Accounting and Finance
Master Thesis No 2001:3

Valuation Procedures for Portfolio Investments

- A Comparative Study between Investment Companies in Sweden, the United Kingdom and the United States -

Peter Lantz, Niklas Ramstedt & Johan Stebrant

Graduate Business School
School of Economics and Commercial Law
Göteborg University
ISSN 1403-851X
Printed by Elanders Novum AB

Acknowledgements

This thesis concludes our Master's degree at the Integrated Masters Program in Accounting and Finance at the School of Economics and Commercial Law, Göteborg University.

We would like to thank Ernst & Young AB, especially Staffan Landén for the idea for this study and also for his feedback during the course of our work. We would also like to express our gratitude to Anders Mörk at Bure Equity AB for his support throughout the thesis.

Finally, we would like to thank our traveling tutor Jan Marton for giving us guidance and ideas in the process of conducting this Master Thesis.

Göteborg, December 2001

Peter Lantz Niklas Ramstedt

Johan Stebrant

ABSTRACT

Investment Companies are financial intermediaries between investors and investments. Investors buy shares in Investment Companies, which are entities that invest these share revenues in order to make income from dividends, received interests and capital gains on sales of investments. One of the issues an Investment Company has to address in providing useful information is the selection of valuation methods to value the company's investments for financial statement purposes. There are a number of recommendations for valuing these investments produced by organizations, such as EVCA, BVCA and NVCA.

This thesis examines Investment Companies in Sweden, the United States and the United Kingdom and their valuation methods for valuing portfolio companies. The study also analyzes why different methods in certain circumstances are applied and the extent to which valuation procedures in the three countries are harmonized. The study concludes with an examination on how Swedish companies' valuation methods influence the disclosure of the Net Asset Value.

The analysis of the theoretical and empirical findings shows that the valuation methods in Sweden are to some extent focused on EVCA's valuation guidelines. Furthermore, the procedures in the United Kingdom are congruent to the guidelines provided by the BVCA. The analysis of the studied companies in the United States, indicates that the valuation procedures are vague and generally based on the companies' own principles. The result of this research also concludes that there are various degrees of standardization within the three countries, and explains how these differences influence the harmonization process of valuation procedures.

Key Words: *Investment Company, Company Valuation, Asset Valuation, Disclosure, Harmonization, Standardization and Net Asset Value.*

TABLE OF CONTENTS

TABLE OF FIGURES

The introduction chapter gives the reader a background discussion and the research issue for this thesis. The chapter also includes the objectives, scope and limitations and the outline of the study.

1 INTRODUCTION

1.1 Background

The growth of the international financial markets, the activities of multinational companies and the behavior of investors, among other factors, have contributed to the internationalization of economic activity. This phenomenon has meant that financial reporting has extended beyond national frontiers. The analysis and interpretation of accounting information on both national and international level, is hindered by a multitude of factors. One factor is the variety of accounting principles and rules governing their preparation. This has placed more pressure on the financial statement analysts and increased the need for more uniform accounting standards.

All the information included in an annual report can constitute a basis for decision-making and therefore it is of great importance to understand and rely on the information given. (Hägglund, 2001) A difficult issue for investors on the capital market is to understand and create a fair view of a company. Anyone who has glanced at an annual report understands how complicated it is to create an overall picture of the company. The use of financial analysis based on published accounts, is both commonplace and fraught with difficulties. These assessments are especially important to investors making economic decisions based on valuations of the actual company.

Investment Companies are financial intermediaries between investors and investments. The role of Investment Companies in investment markets is increasingly important, as more investors decide to delegate the management of their resources to these companies. Investors buy shares in Investment Companies, which are entities that invest these share

revenues in order to make income from dividends, received interest and capital gains on sales of investments. The three largest markets for Investment Companies are Sweden, the United Kingdom and the United States. (www.vencap.se, 2001-09-20)

The Swedish market for Investment Companies include a number of actors with various objectives and classifications, such as venture capital and private equity. The largest market for Investment Companies in Europe is the United Kingdom. (British Venture Capital Association) Compared to Sweden, this market includes, beside venture capital and private equity also other concepts such as investment trusts and venture capital trusts (VCT). The United States is the largest market for Investment Companies and differs from Sweden and the United Kingdom by a specific type of Investment Company known as closed-end-funds.

1.2 Research Issue

One of the issues an Investment Company has to address in providing useful information is the selection of valuation methods to value its investments for financial statement purposes. In this means, valuation can be regarded as a decision process in which a choice between a number of valuation methods has to be made. A number of organizations worldwide, such as the European Venture Capital Association (EVCA), British Venture Capital Association (BVCA) and National Venture Capital Association (NVCA) have established guidelines for valuation and disclosure of Venture Capital portfolios. Investment Companies are valued for a variety of reasons, where the main reason is that investment managers need to provide periodic valuations during the life of an investment as a part of the reporting process to the stakeholders. The stakeholders need such valuations in order to assess the value of their investments in the company and the performance of the investment manager. (BVCA, 1998) According to EVCA, there is also a need for

greater transparency and consistency of valuation standards. The main reasons for this are:

1. The increasing number and diversity of Investment Companies and its development.
2. Accountants and auditors would welcome a set of recommended industry practices.
3. The need to make the asset class more accessible and comprehensive to potential and exiting investors.
4. The need for greater transparency in order to make it possible for stakeholders to monitor and evaluate the performance and development of the Investment Company.

Investment Companies may invest in both listed and unlisted companies. The latter of these two usually creates a problem in the valuation process. The unlisted companies are by definition not traded on a stock exchange, and conclusively a natural market is not obtainable. This results in a need for Investment Companies to arrive at a fair value of these investments. According to BVCA, the valuation of individual unlisted investments is highly a judgmental process, which cannot be subject to a simple mechanistic formula. There are also some problems relating to the valuation of listed companies. The main problem with valuing listed investments is that even though a market value is accessible, there are issues related to the illiquidity of these investments.

There are a number of methods available for reporting and valuing portfolio companies. These accounting differences create problems both on a national and an international level. Even within one specific country, the company directors may choose accounting policies that differ from those applied by their competitors, which make the validity of any comparison questionable. The level of difficulty is increased if the analysis requires comparison of companies from different countries, as the set of available accounting policies differs from each country. This will also result in less appropriate accounting information for decision-

making. (Radebaugh and Gray, 1997) The problem with low standardization of accounting principles and low consistency could result in the fact that two in practice financially identical companies, would appear differently in the financial statements because of diversity of the applied accounting methods.

The choice of valuation method for valuing portfolio companies, affects the Investment Company's Net Asset Value. The Net Asset Value is a widely accepted and applied concept, especially for companies whose assets are tangible, such as Investment Companies'. A common characteristic for these companies' assets is that there exists a functional market, also known as a second hand market. (Hägg, 1991) In order to use Net Asset Value as a reliable tool for company valuation and decision-making, it is important to understand what items are included and how these underlying values are calculated.

The main issues in this thesis are:

- ✓ How are Investment Companies' portfolio investments valued for the preparation of financial statements in Sweden, the United Kingdom and the United States?

- ✓ What are possible influencing factors for choosing a specific valuation method?

- ✓ How do Investment Companies in Sweden define and disclose their Net Asset Value and how can this be related to the choice of valuation method?

1.3 Objective of the Study

The main objective of this thesis is to describe and analyze how various Investment Companies in Sweden, the United Kingdom and the United States value their portfolio companies for financial statement purposes.

This objective will try to observe to what extent the recommended valuation guidelines published by EVCA, BVCA and NVCA are applied in practice. This implies that the study will also look at the process of standardization and harmonization of valuation procedures for Investment Companies. The secondary objective will include an analysis of how Swedish Investment Companies define and disclose their Net Asset Value to their external stakeholders. This section will analyze if there are any relationships between the amount of information disclosed on Net Asset Value and the valuation methods used for their portfolio companies.

1.4 Scope and Limitations

In order to accomplish a research project, a lot of time has to be spent on answering the given question and describing what kind of methods, theories and empirical findings are used. All the different directions conducted are briefly discussed in this part in order to increase the understanding for the reader.

The methodology chapter will describe the approaches used in order to make it possible to answer the research issues, and it will discuss how the research design has influenced the working process. The methodology part will also provide an insight into the various criteria that the studied companies have been selected from. The last section of the methodology chapter will discuss the quality of the research.

The theoretical part of this thesis will include theories focusing on international harmonization, financial reporting and financial disclosure. The chapter will continue with a description of the characteristics of assets. The last part of the chapter will describe different methods of valuing assets and also provide a broader approach where theories considering company valuation will be described.

The empirical study is limited to fifteen listed Investment Companies that are divided into three geographical areas: Sweden, the United Kingdom and the United States. These fifteen Investment Companies are presented in the empirical chapter, where also each company's valuation method is described.

Finally, this thesis is written primarily for anyone who wants further knowledge about asset valuation for Investment Companies and how these procedures are disclosed to external interest groups. We assume that the readers have some basic knowledge of corporate finance and accounting theories and that he or she wants to increase their knowledge in this certain area.

1.5 Definition

The market for companies that invest in other companies consists of a large number of classifications, such as Investment Companies, venture capital, private-equity, investment trusts and closed-end funds. In this study, these concepts will be referred to as Investment Companies, and will be defined as: *A company with the objective of creating value to their shareholder, by investing in listed and unlisted companies.*

1.6 The Outline

Figure 1 below describes the research process and how different chapters are connected in order to fulfill the objectives given earlier. The five boxes constitute the main chapters, which are all used as a basis for the conclusion.

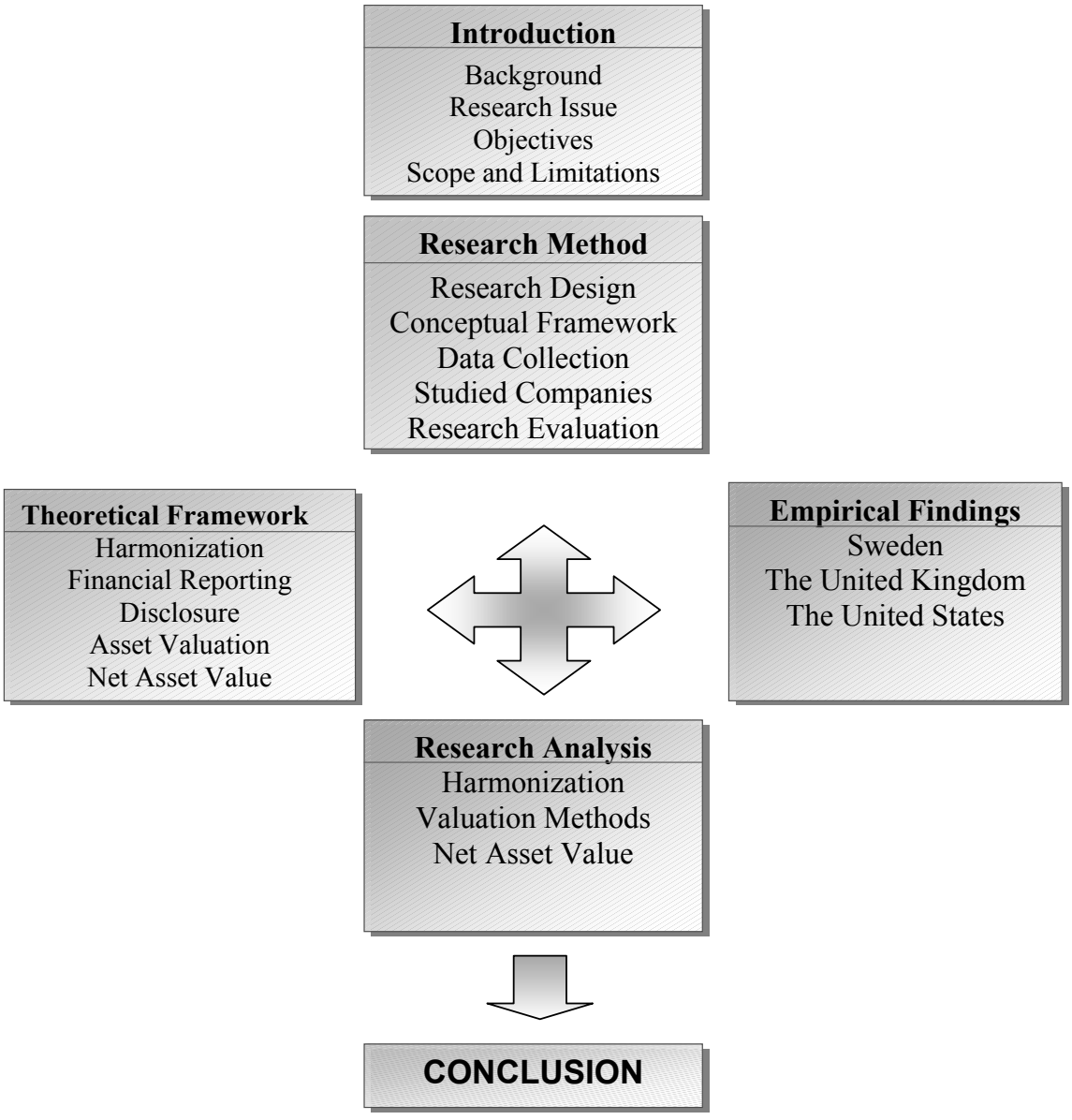

Figure 1 The Outline

This chapter explains and justifies the progress in our research. The chapter includes the research design, the conceptual framework, the choice of data collection and research evaluation discussion.

2 RESEARCH METHODOLOGY

2.1 Research Design

An important notion of the research process is to develop an efficient and relevant research design or strategy. This strategy will ensure that the collected data are consistent with the objectives of the study. A research design describes how the samples, measures and treatments are implemented in the progress of the study in order to assess the effects and outcomes of a certain treatment. Various research designs have certain advantages and disadvantages depending on the objectives of the study. There are five main categories of research design approaches: descriptive, explanatory, explorative, predictive and prescriptive. (Lekvall & Wahlbin, 1993)

The **descriptive approach** is primarily used when the researcher is interested in showing the characteristics of a specific and often well-defined problem area.

The **explanatory approach** entails that the researcher wants to establish causal relationships between a fairly large number of variables.

The **explorative approach** is used when the researcher has limited knowledge about the subject area and there is a need to identify what research issues to address. This approach is common during the initial phase of larger research projects in order to specify the certain research problem.

