

THE CONCEPTS OF DEFINING JOINT VENTURE (ARRANGEMENT) IN UZBEKISTAN

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Abstract. 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, reporting of inter-firm relationships is now transforming too, posing new challenges to managers, accountants, and auditors. This article concentrates on defining joint venture (arrangement), which have not been combined in terms of previous researches.

Key words: joint arrangement, joint venture, joint control, International financial reporting standards, Generally accepted accounting principles, variable interest model, voting model, veto right, partnership contract.

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Introduction. The constant and essential issue of the economy is the inadequacy of the society's needs and the limited economic resources [1]. In the context of limited economic resources, each economic entity needs to study the optimal ways to attract potential investors and partners to implement their commercial projects. 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 [2, 3], 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 ventures² has estimated that the volume of them has even increased more than threefold worldwide since the recession in the beginning of 21st century [4]. According to a survey conducted by KPMG (2009) [5], 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) [6] that is considered a highly prestigious management consultancy estimates that nearly 70 % of executives expect the joint venture activity to increase in the coming years³.

Literature review. The definition of the concept of joint venture (arrangement) in terms of accounting is not fully elaborated in national legislation. The Civil Code of the Republic of Uzbekistan describes the joint activity agreement, i.e. the agreement of a simple partnership, which serves as the basis for the activity without establishing of an entity. It is understood that joint arrangements are based on two or more persons, commonly referred to as partners (founders), to make a contribution to achieving another objective that is not contrary to the law and to engage in joint business without establishing a legal entity and to make decisions on important aspects of the business is the implementation of a joint venture agreement [7]. The Tax Code of the Republic of Uzbekistan describes the procedure for taxation of transactions involving joint activity agreement [8].

It is known that joint arrangements can also be undertaken with the creation of an entity. Creation of an entity is carried out through the organizational legal forms of economic companies and partnerships. However, it should be understood if these established joint stock companies and associations are the object of joint venture (arrangement) in terms of accounting. In this regard, there are no regulatory legal acts that directly regulate reflecting transactions related joint arrangement in the accounting records of the parties of the joint venture (arrangement). This requires the recognition of the concept of a joint venture (arrangement) in accounting as an economic category and accounting object, and the disclosing the essence of its criteria.

Existing researches have discovered many aspects of joint ventures (arrangements), but some areas are yet to be explored.

The purpose of this study is to clarify the definition of the joint ventures (arrangements) applied by practitioners, academics and auditors. Consequently, the research is divided into following subsections:

1. The judgment exercised by the management in the definition of joint venture (arrangement).
2. The approaches employed by professionals in assessing the existence of joint control in joint venture (arrangement).

Joint arrangement is an agreement between two or more parties in which they share influence over decisions regarding a project they have commenced through a legal agreement. In order for an agreement to be made, the parties must agree on the essential decisions regarding the project's revenue.

According to the Regulation of Accounting for Participation of Commercial Banks in Joint venture of the Republic of Uzbekistan, joint ventures (arrangements) are a contractual arrangement, under which two or more parties (two banks or two or more non-banking institutions) are doing economic activity [9]. As explained in the description, the joint arrangement is based on the contractual arrangement and by this arrangement sets out joint control. At the same time, it should be noted that the above Regulation applies only to commercial banks and does not apply to other commercial organizations.

Joint venture (arrangement) has been studied extensively in international practice, and standards or regulations of accounting for joint arrangements have been worked out. Particularly, the International Financial Reporting Standard 11 (IFRS 11) defines the joint arrangement as an “arrangement of which two or more parties have joint control” [10, 11]. All joint arrangements have a contractual arrangement that binds the parties and provides two or more of those parties with joint control of the arrangement.

The definition of a joint arrangement in IFRS 11 is generally consistent with IAS 31’s definition of a joint venture. An arrangement does not qualify as a joint arrangement if one party is able to unilaterally control the arrangement – that is, that party has the power to make the key decisions by itself.

According to the Russian Federation legislation, in particular, Regulation No. 20/03, “Accounting for Participation in Joint Venture”, joint venture is organizing activity without organizing a legal entity by organizations and (or) individual entrepreneurs. As it is clear from the description, joint venture is carried out only without the creation of a legal entity [12].

As a result of studying the concept of joint venture of Russian scholars, joint venture is entrepreneurial activity, based on a contract for the establishment of an economic partnership, or a contract of a simple partnership (a joint venture agreement). Russian scientists believe that joint venture can be carried out either with or without the creation of a legal entity [13].

Joint control over joint activities is not an important criterion both in Russian researches and Russian law. The activities of the parties through the consolidation of the shares are recognized as joint activities.

