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The value-relevance of disclosed summarised financial information of listed associates

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ABSTRACT

While prior research considers limited elements of the summarised financial information reported for equity accounted associates under IAS 28, it does not address the collective or incremental value-relevance of these disclosures. Therefore, this study investigates the incremental value-relevance of all required elements of disclosed summarised financial information for listed associates, and controls for reported fair values. Findings suggest that individual elements of these summarised disclosures are sometimes incrementally value-relevant, but that elements have the greatest incremental value-relevance as a group. These findings suggest that investors value a firm's investments in listed associates at a self-developed intrinsic value, rather than using the market value (or fair value) of that associate directly. Therefore, underlying accounting information of listed associates remains value-relevant, even when alternative market-based valuations are available.

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1. Introduction

The objective of financial statements is to provide information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to an entity (IASB, 2010: OB2). Decision-useful information can be conveyed in financial statements by either recognising an accounting amount in the financial statements or by disclosing information in the notes. To assess the decision-usefulness of financial statement information, a value-relevance approach is often used. An accounting amount or disclosure is considered value-relevant if it has a predicted association with equity market values (Barth, Beaver, & Landsman, 2001: 79), i.e. the amount is utilised by equity investors in valuing the firm's equity.

For equity accounted investments in listed associates, an accounting carrying amount and several disclosures are reported in financial statements. Prior research considers the value-relevance of a limited number of these disclosures on an individual basis. Graham, Lefanowicz, & Petroni (2003) find that the difference between disclosed fair values and carrying amounts of listed associates is value-relevant. Richardson, Roubi, & Soonawalla (2012) conclude that liability disclosures of equity accounted joint ventures are value-relevant for a sample of Canadian joint ventures. O'Hanlon and Taylor (2007) find that disclosed liabilities of equity accounted investees in the United Kingdom are value-relevant, and that the relationship is stronger for joint ventures than associates. However, prior research does not consider all of the available disclosures or

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their collective value-relevance. Therefore, it remains unclear whether these disclosures are incrementally value-relevant, individually or collectively.

This paper contributes to the existing value-relevance literature on investments in associates in several ways. First, this paper focuses explicitly on the incremental value-relevance of disclosed summarised financial information (total assets, total liabilities, revenue and profit or loss of the associates). This information should be incorporated into the fair value (market value) of listed associates, as market participants would take into account all relevant accounting and other information of the associate. Consequently, the disclosed summarised financial information may not be incrementally value-relevant. In contrast to prior research, this study controls for disclosed fair values of listed associates.

Next, prior research does not consider the value-relevance of all required disclosures. Disclosed summarised financial information still to be investigated includes the total assets, revenue and profit or loss of equity accounted investees. These potentially represent important omitted correlated variables, as they are incorporated, directly or indirectly, into the calculation of investee book value. By controlling for all required disclosures, this study provides insight into the incremental value-relevance of reported summarised financial information.

Also, this study finds that individual elements of disclosed summarised financial information for listed associates are not consistently value-relevant. The elements of disclosed summarised financial information have the greatest incremental value-relevance when they are considered collectively. This conclusion is significant, as it implies that investors do not always use unadjusted market valuations to which reported fair values equate. Instead, they develop their own valuation of investments in listed associates.

A debate about the appropriateness of equity accounting is still ongoing, and some have called for it to be replaced with fair value accounting (Nobes, 2002). Consequently, this study provides useful insight into the fair value debate as to what information equity investors use to value investments in listed associates. The findings suggest that equity investors, on average, develop intrinsic values for investments in associates, rather than using their market values directly.

The remainder of this paper is set out as follows. Section 2 briefly discusses the current accounting and disclosure requirements for investments in associates, followed by a review of prior literature. Sections 4–6 set out the research method, sampling methodology and descriptive statistics. The results of univariate investigations are discussed in Section 7, followed by those of the multivariate investigations in Section 8, and results for robustness tests in Section 9. Section 10 summarises the contribution and implications of the paper, and concludes.

2. Current accounting and disclosure requirements for investments in associates

The accounting and disclosure requirements for investments in associates for the sample period are set out in IAS 28, *Investments in Associates*, effective January 2005 (IAS 28) (IASB, 2003). This standard requires the equity method of accounting for an associate investee in which the acquiring entity has significant influence, i.e. the power to participate in financial and operating decisions. Significant influence usually, but not necessarily, exists when an entity holds 20 percent or more of the voting power of an investee.

Equity accounting requires an entity to recognise the investment at cost, and adjust it for the net impact of subsequent changes in equity. This method results in a single line item (investment in associate) on the statement of financial position, as well as single line items for the investor's share of profit or loss and the investor's share of the associate's other comprehensive income. IAS 28 also requires disclosures for the fair values of investments in associates for which published price quotations are available. In addition, the standard requires summarised financial information for associates including total assets, total liabilities, revenue, and profit or loss.

3. Literature review

Early value-relevance research for investments in associates considered the value-relevance of their carrying amounts and disclosed fair values. Barth and Clinch (1998) investigate investments in associates for an Australian sample from 1991 to 1995, and find that disclosed fair values were only value-relevant for mining firms. They also conclude that the carrying amounts of investments in associates were only value-relevant for financial and mining firms. However, as Australia only adopted equity accounting in 1998 (Nobes, 2002) these carrying amounts were the cost of the associates. Graham et al. (2003) find that both the equity accounted carrying amounts and differences between disclosed fair values and the equity accounted carrying amounts are value-relevant. It should be noted that they exclude only financial services firms from their sample, which suggests that disclosed fair values are value-relevant for diverse industries.

Liability disclosures for equity accounted investees also have been researched as such liabilities may represent hidden obligations of the reporting entity (Baumann, 2003; O'Hanlon & Taylor, 2007). Baumann (2003) finds, for example, that investor-guaranteed obligations of equity accounted investments are negatively associated with the investor's market value, although no distinction is made between joint ventures and associates. Richardson et al. (2012) confirm that liability disclosures of equity accounted joint ventures are value-relevant for a sample of Canadian joint ventures. O'Hanlon and Taylor (2007) find that disclosed liabilities are negatively associated with market values of equity for equity accounted joint ventures and associates in the United Kingdom and that the relationship is stronger for joint ventures.

However, research on disclosed liabilities does not control for other investee information, potentially ignoring the fact that an investee may be able to settle its liabilities comfortably. If this is the case, the investee's liabilities may no longer

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