The **predictive approach** is adopted when the researcher aims to do a prognosis for the future development of a phenomenon. However, this

does not imply that the researcher has established any causal relationships underlying the development.

The **prescriptive approach** is based on the researcher identifying what should happen or ought be done. This approach often includes elements of value judgments and theoretical speculations.

The research conducted in this thesis is based on a combination of a descriptive, an explorative and an explanatory approach. The descriptive approach is used to describe the certain phenomena but there is no attempt to generalize the findings into theory. In a descriptive approach only the essential aspects of the phenomenon are investigated. The reason for applying the descriptive approach is that the study aims to describe the existing theories within the financial and accounting framework. Furthermore, this approach is also applied because the thesis aims to describe the existing valuation methods within the studied countries.

As stated above, the explorative approach is used when the researcher has a limited knowledge about the subject area and there is a need to identify what research issues to address. We have applied an explorative approach because the thesis is not based on past research since there are a limited number of research projects conducted on this issue. Another factor for using the explorative approach is that the objective is not to draw any statistical conclusions based on our empirical findings. The explanatory nature of this study can be distinguished in the manner that the analysis attempts to explain why certain valuation procedures have been applied. These explanations will try to answer the research issue on both a national and international level.

2.2 Quantitative or Qualitative Method

The research design can either be categorized into a *quantitative* or *qualitative* nature or a combination of both. The most important

distinction between these methods is that the quantitative method reverses the information received into numbers and from these results a statistical analysis is performed. (Holme I.M & Solvang B.K, 1997) According to Lekvall and Wahlbin (1993), quantitative data is primarily used when the aim of the research project is to answer questions like: How often? How much?, How many? or How usual?, i.e. there is an aspiration to quantify the result.

In a qualitative approach it is the researcher's conception or interpretation of the information that is vital. Qualitative data is often suited for research projects that aim to understand or find a specific pattern within the investigated area. In this approach the researcher collects the information that will be analyzed and interpreted. (Holme I.M & Solvang B.K, 1997)

The method used in this study is more of a qualitative nature. The empirical findings are based on annual reports and the objective of the study is not to draw any statistical conclusions. Instead the thesis aims to find specific patterns in the valuation procedures both at a national and international level. Furthermore, the analysis of the factors determining the choice of valuation method is to some extent based on our interpretation of the collected data, which is in line with the qualitative approach. Nevertheless, the research design has also a few quantitative features. This approach is applied when determining the extent to which valuation procedures are standardized within each country and also in the process of establishing the degree of harmonization.

2.3 Conceptual Framework

According to Patel and Davidsson (1994) there are two perspectives of science in modern research. These two perspectives are the positivistic approach and the hermeneutic approach. In the positivistic approach there is a strong relationship between science and items that are not science.

The main purpose of the research in this method is to explain a phenomenon with the help of cause and effect. (Patel & Davidsson 1994) The positivistic framework focuses on drawing conclusions based on empirically determined knowledge. A researcher adopting a positivistic framework aims to measure the research issue in an objective way. This means that the researcher is in an external position to the subject, which should be examined. (Eriksson & Wiedersheim-Paul, 1999)

The hermeneutic approach has a strong emphasis on the overall view, i.e. no single phenomenon can be comprehensive unless it is not seen as a part of the overall picture. (Patel & Davidsson 1994) The hermeneutic method interprets text and text-like documents in a process, which yield a better understanding of the subject. The hermeneutic approach also indicates that experiences can be gathered, analyzed, and interpreted. These interpretations have to be tested in order to reach knowledge about a subject. (Eriksson & Wiedersheim-Paul, 1999)

We will adopt the positivistic framework in our research. The main argument for this is that based on empirical findings we will identify the valuation procedures in Investment Companies and attempt to explain these procedures with the help of causes and effects. Moreover, because of the information sources used in the study, we have taken an external position in relation to the companies studied, and therefore we believe that the positivistic approach will be appropriate for this study.

2.4 Choice of Data Collection Method

It is common to make a distinction between two different types of data, namely primary and secondary data. Primary data is information collected and used for the first time, and usually through direct examination, whereas secondary data consists of information already available, i.e. it has been collected or produced by a third party and perhaps for a different purpose (Eriksson & Wiedersheim-Paul, 1999). Secondary data can be

divided into two sub groups, internal and external. Internal secondary data are available within the company/organization and external secondary data are provided by sources outside the company/ organization. Relevant research data can be obtained from a variety of sources. (Lekvall & Wahlbin, 1993)

This research will be based on external secondary data in the form the Investments companies' annual reports. These are either collected from the companies' home page or ordered directly from their investor relations department. The main advantage of starting the data collection process with secondary data is that it provided the possibility to establish a thorough understanding of Investment Companies' valuation procedures.

The empirical chapter constitutes the information on the valuation procedures obtained from the annual reports. This information is mostly found as footnotes to the financial statements. However, we have also included other information, besides footnotes, disclosed in the annual report that considers information on the valuation procedures of portfolio companies. The information provided in the empirical chapter is mainly taken directly from the annual reports in order to reduce any possibilities of misinterpreting the collected data. The process of how the empirical data has been interpreted and used in the analysis is explained in section 6.1.

The literature used in this study creates a framework for the analysis of empirical data. In order to elevate the understanding of the research issue area we started by collecting literature, scientific articles and branch magazines. The information about relevant literature is gathered from the library computer systems LIBRIS and GUNDA, CD-ROM databases and the Internet. Key words used when searching in different databases were mainly: *Investment Company, Company Valuation, Asset Valuation, Disclosure, Harmonization, Standardization and Net Asset Value* or different combination of these. The literature regarding Investment

Companies' valuation procedures for portfolio companies were very limited. Nevertheless, it was fairly straightforward to obtain material in related areas such as harmonization, creative accounting, financial disclosure, asset valuation and company valuation.

2.5 Sample of Studied Companies

It is common to divide the sample selection methods into two main categories, the probability sample and the non-probability sample. In the first case the probability sample involves random sampling which makes it possible to calculate statistical inference and estimate confidence intervals, where as the non-probability sample method is based on more qualitative and intuitive estimation levels of inferential results. When using a non-probability sampling method it does not have to mean that the samples are not representative of the population. But it does mean that non-probability sampling method not will be able to depend upon the rationale of probability theory. However, in applied scientific research there may be circumstances where it is not feasible, practical or theoretically sensible to do random sampling. Most of the non-probability sampling methods are purposive in nature because the research approach has a certain plan behind the sampling method chosen. When adopting a purposive non-probability sampling method, the sampling is constructed with a certain purpose in mind. (Lekvall & Wahlbin, 1993)

The main concern with this study was to obtain a sample that would allow us to fully address our research problem, rather than establishing a statistically acceptable level of inference. In order to increase the credibility of the research it is important to obtain a sample that is considerably representative, since a well-defined sample will result in that more significant conclusions can be drawn. This study will therefore adopt an illustrative approach, based on the non-probability sampling, in order to address the research problem.

In order to obtain a sample that would allow to fully address our research problem we established certain criteria that we determined as important. These criteria can be divided into four categories: the industry aspect, the geographical aspect, the portfolio structure aspect and the financial disclosure aspect. The first and the second criteria were studied simultaneously, due to the fact that industry aspect was given in the research issue. The choice of using Sweden, the United Kingdom and the United States was based on the fact that these countries are, according to the European Venture Capital Association, the three largest markets for investment and venture capital. Because of the size of these markets, we believed that these countries would include the companies that apply the most developed valuation guidelines. The sample process started with a more in depth determination of the total population of Investment Companies in Sweden, the United Kingdom and the United States. To define the population we searched in literature and on the Internet for Investment Companies in these countries.

The third criteria considered the portfolio structure of the Investment Companies. The criteria for portfolio structure states that the studied companies have to carry unlisted investments in their investment portfolio. The reason for this is that the study would be rather irrelevant if the companies' portfolios consisted of only listed investments, since these are valued at market and therefore no need for analyzing the valuation procedure is necessary. The fourth criteria states that the companies need to provide certain information. It became clear that there were several companies that would meet the first three criteria, but the availability of information on the companies valuation procedures in the annual reports was in many cases very restricted and therefore the selection process was limited to the companies that made it possible to reach the information needed.

This selection process ended up with 5 Investment Companies for each country. These companies constitute a representative and illustrative picture of their respective market.

2.6 Research Evaluation

When conducting research of any kind, it is of great importance to measure the quantity of possible faults and errors that might influence the quality of the empirical findings. In order to decrease the effect of these kinds of errors, there are a few tests that can be used to estimate and judge the significance of the research. These tests are known as the research validity and reliability. To be able to achieve a high level of credibility for the conclusions presented in this thesis, it is important to demonstrate that the research was designed and conducted in such a way that it accurately identifies and describes the phenomenon that was investigated. In order to do this it is important to describe issues concerning the research projects validity and reliability. (Ryan, Scapens & Theobald 1992).

2.6.1 Validity

Validity is one element of science research, which addresses the issue of whether the research actually measures the things it aims to measure, and that nothing irrelevant affects the result. According to Lekvall and Wahlbin (1993), validity can be divided into constructive, internal and external validity. *Constructive* validity concerns whether there is a correct relationship between theories and empirical findings. *Internal* validity approximates truth about inferences regarding cause-effect or causal relationships. Thus, internal validity is only relevant in studies that try to establish a causal relationship and therefore it will not be discussed further in the research. *External* validity considers whether the findings can be generalized and provide conclusions regarding other situations than the specific case studied.

In order to achieve a high level of validity we were thorough when defining the research design so that the reader can structure his or her own opinion about the data collection and how this data has been analyzed and interpreted. The validity of this research can be considered

to be fairly high, because the sampled companies have been carefully selected on certain criteria specified in section 2.5. We have also applied an iterative approach, which means that the study is based on an interaction with the empirical findings and the theoretical framework. This iterative approach in combination with the fact that we have stated the research issue and design carefully, we believe a rather high level of constructive validity is reached. Nevertheless, the validity could deteriorate due to the fact that annual reports might be considered as subjective, hence it is the companies themselves that formulate these reports and they therefore strive to provide a good picture as possible to their different stakeholders.

2.6.2 Reliability

Reliability considers the quality of measurement. It clarifies to which extent the findings can be replicated when using the same research method, i.e. if the measurement tool will generate the same or similar results if another researcher that follows the same procedure replicates it. Since this report is based mainly on qualitative data, the main issue is whether the results are consistent with the collected data. (Lekvall &Wahlbin, 1993).

During this study we have taken many precautions and verified the information, which implies that the research has not made any significant errors that impact the reliability of thesis. Since our research project is executed using 15 different companies in three countries, operating in a very large market, it would be very hard to replicate this study. It is therefore unattainable to make sure that if the same research was conducted the results would be exactly comparable. When it comes to qualitative research, opinions change and procedures improve over time and therefore it would be more appropriate if replicate research was conducted at the same time as this study.

The empirical chapter includes Investment Companies that disclose extensive information on their valuation procedures, which reduces the need for subjective interpretations of the collected data. Nevertheless, the analysis will still be based on the researchers' own interpretations of the empirical information, because the analysis is only based on the external information that the studied companies provide. Due to the use of these interpretations, the research would again be fairly difficult to replicate. However, we believe that our thesis is still trustworthy since all sources of information were documented carefully. Furthermore, the empirical findings have a good relation with the theories, which will enhance the reliability and therefore we can conclude that our findings are significant with the collected data and that our study is reliable.

2.7 Summary

The methodology chapter is the basis for the study and makes it possible to answer our research issues that we performed. The research design is considered to be a combination of a descriptive and an explorative approach. Furthermore, the approach is also deductive within a positivistic framework. The data gathered and analyzed is principally of secondary and qualitative character. Due to the information and data congregated, the last part of this methodology chapter evaluated the research from our perspective and gives the reader a basis for establishing own judgments.

This chapter outlines the theoretical framework related to the research issue. The theories included in this chapter are the basis for the analysis of the empirical findings.

3 THEORETICAL FRAMEWORK

3.1 Introduction

This chapter will outline and explain the major accounting and financial theories related to the valuation procedures of portfolio companies in Investment Companies. The chapter will start with a section that defines and explains the harmonization process. This section is followed by a presentation of the basis for financial reporting, where an historical aspect is applied in order to understand the current reporting issues. This section will be followed by a description of financial disclosure including the pressures for disclosing, but also the motivational factors for disclosing additional information. The theoretical framework will thereafter describe the characteristics of different assets and their respective valuation procedures. The chapter will conclude with theories regarding company valuation, where the concept of Net Asset Value will be discussed. The outline of the chapter is shown in the figure below.

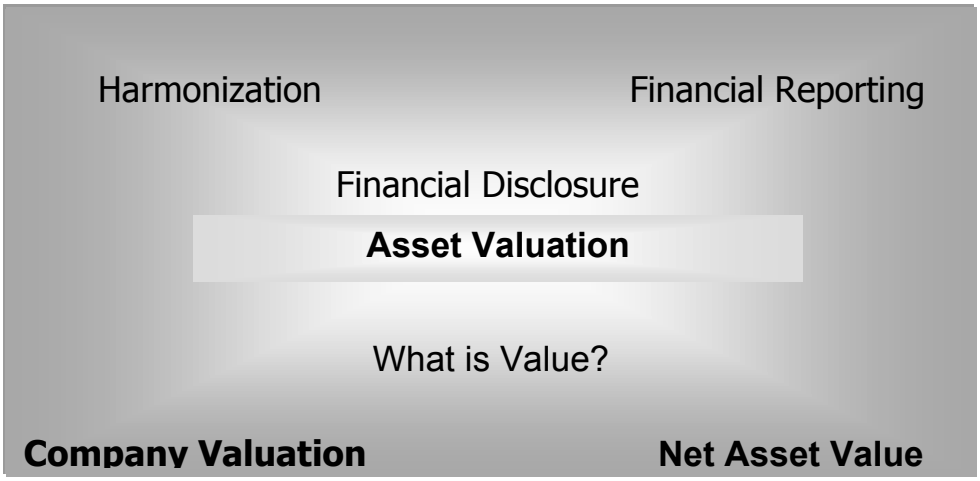

Figure 2 Theoretical Framework

3.2 Harmonization

3.2.1 Harmonization vs. Standardization

Over the last 15 years there has been increasing interest in the harmonization process of accounting and financial reporting. International accounting harmonization may be defined as *"the process of bringing international accounting standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure"* (Haskins, Ferris, Selling 1996).