In Western countries, and in particular in the United States, joint ventures are entities whose operations and activities are jointly controlled by a group of equity investors, which are referred to as “venturers.” Determining whether an arrangement meets the definition of a joint venture is important. It could affect the accounting applied by the parties to the arrangement as well as the accounting applied by the separate reporting entity that may be formed as part of the

arrangement. However, the term “joint venture” is applied loosely in practice and may appear in legal documents and public statements by management, which may result in arrangements being improperly identified as joint ventures.

According to the USGAAP [14] while the definition of a joint venture focuses on a corporate joint venture, entities that meet the definition of a joint venture may be organized in a variety of legal forms. In addition to the corporate form, partnerships and individual interests may also be used to organize a joint venture.

To meet the definition of a joint venture, an arrangement must have all of the following characteristics:

- the arrangement must be organized within a separate legal entity;
- the entity must be under the joint control of the venturers;
- the venturers must be able to exercise joint control of the entity through their equity investments.

In current work the definition of joint activities used in practice and national legislation of Uzbekistan and in international practice have been described. In those definitions, the joint control of the parties in joint arrangement is seen as an important criterion. It is reasonable to examine the criteria for joint control over the joint arrangement or the criteria for evaluating the joint control of joint arrangements.

According to the USGAAP the joint control exists when all of the venturers have, at a minimum, substantive veto or approval rights allowing them to effectively participate in all of the significant decisions of an entity.

According to the Regulation of Accounting for Participation of Commercial Banks in Joint venture and IFRS 11, joint control is contractually agreed sharing of control by two or more parties which requires the independent consent of each party sharing control when decisions about the relevant core activities are made.

Since the crucial element of having a joint arrangement is joint control, it is important to understand the definition of this term.

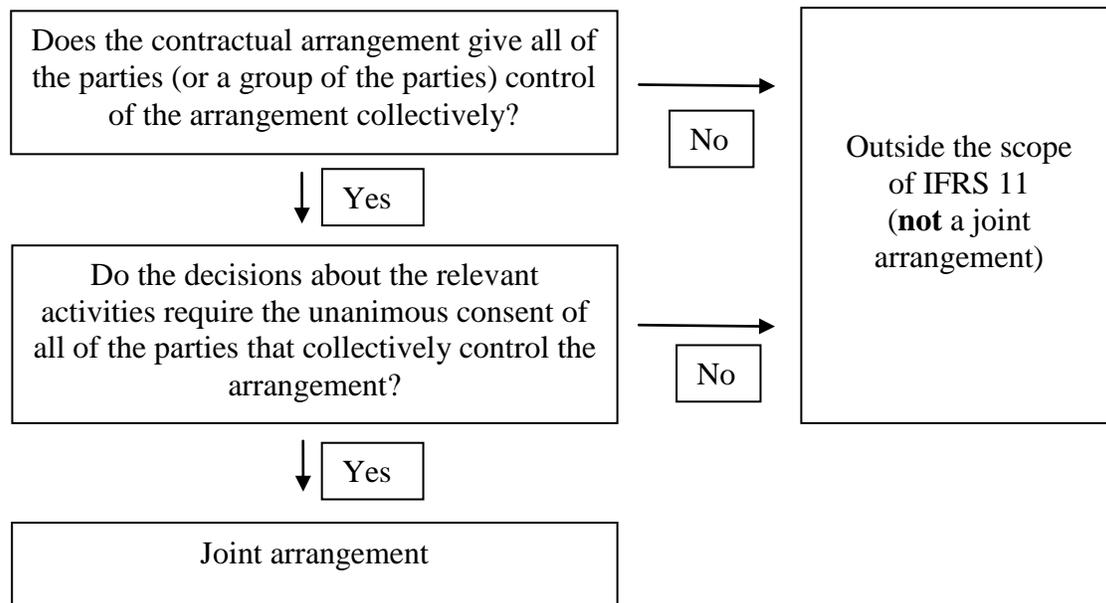
The key aspects of joint control are as follows:

- contractually agreed;

- control and relevant activities;
- unanimous consent — IFRS 11 notes that unanimous consent means that any party (with joint control) can prevent any of the other parties, or a group of the parties, from making unilateral decisions about the relevant activities without its consent.

The flowchart in Diagram 1 illustrates how to evaluate if joint control exists.

Diagram 1 — Is it a joint arrangement?



Management should re-examine joint arrangements, and re-consider whether they have joint control, control or neither of these. Although it was not necessarily the intention of the IASB to widen (or reduce) the scope of IAS 31 when it issued IFRS 11, the change in definition of “joint arrangement” and of “control” may include or exclude different arrangements compared to the past.

