will become more common in the future? Do different arrangements cause challenges to accounting departments, and is accounting personnel prepared for a possibly increasing amount of these undertakings?
- What is the role of auditing regarding joint ventures? E.g. in comparison to listed companies? In which situations do auditors focus more specifically on them?
- What special issues and problems are linked to auditing joint ventures and joint arrangements?
- How the changes in the group structure influence auditing?

Common Questions of the Risk of Material Misstatement

- According to your thoughts, which occur more often considering joint ventures and joint arrangements: error or fraud?
- What are the most common factors behind errors, and on the other hand the most common motives and incentives behind frauds regarding joint arrangements?
- What kinds of entities typically are prone to the risk of material misstatement? E.g. the size of the group or industry.
- In which situations is the material misstatement related to joint arrangements considered so significant that it leads to expression of qualified or adverse audit opinion?

Themes

The Nature of Joint Ventures and Joint Arrangements

Does the following influence the risk of material misstatement?

- FAS: does not have such strict classification rules for joint ventures vs. IFRS: a more specified regulation (definition of joint control, dividing joint arrangements into joint ventures and joint operations).

- Which risks of material misstatement do you consider that are typically related to domestic joint ventures in comparison to internationally organised arrangements?
- What signals indicate threat related to entity's business, when you assess risks? E.g. industry or location in which a common undertaking operates.
- Which conditions in the entity's environment do you find that have a higher impact on the risk of material misstatement? E.g. expanding to new markets through joint venture or joint arrangement.

Accounting Methods

Does the following influence the risk of material misstatement?

- FAS: freedom of choice (equity method or proportionate consolidation for joint ventures) vs. IFRS: requiring equity accounting for joint ventures and removing the option to apply proportionate consolidation.
- FAS: amortisation of goodwill systematically over its expected useful life (maximum period of 5 to 20 years) vs. IFRS: impairment testing.

- Which method do you consider more suitable in accounting for joint ventures in the consolidated financial statements: equity method or proportionate consolidation?
- Which conditions in the entity's environment do you find that have a higher impact on the risk of material misstatement? E.g. the challenges for the proficiency of accounting personnel when alternative accounting methods are used simultaneously.

Disclosures

Does the following influence the risk of material misstatement?

- IFRS: the amount of required notes increases and disclosures are more exact (e.g. assumptions made by the management, lack of certainty related to judgment).

- May there occur disagreements between the auditor and entity about the rationalisation of the existence of joint management and joint control?
- Is the reporting sufficient enough to bring out the rights and obligations of entity, as well as the risks related to joint ventures and joint arrangements?
- How auditors assess related parties? E.g. commerce and transactions between the group and related arrangements.