Harmonization of accounting standards means that the differences in accounting principles among nations should be kept at a minimum. Different and alternative accounting standards and rules may exist in different countries as long as they are in "harmony" with each other and can be reconciled. Harmonization implies further that any departure from the accounting standards needs to be disclosed and information regarding the impact of this departure has to be provided. When the degree of concentration for an accounting method increases, the state of harmony increases and harmonization has occurred. (Walton et al, 1998)

Related to harmonization is standardization, which is used to measure the application of exactly the same rules. The objectives of standardizing accounting principles are to ensure comparability of financial information. Standardization does not accommodate the national differences and it is therefore more difficult to adopt internationally. Harmonization on the other hand, is much more flexible and does not fit all countries' approaches. The result of the discussion above is that international standardization of accounting principles tends to be impossible while harmonization is an effort towards the narrowing of differences and to create a higher degree of international comparability. (Walton et al, 1998)

The expansion of international trade and the accessibility of foreign stock and debt markets have been a force in increasing the debate of whether or not there is a need for a global set of accounting standards. As companies compete globally for limited resources, investors, and creditors, as well as multinational companies, are required to accept the cost of integration financial statements prepared using national standards. (Walton et al, 1998) The figure below gives an overall picture of various accounting differences and why these occur.

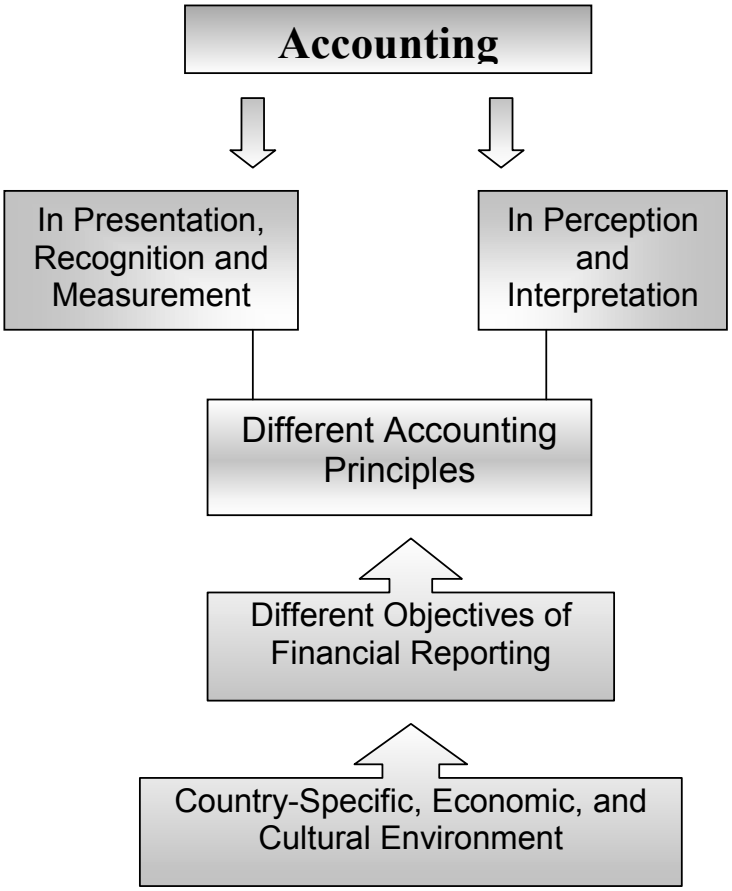

Figure 3 Reasons for the international accounting problem

Source:Walton et al, 1998

Differences in accounting principles are said to create a number of problems. Three of the most frequently mentioned are according to Artsberg (1995):

1. Problems for the company since they have to draw up their accounts according to several different systems. This creates additional work and it is sometimes hard to choose between the most accurate systems.
2. Problems for the groups that have to read and interpret the accounts.
3. A general problem of unfair conditions since accounting has economic consequences. The accounts are a base for decision-making about potential investments and also a base for decisions such as dividends, wage negotiations and taxes.

Different stakeholders have various interests in companies' financial disclosure. Radebaugh and Gray (1997) present a model showing the participants and pressures for international harmonization. These different interest groups are investors, bankers and lenders, governments, employees and trade unions, the general public and, accountants and auditors. The underlying reason for these pressures is the belief that more standardized financial disclosure will enhance comparability of corporate performance and prospects and therefore perceive constant economic benefits.

3.2.2 Reaching Harmonization

Efforts have been made by a number of organizations to reduce the differences between accounting systems. The very first effort to harmonize the accounting standards and the financial reporting process began even before the foundation of the International Accounting Standards Committee (IASC) in 1973. Companies raised capital outside of their home markets and investors attempted to diversify their portfolio internationally and problems regarding this occurred. The International

Accounting Standards Committee (IASC) formalized the coordination of efforts, to compile an international set of standards, in 1973.
Their objective is to:

"work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements".

In response, the European Union's fourth directive illustrates the concept of harmonization and they require all limited liability companies in the EU to issue audited financial statements that "give a true and fair view of the company's assets, liabilities, financial position and profit or loss" (EC Commission, 1978). The Fourth Directive of the European Commission introduced this requirement into European company laws, but the precise meaning of the phrase "true and fair view" remains unclear. The relevance of this issue for financial reporting lies in its implications for the underlying goal and purpose of financial reporting. The British view has traditionally been that the primary purpose of financial reporting is to provide information for investor decision-making, while the continental European view has articulated several purposes for financial reports which may be collectively gathered under the term *"corporate governance"*.

3.2.3 Harmonization and the FASB

In FASB Statement of Financial Accounting Concepts No.2 *"Qualitative characteristics of Accounting Information",* the notion of comparability is expressed. The main theory is that information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark. The

purpose of comparison is to come across and explain similarities and differences.

Another consideration relating to the term comparability is the notion of consistency. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users that base their analysis on the available information. Consistency can be defined as the quality of the relationship between two accounting numbers rather than a quality of the numbers themselves. The main problem regarding consistency is that if consistent use of accounting principles from one accounting period to another is taken too far, this can hinder the accounting progress. (SFAC 2, 2001)

3.3 Basis for Financial Reporting

Elliot and Elliot (2000) state that accountants are communicators, whose main objective is to communicate financial information about a business entity to its stakeholders. The information is communicated in the form of financial statements, which provides information in money terms regarding the economic resources controlled by the management. The authors indicate further that the art lies in the selection of information that is relevant to the users and reliable.

According to Glautier and Underdown (1990), the financial reporting has arisen from the grant of Joint Stock company status to business firms, but also as a consequence of the separation of ownership and management. Traditionally, financial reporting has been based on the stewardship concept of accounting, which is concerned with protection of fraud by the managers and to give some prevention against the possibility of malpractice by company managers. In recent years the traditional stewardship concept has been extended to include meeting investor needs for the purpose of decision-making. This decision-making view has developed to include all users that have an interest in an organization's

business, and not only the shareholders and investors. Thus, according to the authors, the development of financial reporting has resulted in three different views of financial reporting and its objective:

1. The traditional view of financial reporting is based on the concept of stewardship accounting. The reports should focus on the stewardship of the resources, with which the management has been trusted.
2. An extended view of stewardship accounting includes the recognition that shareholders and investors are decision makers who require information for that purpose. This decision-making concept of financial reporting implies, that the main objective with financial reporting is to produce relevant information for shareholders, who are concerned with optimal allocation of their resources.
3. A more modern view, considers that the company should not just report to shareholders and investors, but also report to a larger class of general users. All parties who have an interest in an organization have a right to information about the organization's activities.

A combination of the two latter approaches results in a view of financial reporting which are in accordance with FASB Conceptual Framework. The FASB in Concepts Statement No. 1 paragraph 34 states the basic objective of external financial reporting as follows:

" Financial Reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions."

The various groups of information users have a common concern: to make decisions about the allocation of scarce resources between different alternatives. The objective of financial reporting is therefore to permit stakeholders to make optimal decisions and to make the best allocation of the resources under their control. The financial information should also make it possible to assess the actual result of their decisions with the forecasted result. (Glautier and Underdown, 1990)

The view that accounting information is helpful in the decision-making or evaluative process is widely accepted, and also described in Moonitz's (1961) first postulate:

"*Quantitative data are helpful in making rational economic decisions, i.e., in making choices among alternatives so that actions are correctly related to consequences."*

Kam (1990) agrees that this decision-making aspect of financial reporting is not only based on the information regarding the stewardship function. Kam's standpoint is based on three concepts. First, potential investors and creditors should also be included as users. Second, financial information should be seen as input data for prediction models of users. It is therefore important to focus on providing information that is relevant to use in these prediction models. Third, whereas stewardship mainly provides information about the past, predictions are made for the future, i.e. the financial information needs to be future oriented. Kam's standpoint is in accordance with FASB Conceptual Framework. Statement of Financial Accounting Concepts (SFAC) No 1, paragraph 38, states:

" *Investors, creditors, and others need information to help them form rational expectations about those prospective cash receipts and assess the risk that the amounts or timing of the receipts may differ from expectations, including information that helps them assess prospective cash flows to the enterprise in which they have invested or to which they have loaned funds."*

3.4 Financial Disclosure

3.4.1 The Development of Financial Disclosure

Choi and Muller (1999) describe financial reporting as a process, which is based on four procedural steps: perception, symbolizing, developing and communication. The main objective with the last step, communication, and what simultaneously constitutes disclosure, is to provide a base for decision-making. Without disclosure, accounting measurement serves a non-useful purpose. Corporate disclosure is critical for the functioning of an efficient capital market. Firms provide disclosure through regulated financial reports, including the financial statements, footnotes, management discussion and analysis, and other regulatory statements. In addition, some firms engage in voluntary communication, such as management forecasts, analysts' presentations and conference calls, press releases, Internet sites, and other corporate reports. Finally, there are disclosures about firms by information intermediaries, such as financial analysts, industry experts, and the financial press. (Radebaugh & Gray, 1997)

A starting point for the development of information disclosure was the recognition of corporations as legal entities, with a public ownership of shares and the right of limited liability. The aim with information disclosure was from the beginning to assist creditors in determining the extent to which they were prepared to commit resources to the company and to show the use of these resources they had committed. Information disclosure has been influenced by two main developments: the growth of professional management and the emergence of stock markets. Information disclosure enables stakeholders to make sure that the management behaves in a manner that is in accordance with the owner's interest. The development of the capital market was a result of the demand for finance in the form of shares. The growth of stock markets necessitated the expansion of information availability to a wider

audience, and also served to both deepen and broaden disclosure. (Gray, McSweeney & Shaw 1982)

3.4.2 Pressures for Financial Disclosures

In recent years, the amount of information disclosed by companies has expanded considerably. The pressure for increased disclosure comes above all from the financial and investment community. The demand for more information has also increased in other participant groups, including government, trade unions, employees and general public. Each participant group has their common and unique concerns. Investors are those who have the closest relationship with the company and the access to corporate reports and use them significantly as a basis for decision-making. Bankers and lenders like investors and financial analysts, focus their information needs on corporate information. There are some apparent differences though. Bankers and lenders for example, put more emphasis on risk adjustment regarding loans and other mortgages. (Radebaugh & Gray, 1997).

Both companies and standard-setting bodies in countries with well-developed security markets, such as the United States and the United Kingdom have responded to this pressure. The increasing inter-nationalization of financial market and share ownership, combined with an enlarged awareness of the differences in accounting principles and practices in different countries has increased the demand for additional disclosure to increase the quality and comparability. The emphasis is on timely, future-oriented and disaggregated information. (Radebough & Gray, 1997)

3.4.3 Benefits vs. Costs of Financial Disclosure

Iqbal, Melcher and Elmallah (1997), mean that there are a number of practical motivational factors for corporations to make financial reporting disclosure. Corporations may provide voluntary disclosure when benefits

are expected with little or no risk of adverse effects. Due to the globalization of capital markets, corporations are now able to raise capital from different parts of the world and may therefore choose to voluntarily disclose additional information for self-interest. The company may be able to obtain capital at a lower cost by reducing uncertainty and associated risks to the providers of capital by additional disclosure beside the regular information requirements. Choi and Muller (1999) choose to define this form of disclosure as corporate disclosure. They mean that corporations do not just compete with each other, but also attempt to obtain capital at the lowest cost as possible. Thus, according to the authors, the main objectives with corporate disclosure is to attract capital from the market and lower the uncertainty for investors to invest which results in lower cost of capital for the company. Other reasons, for voluntary disclosure, are according to Iqbal et al (1997):

- ✓ Educating users of financial reports and information regarding operating conditions, outlooks, reasons for specific corporate actions etc.
- ✓ Image building may create goodwill that could result in future economic benefits, for instance, social responsibility disclosure.
- ✓ The corporation may make voluntary disclosure in self-interest if there is a risk that non-disclosure could result in governmental regulation or control.

Radebough and Gray (1997) also state, in accordance with Iqbal et al (1997) that the approach that disclosure may lead to lower cost of capital through the reduction of uncertainty regarding a company's financial performance. Radebough and Gray conclude their proposal by arguing that additional disclosure could also be a consequence of the fact that managers hold stocks in the company, and therefore are concerned that the stock price fully reflect the performance and the prospects of the company.

Even though there are a number of benefits related to additional disclosure, there are also various costs related to it. The total costs of financial reporting disclosure are not limited to the monetary cost of installing and maintaining an accounting system for collecting, processing and reporting financial information. One common threat regarding additional disclosure is that the information obtained through disclosure may be used for making decisions that are not in the best interest of the company that provides the information. Iqbal Et al, (1997) Radebough and Gray (1997) consider that competitive disadvantage is the most frequently cited objective against increased disclosure. Competitive advantage is defined as the use of additional information to the detriment of the corporation disclosing the information. A general rule states that the more future oriented a disclosure is, the bigger potential competitive disadvantages for the provider of the information.