Below, the concepts of control and unanimous consent in the context of joint arrangements will be discussed. Understanding the purpose and design of an arrangement is crucial to identifying whether there is joint control.

To determine whether a contractual arrangement gives parties collective control of the arrangement, after identifying the relevant activities of that arrangement, it is necessary to determine what rights give a party the ability to direct the relevant activities. This is because, to

have joint control, the parties must have collective control. To have control, the parties must collectively have power over the relevant activities. In many cases, the relevant activities are directed by voting rights that are held in proportion to ownership interests. However, this is not always the case, and attention should be paid to the facts and circumstances in each case.

IFRS 10 defines protective rights. Protective rights are rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Protective rights relate to fundamental changes to the activities of the arrangement, or apply in exceptional circumstances. Since power is an essential element of control, protective rights do not give a party control over the arrangement. Holding protective rights cannot prevent another party from having power over an arrangement.

Accordingly, when assessing whether a group of the parties collectively control an arrangement (and therefore whether there is joint control), consideration must be given to whether rights held by any of the parties are:

- protective (in which case, the other parties might collectively control the arrangement);
- substantive (in which case, such rights could prevent the other parties from having joint control, or possibly give the holder of those rights control);

Example 1 illustrates this point with veto rights, which are a frequent mechanism used to convey a protective right, although not all veto rights are protective rights.

Example 1 — Protective rights and joint control

A, B and C enter into a joint arrangement to conduct an activity in entity Z. The contractual agreement between A and B states that they must agree to direct all of the activities of Z. The agreement of C is not required, except that C has the right to veto the issuance of debt or equity instruments by Z. Issuing equity and debt instruments is deemed a protective right, because they represent fundamental changes in Z's business.

In this fact pattern, A and B have joint control over Z, because they collectively have the ability to direct Z, and the contractual agreement requires their consent. Although C is a party to the

joint arrangement, C does not have joint control, because C only holds a protective right with respect to Z.

Rather than structuring the arrangement so that some parties hold a protective right, it may be structured so that, generally, all parties have a vote, but in the case of a tie, or disagreement, one party has the deciding vote.

IFRS 11 does not explicitly address how potential voting rights are treated when assessing whether there is joint control.

However, since the definition of “joint control” in IFRS 11 has the same definition of “joint control” as in IFRS 10, the requirements of IFRS 10 must be considered, if potential voting rights exist.

Understanding the purpose and design of the potential voting right, including the context in which it was issued or granted, is important to evaluating whether the potential voting right is substantive and, if so, whether joint control exists.

If the potential voting right is substantive, then the holder could have joint control together with the other parties, if the terms of the contractual arrangement create an implicit case of joint control. For this to be the case, the holder and the other parties to the arrangement need to: (1) collectively control the arrangement; and (2) unanimously agree to direct the relevant activities of the arrangement.

In some cases, it may be difficult to determine whether a party’s rights give it power over an arrangement. In such cases, the party considers other evidence that it has the current ability to direct the relevant activities. This evidence is also considered when evaluating if the parties to an arrangement control that arrangement collectively (i.e., in the evaluation of joint control).

IFRS 11 states that decisions about the relevant activities require the unanimous consent of all the parties, or a group of the parties, that collectively control the arrangement. Accordingly, it is not necessary for every party to the arrangement to agree to have unanimous consent. To have unanimous consent, only those parties that collectively control the arrangement must agree.

The requirement to have unanimous consent ensures that no single party controls the arrangement. While the requirement for unanimous consent is not new, IFRS 11 clarifies when unanimous consent exists. For example, in some cases, a contractual arrangement may require a minimum proportion of the voting rights to make decisions. When that minimum can be achieved by more than one combination of the parties agreeing, the arrangement is not a joint

arrangement unless it specifies which parties (or combination of parties) are required to agree unanimously to decisions about the relevant activities of the arrangement. IFRS 11 provides some examples to illustrate this point, which are summarized in Diagram 2.

Diagram 2 — Joint control?

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

Conclusion. In our opinion, in the Scenario 2 joint control exists. If the purpose of qualification of joint venture (arrangement) in accounting is providing users with reliable financial information about each party's joint venture (arrangement) operations, then the concept "joint control" should be attached not to a combination of parties of joint venture (arrangement), but to a party. That is, if a party of joint venture (arrangement) is constantly involved in making decisions regarding the significance of activities, then the party has joint control over the activities.

As a conclusion the joint venture (arrangement) should be defined as an “arrangement of which at least one party has constantly control over the activities” and this offer can be justified as the result of changes made in definition of “joint control”.

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