3.5 Creative accounting

Hendriksen and Breda (1993) state that the availability of many alternatives within accounting rules permits a company to choose between different accounting methods. This possibility allows a company to select the accounting policy that gives the most preferable picture of the company. This assertion is usually called creative accounting and depending on the perspective the concept has a number of definitions. According to Jameson (1998), creative accounting consists of dealing with many matters of judgment and of resolving conflicts between competing approaches to the presentation of the result of financial results and transactions. This flexibility provides opportunity for manipulation, deceit and misrepresentation. Another definition of creative accounting is presented by Naser (1993), who characterizes the concept as: *the transformation of financial accounting figures from what they actually are to what prepares desire by taking advantage of existing rules and/or ignoring some of them or all of them.* Naser (1993) means further that the flexibility and the inconsistency of the existing accounting principles

stated by different accounting associations, together with legal requirements permits a variety of alternatives practices. This can result in a tailor-made accounting procedure where the objective is to meet the individual needs of a company, which concludes that the financial statements will give a misguided or irrelevant impression of the company's financial position. According to Naser (1993), the following five factors motivate managers to adopt creative accounting:

1. Misinformation, signaling and financial motives

In the context of creative accounting, misinformation means being economical with the truth by reporting correct but incomplete information. Signaling means that the company might report their superior information if, and only if, they feel it is beneficial to provide the information. Companies may hide information to improve the financial statements and also employ creative accounting to report better financial ratios.

2. The agency and the political cost incentives

Accounting researchers argue that any adopted accounting procedure will affect the cash flow of the firm's operations. This will in turn affect, among others, compensation plans and political issues. The management will therefore manipulate the accounting figures to meet the requirements in maintaining high levels of compensation. The management will also use creative accounting to reduce earnings and get away from political pressures, in form of taxes and also to increase subsidies to the company.

3. Poor management

There is also a relationship between the use of creative accounting and poor management. Poor management tends to neglect the accounting system of accounting information and will not respond to change. One common characteristic of poor management is the use of high levels of debt to finance the operations, which results in deteriorating financial ratios. Poor management therefore involves the use of creative accounting to reduce these weakening ratios.

4. Reducing uncertainty and risk

Creative accounting is employed as a result of increased volatility in the related market elements such as interest, inflation and exchange rates. The movement from fixed currency to floating exchange rates resulted in greater uncertainty. The sharp increase in the inflation rates together with growing changes in interest and currency rates contributed also to new financing methods and therefore to the need for forward contracts. Furthermore, it is obvious that in a more uncertain environment, it becomes highly motivated to adopt instruments to reduce associated risk.

5. Pressure from big institutional investors

It could be argued that the users of financial information may contribute to the use of creative accounting. Today, the pressure on companies to report flattering results is greater than ever before. A combination of the increasing power of the big institutional investors and more interest and greater share of ownership by individual investors has forced companies to focus more on their results to meet the demand from the stock market. The demands from the stock market include that the company produces a steady growth in profits and earnings and that it consistently corresponds with the expectations. These pressures and demands have led to innovations in and use of accounting creativity, which makes it increasingly difficult for users of financial information to discern fact from fiction.

According to Amat, Blake, and Dowds (1990), the various methods of creative accounting can be divided into four categories.

1. The accounting rules allow a company to choose between different accounting methods. A company can therefore choose the accounting policy that gives their preferred image.
2. Certain entries in the accounts involve an unavoidable degree of estimation, judgment and prediction. In some cases these estimations are done inside the business and the creative accountant has the opportunity to either make the estimations in an

optimistic way or in a pessimistic way. In other cases an outside expert is conducted to make estimates. In this situation the creative accountant has two possibilities to manipulate the valuation. The first possibility deals with the way the valuator is informed by the management and second by choosing a valuator known to take a pessimistic or an optimistic view, depending on what the accountant prefers.

3. Artificial transactions can be entered to manipulate the balance sheet amounts but also to move profits between accounting periods.
4. Genuine transactions can also be timed to give the desired impression in the accounts.

3.6 What is an Asset?

3.6.1 Definition of Assets

In order to define and categorize assets it is essential first to clarify the meaning, importance, and principal characteristics of an asset (Sharp 1995). Although there is much debate in management, marketing, finance, and economics literature as to what constitutes an asset or a resource (Mahoney and Pandian 1992). An asset can be defined broadly as any physical, organizational, or human attribute that enables a firm to generate and implement strategies that improve its efficiency and effectiveness in the marketplace. Thus, assets can be tangible or intangible, on or off the balance sheet, and internal or external to the firm. However, regardless of the type of asset, the definition clearly emphasizes that the value of any asset is ultimately realized, directly or indirectly, in the external product marketplace.

Paton (1940) defines assets as properties that possess some form of value i.e.“*a property is any consideration, material or otherwise, owned by a specific business enterprise and of value to that enterprise”*

An asset is defined by the FASB as "*probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events."* Assets are "probable" because they refer to the future and thus can only be "reasonably expected or believed on the basis of available evidence or logic. (SFAC, 1980)

According to the FASB, an asset has three important characteristics. Firstly, it embodies a probable future benefit that involves a capacity, by itself or in combination with other assets, to contribute to future net cash inflows. Secondly, a particular entity can obtain the benefit and control other's access to the asset and finally the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. (SFAC 6 paragraph 26)

According to IAS statement 32, a financial instrument "*is any contract that gives rise both to a financial asset of one enterprise and a financial liability or equity instrument of another instrument."*

A financial asset is any asset that is:

a) cash;
b) a contractual right to receive cash or another financial asset from another enterprise;
c) a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favorable; or
d) an equity instrument of another enterprise.

In order for an item to be recognized in the financial statements as an asset, FASB has stated four fundamental recognition criteria that should be met. These four criteria are:

Definitions- The item meets the definition of an element of financial statements.

Measurability- It has a relevant attribute measurable with sufficient reliability.
Relevance- The information about it is capable of making a difference in user decisions.
Reliability- The information is representationally faithful, verifiable and neutral.

3.6.2 Classifications of Assets

Assets have to be classified on the company's balance sheet. The two main groups are fixed assets and current assets. A fixed asset is defined as *an asset held for use on a continuing basis* and the definition of a current asset is, *not intended for continued use but held on a short-term basis*. The fixed assets are further divided into tangible and intangible assets. Examples of intangible assets are copyrights, intellectual property, goodwill and patents. Tangible assets are for instance land, buildings and cash. Financial assets can both be treated as fixed assets or as current assets depending on the time perspective of the investment. (www.xrefer.com, 2001-10-25)

Investment Companies consist mostly of fixed assets. An advantage concerning fixed assets, according to Griffiths (1990), is that their values are completely mobile. The assets are for many companies the backbone of the business, which allow the company to carry out its operation. Despite their importance, the rules or methods regarding the reported values are remarkably flexible. The value placed on the assets can be adjusted either upwards or downwards almost at will. The base for this flexibility is embodied in company law and in guidelines, which permits a number of different bases for valuations of fixed assets to be adopted. The possibility to use the most suitable method can lead to different pictures of two identical companies and a consequence of this is colored and misleading information regarding decision-making for actors on the market.

3.7 Asset Valuation

3.7.1 Asset measurement practices in UK, US and Sweden

In many ways the accountings systems in the United States and the United Kingdom are very similar, which can be seen as a result of historical and investment connections between the two countries. In both these countries the securities markets have significant influences on the accounting practices. Accounting in Sweden, on the other hand, has been more influenced by legal and taxation requirements, which has encouraged a more conservative accounting approach. (Radebaugh & Gray, 1997)

In the United States, accounting is focused very much on the interests of investors, even though the needs of creditors and other users are recognized. The accounting practices in the United States regarding asset measurement tend to be a strict historical cost approach. However, these historical values are subject to adjustments to market values when necessary. Historical cost accounting is also implemented in the United Kingdom and constitutes the basis for the measurement system. The difference between these two countries is that the system in the United Kingdom is more flexible and less conservative in its measurement practice. One example of this flexibility is that tangible fixed assets may also be held at valuation. (Walton et al 1998) This could be explained by the higher threat of takeover or the need to strengthen the balance sheet for financing purposes. The accounting system in Sweden has been focused mostly on the information needs of creditors, governments and the tax authorities. Nevertheless, this situation is changing and the accounting system is leaning towards a more investor-oriented focus. The valuation in Sweden is also based on historical costs. However, revaluations are allowed in circumstances where valuations are in "material excess" of book values. (Radebaugh & Gray, 1997)

3.7.2 Asset Valuation in Investment Companies

One of the issues an Investment Company has to address in providing useful information is the selection of valuation methods to value its investments. Valuation is a process of determining the monetary amounts at which the elements of financial statements are to be recognized and carried in the balance sheet and the income statement (IASC, 2001). The objective of valuation of these elements is to represent their fair value. The fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction (IAS 32, 2001). Fair value information is widely used for business purposes in determining an enterprise's overall financial position and in making decisions about individual investments. Fair value information permits comparisons of investments having substantially the same economic characteristics. (IAS 32, 2001)

In order to express the fair value of investments in the financial statements of an Investment Company, a particular valuation method has to be selected. Valuation methods, which can be chosen according to the IASC, 2001, and IAS 32, 2001, are:

a) *Historical cost*

Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition (IASC, 2001) The historical cost method is usually combined with the lower of cost or market rule. Valuation based on historical cost is revealed on entry markets (Edwards and Bell, 1961).

b) *Current cost*

Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently (IASC, 2001). Valuation based on current cost is revealed on entry markets (Edwards and Bell, 1961).

c) *Realizable (settlement) value*

Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. (IASC, 2001) Valuation based on realizable value is revealed on exit markets. (Edwards and Bell, 1961)

d) Present value

Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business (IASC, 2001, paragraph 100) According to FASB's Statements of Financial Accounting Concepts No. 7 the objective of present value when used in accounting measurements is to estimate fair value. In order to calculate the present value of an asset five elements have to be considered.

1. An estimate of the future cash flow, or in more complex cases, series of future cash flows at different times
2. Expectations about possible variations in the amount or timing of those cash flows.
3. The time value of money, represented by the risk-free rate of interest
4. The price for bearing the uncertainty inherent in the asset or liability
5. Other, sometimes unidentifiable, factors including illiquidity and market imperfections.

In concept No. 7, FASB states that present value measurements occur under conditions of uncertainty. In this statement the term uncertainty refers to the fact that the cash flows used in a present value measurement are estimates, rather than known amounts.

e) *Market value*

Market value is defined as the amount obtainable from sale, or payable on the acquisition, of an investment in an active market (IAS 32, 2001).

Market value can be equal to present value, realizable (settlement) value, current cost and historical cost. For instance, the value of a marketable stock traded on an active stock exchange is equal to the price on the stock exchanges. This price reflects the judgments of the financial markets as to the present value of expected future cash flows relating to the stock (IASC, 2001). The price on the stock exchanges is also equal to the realizable value, assuming that additional charges, such as transaction costs are ignored. Because on a stock exchange the exit market and the entry market are equal, the realizable value is equal to the current cost assuming that transaction costs are ignored. The bid price and the asking price for the stock are approximately equal. (Edwards and Bell, 1961)

3.7.3 Other Valuation Methods

According to Wright and Robbie (1997), various standard methods of valuing investments are used by venture capitalists. These different valuation methods are shown in table 1 below.

- ✓ Historic cost book value
- ✓ Capitalized maintainable earnings (P/E multiples)(prospective basis)
- ✓ Capitalized maintainable earnings (EBIT multiples)
- ✓ Recent P/E ratio of the parent company's shares
- ✓ Recent transaction prices for acquisitions in the sector
- ✓ Responses to attempts to solicit bids for potential investee
- ✓ Industry's special "rule of thumb" pricing ratios (e.g. turnover ratios)
- ✓ Liquidation value of asset (orderly sale)
- ✓ Replacement cost asset value
- ✓ Liquidation value of asset (forced sale)
- ✓ Discounted future cash flows
- ✓ Dividend yield basis
- ✓ Capitalized maintainable earnings (P/E multiples)(historic basis)

These different valuation methods can be grouped into three main types: asset value, price earnings multiples and discounted future cash flows. Wright and Robbie's survey showed that the most commonly used valuation methods employed were variations of price earnings ratio multiples. Out of the three price earnings valuation methods stated above the one using capitalized maintainable earnings on a prospective basis was the method most used. The historic basis valuation was only marginally less frequently used followed by capitalized maintainable earnings using EBIT multiples. The least used method was the recent P/E ratio of the parent company's shares. (Wright & Robbie, 1997)

The evidence of the survey implies that several valuation methods are frequently used by venture capitalists. The survey also showed that more than 80 % of the venture capitalists place the greatest weight on one single method, but use others as a control value. It was also apparent that none made frequent use of the method that provided the highest valuation. (Wright & Robbie, 1997)

3.7.4 Estimating Fair Value

Fair value is an important concept in the valuation process. FASB provides specific guidelines for estimating the fair value in paragraph 68-70 of FASB Statement No.140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* According to this statement, quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement. If a quoted market price is available, the fair value is equal to the product of the number of trading units times that market price. (FASB 140, paragraph 68)

If quoted market prices are not available, the estimate of fair value should be based on the best information available. The estimate of fair value should consider prices for similar assets and the results of the valuation techniques that have been applied. Examples of valuation techniques

include the present value of estimated future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities shall be consistent with the objective of measuring fair value. The techniques should consider assumptions that market participants would use in their estimates of values, future revenues and future expenses. These assumptions include interest rates, default, prepayment and volatility. (FASB 140, paragraph 69)

The main reason for applying the fair value of equity securities is that it assists investors, creditors, and other users in evaluating the performance of an enterprise's investments strategies. Nevertheless, there is also a lot of research that questions the relevance of fair value measures for investments in securities, arguing instead for the use of cost as the basis for financial reporting. Their argument is based on the notion that cost provides relevant information because it focuses on the decision to acquire the asset and the earnings effect of that decision. The opponents of this theory argue that fair value ignores those concepts and focuses instead on the effects of transactions and events that do not involve the enterprise. Furthermore, these opponents of fair value reporting also challenge the subjectivity that may be necessary in estimating fair values if these securities are not traded on an open market. (FASB 115, paragraph 40-43)

3.8 Company Valuation Methods

3.8.1 What is Value?

Value is related to the practical needs to evaluate alternative ways of allocating and using economic resources in order to choose the optimal alternative. Value is therefore an important analysis tool in economic practice. Since accounting is concerned with providing information for decision-making, and much of the information is based on valuation,

value and its measurement have a central and important role. (Glautier & Underdown, 1976)

According to Glautier and Underdown (1976), the term value relates to benefits that can be derived from objects, abilities or ideas. There are a number of definitions for concept of value. Economists define for instance value as the satisfaction of an economic resource to the person considering or enjoying its use. A conflict between value and price often arise when discussing value. The conflict depends on the fact that utility does not necessarily have a value in the usual monetary sense. Price is useful regarding exchange, while value is concerned with keeping an object and using it. Glautier and Underdown mean further that if value is expressed as price, the measurement involves the comparison of the utility, which others get from an object, and the strength of this utility is measured by their desire to exchange money for this object. Since exchange is a question of choice, value is central to the process of exchange. The decision to hold an asset rather than sell depends on the value or worth of the two alternatives. According to Kam (1990), there is no true economic value, since it is a very subjective concept, which is based on the preferences or desirability people have for an object.

3.8.2 The Present Value Methodology

According to Andersson (1977), the reason for conducting a company valuation is to assess the market value of a specific company. With the formulation of present value, the development of company valuation progressed. Irving Fisher is credited for formulating the concept of present value in a way that it is suitable for accountants as a tool for measurement. Nevertheless, it was another economist John Canning, who actually demonstrated that the value of an asset or liability is equal to the present value of the future net cash flows related to it (Kam, 1990). The present value concept is characterized by the fact that there is a time dimension attached to it regarding the notion of the value of money. This

implies that users prefer to receive a given amount of money now rather than in the future (Kam, 1990).

In order to obtain the present value of an asset, three variables are needed: future cash flows, the discount rate and the time perspective. Future cash flows are the cash flows that are related to the asset or liability that are valued. The discount rate represents the risk due to waiting or the cost of bearing the risk of the investment. The discount rate is appointed, through comparison of equivalent investment alternatives in the capital market. The discount rate is often referred to as the opportunity cost because it is the return foregone by realizing the actual investment. (Brealey & Myers, 2000) Depending on the uncertainty in the variables the present value is a matter of estimations. The present value method results therefore in an estimated value (Kam, 1990). Harvey and Keer (1978), state that the estimates of these variables will be subjective. However, in an uncertain world, subjectivity is the price that may have to be paid for relevant and useful information. Thus, the economic theory teaches that the value of any resource equals the present value of the returns expected from the resource, discounted at a rate that reflects the risk inherent in those expected returns. (Bodie & Merton, 1986)

According to Alfred Rappaport (1998), the rationale for using expected cash flows in order to determine a value is based on two factors:

1. Cash is the ultimate source of value. A resource has value because of its ability to provide future cash flows.
2. Cash serves as a measurable common denominator for comparing the future benefits of alternative investment opportunities.

3.8.3 Other Valuation Methods

According to Hult (1998), there are a number of different approaches in order to obtain the “fair” value of a company. The methods used for valuing a company can be divided into two main groups. One that

includes methods which are based on future expectations and one that consists of methods that have the current position of the company as a starting point. The figure below shows the alternative valuation methods based on the two main groups mentioned above.

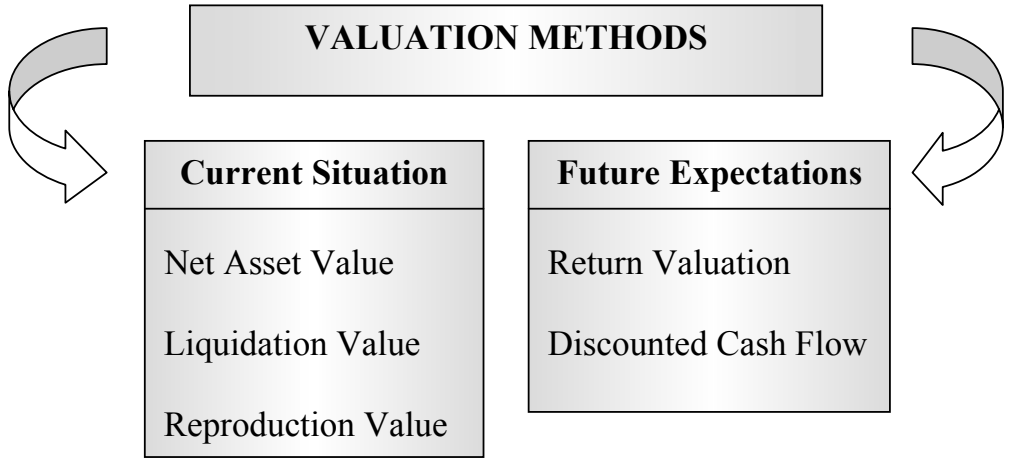

Figure 4 Valuation Methods in order to find the "fair" value
Source: Hult, 1998

Methods that are not included in the figure above, but are widely used are the *Relative valuations.* This method implies that valuations on other similar companies are used and applied to the actual company. These methods are often used as a complement to other valuations to make sure that the value is reasonable. (Hägg, 1991)

3.8.4 Net Asset Value

The Net Asset Value is one of the valuation methods based on the current situation shown in the figure above. The notion of Net Asset Value is often used for companies whose assets are tangible, such as Investment Companies, real-estate companies and shipping companies. A common characteristic for these companies' assets is that there exists a functional market, also known as a second hand market. Companies based on assets with these kinds of characteristics are suitable for net asset valuation. (Hägg, 1991) According to Olbert (1992), a possible explanation of the

Net Asset Value's popularity is that investors prefer current and reliable information, as with the information used within the net asset valuation method rather than information that is based on expectations about the future.

The main argument for valuing net assets is to assess how much the capital that has been invested in the company is worth (Hult, 1998). Nilsson provides two other motivational factors for the use of net asset valuation:

- ✓ The Net Asset Value should provide a control for and a complement to the value calculated through other methods, for instance discounted future cash flows. The Net Asset Value is needed to make sure that the expected returns are high enough to give a satisfied return on the existing net assets.

- ✓ The Net Asset Value demonstrates, from the buyer's perspective, the current situation of the company and which assets really generate positive returns.

There are a number of different definitions of Net Asset Value. The most simplified definition is presented by Hult (1998) and is based on the principle that the objective of Net Asset Valuation is to calculate adjusted equity, i.e. total equity adjusted for possible differences to the reported book values. Applying this definition, the value of the company can be expressed as: adjusted assets – adjusted liabilities = adjusted equity. (Hult, 1998) The differences in definitions of Net Asset Value usually arise in specific items, such as various methods of treating deferred tax debts according to differences from market value. (Hägg, 1991)

The figure below shows the how the Net Asset Value is obtained using the balance sheet as the starting point. The figures stated in the balance sheet are adjusted for tax considerations and for market adjustments. (Hult, 1998)

Equity
+Hidden Reserves
-Deferred Taxes
Net Asset Value before Deferred Distribution Tax
-Deferred Distribution Tax
Net Asset Value

Figure 5 Model for calculating the Net Asset Value
Source: Hult, 1998

According to Hult (1998), the adjustments presented in the figure above are conducted because it is difficult to assert that the balance sheet gives a fair picture of the company. Items that need to be adjusted to market value when calculating the Net Asset Value are among others: plant and inventories, properties, claims, liabilities and investments. (Nilsson, 1972) Other items on the balance sheet that have to be taken into consideration when assessing the Net Asset Value are those within the untaxed capital that include deferred taxes, e.g. the tax debts have to be deducted from the untaxed capital. (Hult, 1998)

3.9 Summary

This chapter has outlined the various accounting and financial theories connecting to the valuation procedures of portfolio companies in Investment Companies. Harmonization has shortly been defined as *the process of bringing international accounting standards into some sort of*

agreement. The pressure for a more harmonized accounting system has also resulted in greater pressures for financial reporting and disclosure.

The chapter also described an asset as *probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.* This section was followed by a description of the numerous valuation methods that are available for valuing assets. The section on asset valuation was then linked to a section describing different techniques for valuing companies as a whole The last part of the theoretical framework described the Net Asset Value and presented arguments for applying this valuation technique for Investment Companies.

This chapter outlines the valuation guidelines given by the three existing venture capital associations.

4 VALUATION GUIDELINES

4.1 Introduction

Venture Capital Associations interested in the process of valuing portfolio companies have prepared valuation guidelines, for which are intended to provide a framework for Investment Companies to carry out valuations of their investments. The main objectives with these valuation guidelines are to provide greater transparency and a greater degree of consistency for existing and potential stakeholders in order to monitor and evaluate the performance of the investments and to facilitate the comparison of different companies on both a national and international level.

An important notion to bear in mind when reading this chapter is that parts of the information are directly taken from the publications provided by the associations. This is done in order to exclude any misinterpretations of the material.

4.2 EVCA Valuation Guidelines

The European Private Equity and Venture Capital Association (EVCA) represents the European private equity sector. The organization has over 750 members throughout Europe, and its different roles include such things as providing information services for members, creating networking opportunities, promoting private equity and venture capital to institutional investors worldwide, creating an entrepreneurial environment in Europe and promoting a set of standard measurement principles and guidelines for reporting to investors.

The EVCA Reporting Guidelines were published in 2000, and were mainly formed in order to provide greater transparency to its investors. These guidelines seek to define a common method of valuation, but it is important to understand that these guidelines do not impose an obligation on managers' funds, but instead set a benchmark against which members may wish to relate their reporting.

EVCA provides two principles that are the base for valuing investments. First, the valuation should be prudent and applied consistently and professionally. Second, the data and process used in coming to the valuation should be clearly disclosed. EVCA has divided investments into two categories:

- ✓ Quoted Investments, being investments where the principal security is traded on a recognized exchange or where regular third party dealings in those securities take place.
- ✓ Unquoted Investments, which are all other investments.

Regarding the unquoted investments, two valuation methodologies should be applied: The Conservative Value and the Fair Market Value. According to EVCA all unquoted investments should be valued at cost unless either:

1, a new financing round or partial sale, involving a material investment by a third party at arm's length, has taken place in which the valuation should be based on the transaction price; or

2, there has been a material and permanent diminution in the value of the investment below cost, in which case the investment should be written down by multiples of 25% only.

EVCA's definition of fair market value is stated as:

"The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion."

In order to obtain an appropriate indication of the fair market value an independent third party transaction within the valuation period is necessary. If such a third party transaction has not taken place, EVCA distinguish the valuation choice between two types of companies:

1. Companies with revenues and either profits or positive cash flow.
2. Companies with or without revenues, but without either profits or positive cash flow.

Investments that are classified into the first category may be valued by the use of the average of the pool of price/earnings ratio (P/E), price/cash flow (P/CF), enterprise value/earnings before interest and tax (EV/EBIT) and depreciation and amortization (EV/EBITDA) multiples derived from comparable companies. In order to use these multiples, the companies need to have similar accounting standards, similar business focus, similar size and profitability and have established valuation. The valuations that are based on comparable multiples should be discounted to take account of the illiquidity of the investment. This discount is recommended to be at least 25 % and one level of discount should be applied to all unquoted investments in a portfolio.

If the manager is unable to find appropriate comparables, two other methods are suggested by EVCA. The first states that relevant and applicable sub-sector average multiples may be used and the second valuation method states that the manager may apply the actual entry multiples paid for the investments to the investment's last trading figures. Investments that are classified into the second category i.e. companies

with or without revenues, but without either profits or positive cash flow should be valued using the conservative value as the fair market value.

Quoted investments should be valued on the basis of their quoted mid-market price on the last day of trading in the valuation period. The values should be discounted by one of the following discounts:

1. for quoted investments which are not subject to a restriction on their sale, the level of discount is recommended by EVCA to be between 10 % and 20 % and should be fixed by the manager.
2. for quoted investments which are subject to a restriction or lock-up, a minimum discount of 25 % should be applied.
3. where the number of shares held is high in relation to the quarterly trading volumes, an additional discount of 5 % to 10 % should be applied.

4.3 BVCA Valuation Guidelines

The British Venture Capital Association (BVCA) represents the British venture capital and private equity sector. The organization has 298 corporate members, where 155 are full members who are venture capital companies active in making equity investments, primarily in unquoted companies. The other 143 are known as Associate Members and are professional firms including accountants, lawyers and consultants advising on venture capital transactions or organizations that invest in venture capital as a minor part of their overall activities.

BVCA's fundamental principle is that all valuations of venture capital should show a fair valuation of the investment to the investor. The BVCA has divided investments into three categories: Early Stage Investments, Development Stage Investments and Quoted Investments.

All early stage investments should be valued at cost, less any provision considered to be appropriate, until the investment ceases to be seen as an early stage investment. This principle is not applied if a transaction involving a third party at arms length has taken place. The provision should be made, as a percentage of cost at around 25 % depending on what the valuer believes is appropriate.

All development stage investments should be valued according to the different methods set out below:

- ✓ Cost (less any provision required)
- ✓ Third Party Valuation
- ✓ Earnings Multiple
- ✓ Net Assets

According to BVCA, the choice of the four valuation methods above is usually a matter of judgment. As a general rule, material arms-length third party valuations are evidence of fair valuation and should be superior to other methods until the circumstances change. BVCA also states that once it has been concluded that costs are not a reliable indication of value, it should seldom be used again.

Developments stage investments should be valued at cost for at least one year unless this method of valuation is unsustainable. A provision should be applied if the performance of the investment is significantly below the expectations. An investment may be valued on the basis of a third party if a subsequent issue of capital is made, or if a transaction of cash in the relevant security takes place. However, this basis for valuation can only be justified according to BVCA, if the transaction involves a significant investment by a new investor. One problem of using third party valuation is that some investors may have strategic reasons for investing, which might lead to a valuation that would be inappropriate.

The most common method of valuing investments in the development stage is on an earnings basis. BVCA does not recommend that this basis should be used until at least a year has elapsed since the investment was made. There are a number of different methods of earnings basis valuation. BVCA suggests that venture capital companies apply a discounted Price/Earnings multiple (P/E) to the investment's earnings from which corporation tax has been deducted. It is in the valuer's own judgment, whether the earnings should be taken before or after interest.

The most appropriate P/E multiple is obtained from a quoted company or companies, which are comparable both in business activities and in amount of sales and profits. If such companies are not available, the specific sub-sector can be used as a base. According to BVCA, the reason for discounting the P/E multiple is to account for the illiquidity and risk of unquoted investments. This discount is highly judgmental, but it is recommended that the minimum discount should be 25 %.

The last valuation method recognized by the BVCA for development stage investments is the net asset basis. This valuation method will rarely be used, but nevertheless some investments are more appropriately valued on this basis. A proper situation would be if there were significant property elements to the invested business. When using this basis of valuation, the valuer has to consider when and how each of the assets has been valued. Once again, BVCA recommends a level of discount to be applied to account for the illiquidity of the investment.

For quoted investments, BVCA suggests that the mid-market price provides a reasonable indication of fair value. However, a discount should be applied if the shares are subject to any restrictions or if the holding is significant in relation to the issued share capital. This discount should normally be in the range of 5% to 25%, depending on the specific circumstances.

4.4 NVCA Valuation Guidelines

The National Venture Capital Association (NVCA) has defined 10 industry practices in the United States divided into two classifications: Private Companies and Public Companies. The Guidelines for the private companies are based on the seven principles explained below.

1. Investment cost is presumed to represent fair value except in the circumstances indicated in the guidelines.

2. Valuation should be reduced if a company's performance and potential have significantly deteriorated. This kind of reduction should be disclosed in the notes to the financial statements.

3. Valuation should be adjusted if a subsequent significant equity financing has taken place which includes a sophisticated and unrelated new investor. A subsequent significant equity financing that includes the same group of sophisticated investors, as the prior financing should generally not be the basis for an adjustment in valuation.

4. If substantially all of a significant equity financing is invested by an investor whose objectives are in large part strategic, it is presumed that no more than 50 percent of the increases in the investment price compared to the prior significant equity financing is attributable to an increase in the value of the company.

5. Valuation of a company acquired in a leveraged transaction should be adjusted if the company has been self-financing for at least two years and has been cash flow positive for at least one year. The adjustment should be based on P/E ratios, cash flow multiples, or other appropriate financial measures of similar companies, generally discounted by at least 30 percent for illiquidity. These adjustments should occur no more frequently than annually and should be disclosed in the notes to the financial statements.

6. Warrants should be valued at the excess of the value of the underlying security over the exercise price.

7. The carrying value of interest bearing securities should not be adjusted for changes in interest rates.

NVCA's last three principles regarding valuation guidelines are concerned with public companies.

8. Public securities should be valued at the closing price or bid price except as indicated otherwise in these guidelines.

9. The valuation of public securities that are restricted should be discounted properly until the securities may be openly traded. Such a discount should generally be at least 30 percent at the beginning of the holding period and should decline proportionately.

10. When the number of shares held is substantial in relation to the normal quarterly trading volume, the valuation should generally be discounted by at least 10 percent.

This empirical chapter together with the theoretical framework constitutes a basis for the analysis.

5 EMPIRICAL FINDINGS

5.1 Introduction

The empirical chapter is divided into three sections based on the three countries included in the study. Each section will start with a short description of the Investment Company market in the respective country. This part will be followed by a section where each Investment Company's valuation procedures are described. For the Swedish companies, the definition and the disclosure related to the Net Asset Value will also be provided. The chapter will include five companies from each country selected on the criteria described in the methodology chapter. The studied companies' valuation methods are in some circumstances taken directly from the annual reports, in order to minimize any possible misinter-pretations.

5.2 Sweden

The Swedish market for Investment Companies includes a number of companies that have various objectives and classifications. Concepts and definitions that are common on the Swedish Investment Companies market are venture capital, private equity and Investment Companies. According to Svenska Riskkapitalföreningen, venture capital is investments in companies that are in the early stage of their development. A venture capital company does not only provide capital, but also supplies an active commitment at the managerial or operational level. A private equity company is, according to the same association, similar to a venture capital company. However, private equity companies rather invest in companies that are in a later stage of their development. An Investment Company is referred to as a more general definition including all types of holding companies with the main purpose of investing capital

in other companies. (www.vencap.se, 2001-10-01) This study includes various Investment Companies with different objectives and definitions in order to make this study as comprehensive as possible.

5.2.1 Bure Equity

Bure is a private equity company that mostly invests in unlisted companies within the TIME-sector i.e. Telecom, IT, Media and E-knowledge. Bure Equity was founded 1992, and at this time their portfolio consisted of listed companies with large spread over different sectors. Bure's portfolio has gradually changed towards more knowledge-intensive service sectors, characterized by high growth and where Bure can create new sector structures through direct and active ownership. To indicate this focus on unlisted investments the company changed name from Investment AB Bure to Bure Equity AB in 2000.

At the end of 2000, Bure's portfolio consisted of 74 companies. The total investment portfolio had a book value of more than 3 200 MSEK and a Net Asset Value of 6 400 MSEK. Bure's indirect investments, i.e. investments through funds and venture capital represented 18 % of the total invested capital. The company has been listed on the A-list on the Stockholm stock exchange since 1993.

5.2.1.1 Valuation Principles

All Bure's listed holdings have been valued at the latest price per balance sheet date. Unlisted holdings have been valued by the use of European Venture Capital Association (EVCA) or by the valuation of an external party. Bure Equity has applied EVCA's recommendations in a matter that the market value is determined on the basis of the value of the latest transaction in the security in which an external party has taken part. Other unlisted shares have been valued at the acquisition price. Three of Bure Equity's investments have been valued in accordance to more than one method.

5.2.1.2 Definition of the Net Asset Value

Bure Equity defines it's Net Asset Value as *" the parent company's assets and liabilities adjusted for the surplus values which exists in the parent company's investments. "*

5.2.1.3 Information Disclosed Regarding the Net Asset Value

- ✓ Specific valuation method disclosed for each of Bure Equity's investments.
- ✓ Book values and Net Asset Values are presented in the calculations of the Net Asset Value.
- ✓ The Net Asset Value development from 1996-2000 is presented in a diagram.
- ✓ A diagram showing the direct and indirect ownership percentage of the Net Asset Value. The Net Asset Value is also divided into Bure Equity's investment areas.
- ✓ A diagram illustrating the relationship between the opening Net Asset Value, exits and investments from 1998 to 2000.
- ✓ A chart showing an *uplift* index, which measures the difference between the latest reported Net Asset Value of a realized asset and the exit value.
- ✓ A brief discussion concerning the Net Asset Value discount including the most important factors Bure Equity needs to accomplish to reduce this discount.

5.2.2 Custos

Custos is an Investment Company that invests in a limited number of mainly market-listed companies. Custos strives to have sufficiently large holdings to make active ownership possible. The company's focus is mainly on the Swedish and Nordic market, but in selective circumstances investments are also made in other European countries. Custos

investments are not limited to specific business sectors instead the potential for value enhancement establishes the investment decisions. The result of this strategy is that Custos' portfolio companies can be found in most industries.

At the end of 2000, Custos portfolio had a book value of 2 760 MSEK and a market value of 5 471 MSEK. The total Net Asset Value for 2000 was 4 981 MSEK. The company has been listed on the O-list on the Stockholm stock exchange since 2000 and prior to that the company was listed on the A-list.

5.2.2.1 Valuation Principles

For the Net Asset Value calculation, listed companies have been valued at their market share price. Unlisted companies, excluding Acando and Open Training Sweden, have been valued at adjusted shareholder's equity plus surplus value of listed securities. Acando has been valued by the Executive Management of Custos according to an internal appraisal based on Acando's earnings capacity. This specific valuation is in line with EVCA's valuation guidelines and is applied according to Custos management because Acando's has built a strong platform for continued good profitability and growth. Open Training Sweden has been valued at the acquisition value.

5.2.2.2 Definition of the Net Asset Value

Custos defines its Net Asset Value as *" reported equity adjusted for net liabilities for synthetic share buy-backs plus surplus value in the portfolio, without subtracting deferred taxes."*

5.2.2.3 Information Disclosed Regarding the Net Asset Value

- ✓ Specific valuation method and market value disclosed for each of Custos investments. These values are later used in the calculations of Custos' Net Asset Value.
- ✓ A table showing the Net Asset Value allocated by total assets and total liabilities presented both on a total market value basis and on a per share basis.
- ✓ A table showing the change in the Net Asset Value from 1999 to 2000 divided into all appropriate balance sheet items, including the specific investments and also items relating to the passive side of the balance sheet.
- ✓ A brief discussion concerning the Net Asset Value discount including the most important ways for Custos to reduce or eliminate this discount.

5.2.3 Ledstiernan

Ledstiernan is a seed and venture capital company with a focus on mobile communication. The company was established in 1994, but it was first in April of 2000 that Ledstiernan obtained a listing on the Stockholm stock exchange's O-list. Ledstiernan is a major shareholder in more than 30 portfolio companies. More than half of the invested capital is focused on mobile communication and due to the fact that Sweden and Finland are world leaders in technical developments, Ledstiernan's investments are mostly conducted in this area. Ledstiernan's total investments in its portfolio amounted to 452 MSEK at the end of 2000.

5.2.3.1 Valuation Principles

Ledstiernan listed shares are stated according to the same principle at their latest market value. The unlisted shares have been valued according to EVCA's valuation principles. This implies that unlisted shares in

which no external transactions have taken place are stated at Ledstiernan's acquisition cost. In the event of a significant financing involving outside parties, the investment is stated according to the latest issue.

5.2.3.2 Definition of the Net Asset Value

Ledstiernan does not provide any information concerning the Net Asset Value.

5.2.3.3 Information Disclosed Regarding the Net Asset Value

Ledstiernan does not provide any information concerning the Net Asset Value.

5.2.4 Novestra

Novestra was established as a venture capital company in 1997 focusing on investing in businesses with strong growth. As of today, all Novestra's portfolio companies are young, with a significant customer base and great growth potential. Novestra has divided its holding into two categories: *industrial holdings* and *investment holdings*. The industrial holdings consist of companies in which Novestra is actively involved. This could either be expressed by board representation or active participation in the company's operations. Investment holdings are holdings in companies in which Novestra does not actually participate in the company's operations. At the end of fiscal year 2000, Novestra's portfolio had a book value of 397 MSEK and a total Net Asset Value of 887 MSEK. The company has been listed on the O-list on the Stockholm stock exchange since June 21, 2000.

5.2.4.1 Valuation Principles

All Novestra's listed investments have been valued at the actual market value adjusted for a possible discount if the divestment of shares is restricted. EVCA valuation guidelines have been applied in valuation for Novestra's unlisted companies. The shareholdings in Bredbandsbolaget, DCM, Fanglobe and Netsurvey have been valued based on the most recent capital procurement to external parties. Other unlisted investments have been valued at acquisition value in the calculation of Net Asset Value.

Novestra's interim report for the third quarter states that the extreme volatility in the market and its effects on market valuations has resulted in EVCA's valuation guidelines becoming less representative with regards to underlying values. Novestra has therefore decided to apply a more conservative method in which the Net Asset Value is based on the book value adjusted for possible write-downs. The interim report also states that if EVCA's valuation methods had been used, the Net Asset Value would have been significantly higher than the reported value.

5.2 4.2 Definition of the Net Asset Value

Novestra defines its Net Asset Value as " *shareholders equity adjusted for market value of holdings of publicly traded and / or market value shares before tax."*

5.2.4.3 Information Disclosed Regarding the Net Asset Value

- ✓ The only information provided is the Net Asset Value development from 1997/1998 to 1999/2000.

5.2.5 Investor

Investor is Sweden's largest listed industrial Investment Company. Investor is a long-term and active shareholder in a number of public global companies such as ABB, AstraZeneca, Ericsson and SKF. In addition to these core investments, Investor has also a growing portfolio of private equity and venture capital investments in companies operating primarily in the IT and healthcare sector.

At the end of 2000, Investor's portfolio consisted of 14 core holdings, approximately 100 new investments and a number of other investments. The total investment portfolio is valued at 159 423 MSEK and the Net Asset Value amounts to 149 115 MSEK as of December 31, 2000.

5.2.5.1 Valuation Principles

Valuations are stated in accordance with the ECVA/BVCA principles with the exception of unlisted holdings. The principles for valuation of unlisted holdings where changed in 2000 to a more conservative method were the investments are valued at acquisition value with the deduction of any write-downs. Previously, where applicable, in accordance with EVCA/BVCA principles, unlisted holdings were stated at the most recent external financing round valuation. Listed holdings are valued previously at their current price with a liquidity discount of 10 to 20 percent.

5.2.5.2 Definition of the Net Asset Value

Investor defines its Net Asset Value as *" shareholders' equity, convertible debenture loans and surplus. "*

5.2.5.3 Information Disclosed Regarding the Net Asset Value

- ✓ A diagram showing the Net Asset Value development for the past five years.
- ✓ The Net Asset Value for each type of investment segment is presented. Investor also presents information regarding the Net Asset Value for all companies within the specified investment classification.
- ✓ Investor also provide a table showing an overview on how these segments have contributed to the overall growth in Net Asset Value for the years 1999 and 2000.

5.3 The United Kingdom

The market for Investment Companies in the United Kingdom is the largest in Europe. (BVCA, 2001) Compared to Sweden, this market includes, beside venture capital and private equity also other concepts such as investment trusts and venture capital trusts (VCT). The Association of Investment Trust Companies defines an investment trust as: a public limited company that uses the funds provided by its shareholders to make money through buying and selling shares in other companies. A VCT is a company in itself, which invest in small companies and smaller company funds or hedge funds. (www.trustnet.com, 2001-10-31).

5.3.1 3i Group

3i is Europe's leading venture capital company, with operations in 12 European countries. 3i is also intending to establish significant businesses in the United States and Asia Pacific. The company invests in unquoted companies with high growth potential and strong management in a wide range of industry sectors. Investments are made throughout all stages of a company's development, from start-ups to buy-outs.

During 2000 3i invested nearly £ 1.0 billion in 328 companies across a wide range of sectors and maintained their position in both the technology and mid-market buy-out sector. The value of 3i's total investment portfolio is £ 5,805 billion and the portfolio is well diversified into industry sectors, either by geography or by the stage and size of the investment.

5.3.1.1 Valuation Principles

3i values its quoted investments at the closing price at the balance sheet date. Where there are restrictions on dealing in quoted investments, an appropriate discount is applied to the restricted shares. For the unquoted investments, a three-stage valuation process is used.

The first stage involves the actual valuation of all the unquoted investments. According to 3i, new investments are valued at costs for the first 12 months. Any investment in a company that has failed or expected to fail within the next 12 months is valued at nil. The value of other investments are obtained by applying the 3i's proportion of equity shares held to the valuation of the company calculated by multiplying the latest earnings by the average price earnings ratio of the relevant sector of the FTSE SmallCap Index. If the result of this valuation is less than half of 3i's share of net tangible assets than the investment is valued at half of the 3i's share of net tangible assets. The value of technology investments is established through the use of the above method except that the valuation is not reduced below cost.

3i's investments that are valued at more than £3 million by the first stage of the process are individually reviewed in line with internal guidelines. This evaluation covers factors, which may affect the value and if that is the case the valuation may be adjusted. These factors include:

- ✓ Reliable financial information more recent than the audited accounts.

- ✓ Non-recurring profits and losses and unusual tax changes.
- ✓ Imminent sale or IPO;
- ✓ Significant third party transactions including a substantial new outside investor
- ✓ Potential issues of shares dilutive to 3i or other shareholders.
- ✓ Forecasts by the investee business of lower earnings
- ✓ An industry standard basis of valuation, for example property companies, which are valued by reference to their net assets
- ✓ Large cash holdings
- ✓ Very high gearing

The third stage includes applying specific discounts to account for the illiquidity of unquoted investments. 3i's discounts are stated below:

- ✓ Investments valued at cost or half net tangible assets 0%
- ✓ Investments valued at expected disposal proceeds or IPO value 10%
- ✓ Other investments 25%

5.3.2 Caledonia

Caledonia is a U.K. based trading and Investment Company with an international spread of interest. The U.K. market is the most important market to Caledonia, where 72 % of its holding are located. The second largest market is the North American, where Caledonia has 21 % of its investments. Caledonia invests in both listed and unlisted companies focusing on six broad sectors. These sectors are classified into the financial sector, the industrial sector, the investment funds sector, the technology sector, the leisure and media sector, and the property and general sector. The total market value of Caledonia's portfolio for 2000 was £ 946.1 million. The two largest sectors were the financial and the investment funds sector, which amounted to 34 % and 22 % respectively of the total market portfolio.

5.3.2.1 Valuation Principles

Caledonia values its listed investments at market prices at the balance sheet date. Other investments are held at cost or valued at market prices at the balance sheet date where an organized market exists, or by the directors based on dealing prices, stockbroker's valuation, Net Asset Values or other appropriate information.

5.3.3 Candover

Candover is structured as an investment trust and was listed on the London Stock Exchange in 1984. Candover focuses on arranging and leading large buyouts and its strategy is to work in partnership with management teams to acquire companies in the United Kingdom and continental Europe. Candover concentrates its investments into six business industries: the media industry, manufacturing & engineering industry, financial services industry, chemical industry, support services industry, consumer industry and the IT industry. The total market portfolio of Candover's investments amounted to £188.9 million for 2000, which is equivalent to an increase of the portfolio value of 24 % from the preceding year.

5.3.3.1 Valuation Principles

Candover applies British Venture Capital Association guidelines for valuing its unquoted developments stage investments. All investments are valued according to one of the following methods:

- ✓ Cost (less any provision required)
- ✓ Open market valuation
- ✓ Earnings multiple
- ✓ Net assets

Candover's investments held for more than one year are valued on one of the valuation bases described above. The method that is the most commonly applied is the earnings multiple unless this method is inappropriate as in the case of specific asset-based businesses. When valuing on earnings multiple basis, profits before interest and tax will normally be used. The price/earnings multiples adopted are usually related to comparable quoted companies and are normally discounted by 25 per cent.

In the event that a company has incurred losses, or if comparable quoted companies are not primarily valued on an earnings basis, then the valuation may be calculated with regard to the underlying net assets and any other relevant information. This information could include the price for subsequent investments by a third party in a new financing round. When investments have obtained an exit after the valuation date but before Candover's relevant accounts are finalized, the valuation is based on the exit valuation subject to an appropriate discount.

5.3.4 Amerindo Internet Fund

The company is based in the United Kingdom and invests mainly in shares of quoted and unquoted United States technology companies focused on the Internet and the biotechnology sector. The company's three largest business segments are business-to-business, business-to-consumer and, equipment and components. These three segments amount to 60 % of Amerindo's total holdings.

5.3.4.1 Valuation Principles

Amerindo valuation policy for unquoted investments is based on the price reflecting the most recent significant issue of shares. This price is subject to an adjustment to account for compelling circumstances such as operating results in a particular company or macro factors influencing the

company's sector. Listed investments are valued at their closing middle-market prices as issued by the exchange on which they trade.

5.3.5 Northern Venture Trust

Northern Venture Trust is a venture capital trust established in 1988. In 1995 the company obtained a listing on the London Stock Exchange. The company specializes in making equity investments of between £500,000 to £5 million in the United Kingdom based unquoted companies. Northern Venture Trust diversifies its investment portfolio into 5 main industries: the service industry, the industrial and manufacturing industry, the computer and electronic industry, the consumer industry and the healthcare industry. The total market value of Northern Venture Trust PLC investment portfolio for 2000 was £49,128,000, which can be compared to the book value of the same portfolio of £34,928,000.

5.3.5.1 Valuation Principles

Listed investments are stated at middle market price, discounted where necessary to reflect lack of liquidity. Unlisted investments are stated at director's valuation and are in accordance with the guidelines laid down by the British Venture Capital Association. This means that the director's policy is to carry them at cost except in the following circumstances:

In the event that a company is under-performing against its plan and therefore a provision against cost is made in the area of 25 %.

- ✓ Where the company is well established and profitable. The company should be valued by applying a suitable price-earnings ratio to the company historic post-tax earnings. The ratio used is based on a comparable listed company or sector and should be discounted by 25-50 % to reflect un-marketability.
- ✓ Where a value is indicated by a material arm's-length transaction by a third party in the shares of a company.

Unlisted investments will not be revalued upwards for a period of at least twelve months after the acquisition date.

5.4 The United States

The United States is the largest market for Investment Companies in the world. The organizational structure of Investment Companies in the United States has traditionally been different from the structures of Investment Companies in other parts of the world, including Sweden and the United Kingdom. The classical organizational structure of an Investment Company in the United States is constituted of a management company, which controls one or several funds (Svenska Riskkapital-föreningen). These funds are companies by themselves in which investors can invest in. (See the figure below) This structure has in recent years, been more and more spread around the world.

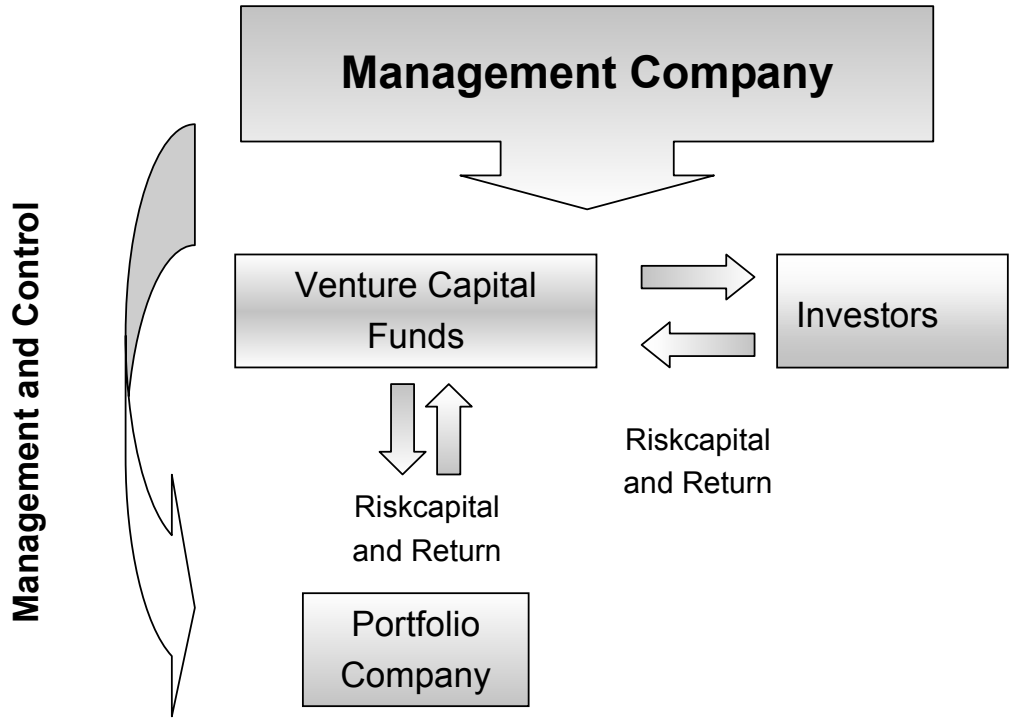

Figure 6 The Investment Company Structure in the United States
Source:www.vencap.se,

There are a number of different classifications of Investment Companies in the United States. One of the most common concepts is what is known as a closed-end fund, which implies a publicly traded company that invests in securities in accordance with the investment objectives. A closed-end fund is further a fixed pool of assets with a fixed number of outstanding shares (Paine Webber) A venture capital company is in the United States defined as a private partnership or a closely held corporation founded by private and public pension funds, endowment funds, foundations, wealthy individuals, venture capitalists themselves etc, which invest in new and rapidly growing companies (www.nvca.org, 2001-10-01).

5.4.1 Allied Capital

Allied Capital is a closed-end management investment company that has elected to be regulated as a business development company. The company is the leader in the United States in providing private investment capital to middle-market companies. The company has been publicly owned since 1960 and today carries a diversified portfolio exceeding $2 billion. Allied capital invests in both private and undervalued public companies.

5.4.1.1 Valuation Principles

Public investments are stated at the public market value. The company's equity interest in public companies that carry specific restrictions on sale are normally valued at a discount from the public market value. Both restricted and unrestricted investments may also be valued at a discount due to the investment size and market liquidity issues.

Equity securities in portfolio companies for which there is no liquid public market are valued based on various factors including a history of positive cash flow from operations, the market value of comparable publicly traded companies, and other factors such as recent offers to

purchase a portfolio company's securities or other liquidation events. The determined values are usually discounted to account for liquidity issues and minority control positions.

5.4.2 UTEK Corporation

UTEK Corporation is a non-diversified closed-end management Investment Company that acquires, develops and finances university technology for its customers. The company investments are concentrated in small or development stage companies that license and develop new technologies for commercial applications. UTEK, with its capable management team, seeks to strengthen its customers with the judicious acquisition and development of new technologies.

5.4.2.1 Valuation Principles

Equity securities in public companies that carry restrictions on sale are normally valued at a discount from the public market value of the securities. UTEK corporation's Board of Directors is responsible for determining the fair value of securities and assets for which market quotations are not readily available. In order to make this determination, the Board of Directors has to consider certain valuation appraisals. According to UTEK Corporation, each investment is valued using industry valuation benchmarks and discounted in order to account for the illiquid nature of the investment. On the occasion that an external event such as a purchase transaction, public offering, or subsequent equity sale occurs, the pricing indicated by the external event is used as the private equity valuation.

The Board of Directors bases its determination of fair value on applicable quantitative and qualitative factors. These factors may include the type of securities, nature of business, marketability, market price of unrestricted securities of the same issue, comparative valuation of securities of publicly-traded companies in the same or similar industries, current

financial conditions and operating results, sales and earnings growth, operating revenues, competitive conditions and current and prospective conditions in the overall stock market.

5.4.3 Capital Southwest Corporation

Capital Southwest is one of the largest venture capital and business development companies in the United States. Since the company was founded in 1961 it has provided venture capital to support the development and growth of small and medium-sized businesses in various industries throughout the United States.

The company invests for the long term and focuses their holdings on enterprises that have exceptional growth potential. The portfolio is a combination of companies in which Capital Southwest Corporation has major interests as well as a number of developing companies and marketable securities of established publicly owned companies. The company's current portfolio consists of both listed and unlisted companies and the total fair value of its holdings amounts to $ 315 million.

5.4.3.1 Valuation Principles

Capital Southwest classifies its investments into unrestricted securities and restricted securities. Unrestricted securities are considered to be freely marketable securities having readily available market quotations. The restricted securities are regarded as all other securities that are subject to one or more restrictions on resale and are not freely marketable. Unrestricted securities are valued at the closing sale price for listed securities and at the closing bid price for Nasdaq securities on the valuation date.

Restricted securities are valued at fair value as determined by the Board of Directors. According to Capital Southwest, fair is considered to be the

amount that the company may reasonably expect to receive for portfolio securities if such securities were sold on the valuation date. In order to determine the fair value for these restricted securities, the Board of Directors have to determine certain factors. These include the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, the market for and recent sale price of the issuer's securities, the values of similar securities issued by companies in similar businesses, the proportion of the issuer's securities owned by the company and the nature and duration of resale restrictions. In determining the fair value of restricted securities, the Board of Directors considers the inherent value without regard to the restrictive feature and adjusts for any diminution in value resulting from restrictions on resale.

5.4.4 Equus II Incorporated

Equus II Incorporated is a fund managed by Equus Capital Management Corporation. The company is an Investment Company that trades as a closed-end fund on the New York stock exchange. Equus II Incorporated's objective of generating long-term capital gains is implemented by making equity investments in small- to medium-sized privately owned companies. The company's current portfolio consists of investments in 27 businesses in various industries in the United States with a fair value of $94 Million.

5.4.4.1 Valuation Principles

The investments in companies whose securities are publicly traded are valued at their quoted market price, less a discount to reflect the restrictions on the sale of such securities. Investments in securities for which no market quotations are available are valued at fair value. Equus II Incorporated defines fair value of an investment as the amount that a fund might reasonably expect to receive for it upon its current sale. Cost is used to determine fair value until significant developments affecting an

investment provide a basis for use of an appraisal valuation. Thereafter, the portfolio investments are carried at appraised values.

Appraisal valuations are based upon such factors as the portfolio company's earnings, cash flow and net worth, the market prices for similar securities of comparable companies and an estimation of the company's future financial prospects. In the case of unsuccessful operations, the appraisal may be based on liquidation value. The fund may also use third party transactions in a portfolio company's securities as the basis of valuation (the "private market method"). This method will be used only with respect to completed transactions or firm offers made by sophisticated, independent investors. Securities with legal, contractual or practical restrictions on transfers may be valued at a discount from their appraisal value.

5.4.5 Van Kampen High Income Trust

Van Kampen High Income Trust is registered as a diversified closed-end management Investment Company under the Investment Company Act. The Trust's investment objective is to provide high current income, consistent with preservation of capital, by investing in a portfolio of medium or lower grade fixed income securities, or non-rated securities of comparable quality. The Trust began its investment operations on January 26, 1989.

5.4.5.1 Valuation Principles

Investments are stated at value using market quotations or indications of value obtained from an independent pricing service. For securities where quotations or prices are not available, valuations are obtained from yield data relating to instruments or securities with similar characteristics in accordance with procedures established in good faith by the Board of Trustees.

This chapter includes an analysis of the interpretations of the empirical findings based on the theoretical framework.

6 RESEARCH ANALYSIS

6.1 Introduction

This chapter analyzes the empirical data by connecting it to the theories presented in the theoretical framework. The chapter will firstly describe the standardization of valuation procedures both within and between the studied countries. As the empirical chapter shows, none of the companies apply exactly the same valuation procedures. This means that the analysis of the harmonization process will be based on interpretations of the valuation procedures in order to analyze the level of standardization within each country.

The second part of this chapter examines the different valuation methods applied by the studied companies. This part will try to find some influencing factors for the choice of valuation method. This analysis is only based on the external information that the studied companies provide i.e. the annual reports and therefore the reasoning in the analysis is centered on the researchers' own interpretations of the collected data. Thus, the explanatory part of this study is based on these interpretations, which is in line with the qualitative nature of this study.

The last part of this chapter examines the Swedish Investment companies' definitions of Net Asset Value and also the relationship between the choice of valuation method and the disclosure of Net Asset Value. Once again, this information is obtained from the annual reports and is subject to the researcher's own interpretations.

6.2 Harmonization

6.2.1 Sweden

Harmonization of accounting standards means that the differences regarding accounting principles among nations should be kept at a minimum. The term "harmonization" is in theory only related to international differences and cannot be analyzed on a national level. The analysis considering national accounting differences will therefore be based on the term *standardization.* The Swedish accounting procedures for valuing portfolio companies can be seen from two perspectives. The first perspective is based on the fact that all five of the Swedish companies included in the study state that they value their investments in line with the recommendations produced by EVCA. This perspective gives the impression that there is a considerably high state of uniformity in the accounting procedures applied in Swedish Investment Companies.

The second perspective considers the Swedish Investment Companies' application of EVCA's valuation guidelines. Even though the Swedish accounting procedure for valuing portfolio investments can be seen as a standardized set of principles from one perspective, the reality shows that the EVCA guidelines are applied in different matters. These different applications make the valuation procedures fairly incongruent. The result of this discussion is that the level of standardization can neither be considered high or low.

6.2.2 The United Kingdom

The degree of standardization in the United Kingdom is considerably high compared to Sweden. This statement is based on two considerations. Firstly, the three companies applying BVCA's valuation guidelines are using these in a much more uniform matter than the companies applying EVCA's valuation guidelines in Sweden. The second consideration concerns that the other two companies not applying BVCA's valuation

guidelines, use methods that are congruent to these guidelines. It therefore seems obvious that the valuation procedures in the United Kingdom are fairly standardized and in line with the objective of standardization presented in the theoretical framework as: *The objective of standardizing accounting principles are to ensure comparability of financial information.*

6.2.3 The United States

The empirical study shows that the degree of standardized valuation procedures in the United States is fairly low. This statement is based on two factors. The first is centered around the lack of a strong organization that provides industry accepted valuation guidelines. None of the studied companies state in their annual reports that they apply National Venture Capital Association's valuation guidelines. Nevertheless, two of the studied companies, Allied Capital and Capital Southwest are members of the National Venture Capital Association. Despite this fact, the two companies do not apply precisely the same valuation principles that NVCA recommends. The second factor to the low degree of standardization is that the other companies don't follow any guidelines and instead use their own valuation procedures. These valuations become very subjective and by definition these valuation principles cannot be standardized. These considerations are contradictory to the theory that the accounting practice in the United States is focused very much on the interests of the investor. Investors would rather prefer information that ensure comparability of financial information, and are not as based on subjectivity as the current procedures are.

6.2.4 Comparative Analysis

The comparative analysis of the three countries can be focused on the degree of standardization within each country. The empirical study shows that the United Kingdom has the highest level of standardized valuation procedures. The valuation procedures in Sweden are not as standardized

as the procedures in the United Kingdom, because of the different applications of EVCA's valuation guidelines. The least standardized valuation methods can be found in the United States, mainly because of the lack of a strong organization providing industry accepted valuation guidelines.

The degree of standardization within each country provides a base for analyzing the harmonization process in the Investment Company market on an international level. With the establishment of EVCA, BVCA and NVCA the reporting and disclosure procedures for the Investment Company market have reached a higher degree of harmonization. Nevertheless, the valuation procedures for portfolio companies within Investment Companies are not in full harmony. There are three main reasons for this statement. Firstly, as seen in chapter four, the valuation guidelines provided by the venture capital associations are not in full conformity. Secondly, the application of these guidelines differs in all three countries, which minimizes the harmonization process. The third reason is based on the fact that all of studied Investment Companies in this research do not apply valuation procedures developed by an association mentioned above, and instead use their own methods. These three factors give an overall picture of the current situation of the harmonization process within the research issue.

6.3 Valuation Methods

6.3.1 Sweden

The choice of valuation method in Sweden can be focused around the European Venture Capital Association guidelines. All five of the Investment Companies that are included in this study state that they use these guidelines. Nevertheless, each company applies these valuation guidelines in different matters.

6.3.1.1 Listed Investments

The different implementations of the EVCA guidelines are not as obvious for listed investments as for unlisted, but a diverse application of methods can still be detected. As for all companies, except Investor and Novestra, the listed investments are valued at the latest market price per balance sheet date. Investor and Novestra differ from this method in the means that they apply a discount to the market value. Novestra implements this discount only if the divestment of shares is restricted. Investor on the other hand applies a discount of 10 to 20 percent on all listed investments.

The interesting notion regarding the implementation of a discount to the current market value is to understand why some companies apply it and why some companies do not. First of all it is important to understand the reasoning behind the discount. The discount is applied mainly to reflect the liquidity of the investments i.e. the problem of selling the security at short notice with no substantial loss of money. In the case that a company owns large numbers of shares in relation to the trading volume, the company would have significant problems to find a buyer for the divestment. Thus, the current market value would not reflect the fair value that the Investment Company would obtain in the event of a divestment.

There are two factors that could explain why Investor applies a discount to the market value of its listed investments. First of all, 91 % of the investments in Investor's portfolio are listed. This is a substantially higher degree of listed investments compared to the other companies employed in this study excluding Custos. Due to the higher degree of listed investments, the materiality concept becomes fundamental and therefore a need to establish a more accurate estimate of fair value. The second factor that could explain Investor's use of discount is the company's large holdings in their portfolio companies. These substantial holdings result in greater problems of selling the security at the current

market value and consequently the liquidity problem arises, which can be accounted for in the net asset calculation by adopting a discount rate.

Novestra's reasoning for applying a discount for listed investments is more complex to understand. The company has neither a high degree of listed investments nor large substantial holdings. However, one explaining factor could be Novestra's attempt to more strictly follow the EVCA valuation guidelines, which states that a discount should be applied for quoted investments. This aspect can be reinforced by looking at the information that Novestra discloses regarding their application of EVCA's valuation guidelines. The company provides significantly more information than the other companies, which could explain a more strict approach where a discount to listed investments is applied.

Custos has the same portfolio structure as Investor, with over 90 % investments in listed companies. A significant difference between these two companies is that Custos do not apply a discount to their listed investments. The impact of this choice can be distinguished by recalculating Custos Net Asset Value and this time including a discount of 15 % to the listed investments.

Subtotal, listed companies	5050
Discount, 15 %	*- 757.5*
Option issued	- 26
Total listed companies	**4266.5**
Subtotal, unlisted companies	611
Options issued	- 164
Total unlisted companies	**447**
Total securities portfolio	**4713.5**

By using a discount of 15 %, the market value of the listed investments decrease from 5050 to 4292.5, which is a difference of 757.5 MSEK. The Net Asset Value will decrease by the same amount. This example explains how the use of different valuation approaches affect the Net

Asset Value and highlights the importance for investors to understand and be aware of the differences in order to use the information as a base for decision-making.

One aspect that could explain Custos' reasoning in excluding the liquidity discount is related to the notion of creative accounting. Naser states that creative accounting is "*the transformation of financial accounting figures from what they actually are to what prepares desire by taking advantage of existing rules and/or ignoring some of them or all of them."* Custos appears to take advantage of existing rules by excluding the discount, which consequently increases the company's Net Asset Value. Even though EVCA has provided guidelines for valuing listed investments, these guidelines cannot be considered as rules, but just as recommendations for members and therefore provides opportunities for companies to apply some form of creative accounting.

6.3.1.2 Unlisted Investments

The differences in the valuation procedure are even more noticeable when considering the unlisted investments. The EVCA guidelines have been applied to all Swedish companies for unlisted investments except Investor. The interesting impression when analyzing the applied valuation methods is that the studied companies only follow EVCA guidelines to a certain degree.

For the valuation of unlisted investments, Bure Equity, Novestra and Ledstiernan have adopted the same principles. This implies that the market value is determined on the basis of the value of the latest transaction in the security in which an external party has taken place. Other unlisted investments for these companies have been valued at the acquisition price.

These three companies state in their annual reports that they have valued their unlisted investments in accordance with EVCA's valuation

guidelines. Nevertheless, none of these companies has applied the guidelines to full extent. According to the companies, fair value is only obtained if a transaction has taken place in the security involving a new financing round. In the event that a transaction has not taken place, and the company has revenues and either profits or positive cash flow, EVCA suggests that the fair market value may be determined by the use of the average of the pool of price/earnings ratio (P/E), price/cash flow (P/CF), enterprise value/earnings before interest and tax (EV/EBIT) and depreciation and amortization (EV/EBITDA) multiples derived from comparable companies.

Instead of applying these guidelines, Bure Equity, Novestra and Ledstiernan value their remaining unlisted investments at the acquisition price. The cost valuation procedures applied by these companies are not in accordance with Kam's standpoint that financial information needs to be future oriented in order to emphasize the decision-making aspect of financial reporting. This would be appropriate if the valuation was conducted in the initial post investment period (12 months) or if the company did not generate any profits or positive cash flow. However, all three companies have investments that according to EVCA could be subject to a valuation based on comparables. There are four possible factors that could explain these companies' choice of valuation method. Firstly, the accounting system in Sweden is still influenced by the legal and taxation requirements, which have encouraged a more conservative reporting approach. This conservative approach proposes the use of valuation more or less based on cost accounting principles. According to the theoretical framework, one common argument for applying this method is based on the notion that cost provides relevant information because it focuses on the decision to acquire the asset and the earnings effect of that decision. The opponents of this theory argue that fair value ignores those concepts and focuses instead on the effects of transactions and events that do not involve the enterprise. Furthermore, valuation based on comparables is focused more on the short-term perspective,

where the objective is to maximize the value of the company with no regard for future prospects.

A second factor why comparables are not applied for these companies in Sweden is related to the first issue, and proposes that valuation based on e.g. P/E ratios increases the volatility in the valuation. The reason for this is that both earnings and prices have to frequently be adjusted due to market changes. The third explanation why comparable valuation is not applied for these Investment Companies could be that there are difficulties in finding relevant companies to include in the comparison. This is related to the fact that the Swedish market is smaller than for example the markets in the United States and the United Kingdom. The fourth explanation for not using comparables could be that there is a notion of anxiety at being the initial applier of comparable valuation. In the event that one company starts using this kind of valuation it is very likely that other investments companies will follow the same principles.

Custos has implemented a different approach to value its unlisted investments than the three companies mentioned above. All Custos unlisted investments, except Acando and Open Training Sweden have been valued at adjusted shareholder's equity plus surplus value of listed securities. Acando has been valued according to an internal appraisal based on Acando's earnings capacity that is in line with EVCA's valuation guidelines. Open Training Sweden has been valued at acquisition value.

Custos method of using adjusted shareholder's equity plus surplus value of listed securities can be explained by the fact that their unlisted investments excluding Acando amounts to only 2 % of the total value of the portfolio and therefore a more thorough valuation procedure is not applicable. The most interesting issue regarding Custos choice of valuation method is their valuation of Acando. The reason for this is that the company does not apply EVCA's guidelines for any of its investments except Acando. Again it seems obvious that Custos seeks to

maximize its Net Asset Value. The book value of Acando is 68 MSEK and its market value based on an Acando's earnings capacity is 499 MSEK. This shows how the company can enhance its Net Asset Value with approximately 431 MSEK by using a different valuation approach. Custos valuation approach can be connected to Amat et al's first category of creative accounting. This principle states: "*The accounting rules allow a company to choose between different accounting methods. A company can therefore choose the accounting policy that gives their preferred image."*

Due to Custos use of various accounting principles for different investments, the reliability of the accounting information can be questioned. In FASB Statement of Financial Accounting Concepts No.2 *"Qualitative characteristics of Accounting Information",* the notion of comparability and consistency is discussed. These concepts are two of the main characteristics for obtaining reliable accounting information. Consistency can be defined as the quality of the relationship between two accounting numbers rather than a quality of the numbers themselves. The quality of the valuation of Acando cannot be questioned, but the relationship between the valuation of Acando and Custos' other unlisted investments are not consistent, which has a deteriorating effect on the quality of the accounting information.

Investor is the only company that does not use EVCA's valuation guidelines to any extent for unlisted companies. Investor's valuation approach was changed from applying EVCA's guidelines to a more conservative approach where investments are valued at acquisition value with deduction of any write-downs. The decision to use a more conservative approach is probably based on the downturn in the stock market. This statement can be reinforced by looking at Investor's new investments in unlisted companies. 70 % of these investments are conducted in the technology and the healthcare sector, which both had extreme future expectations and consequently high market values. According to Investor, a conservative method would therefore provide a

better estimate of fair value of the portfolio companies. As mentioned in the empirical chapter, Novestra also changed its valuation policy in its interim report for July 1 2000 from EVCA to a more conservative approach. Again this can be explained by the extreme volatility in the market.

An interesting issue is to compare the valuation procedure between Novestra on the one hand and Custos on the other. As stated before, Custos applies a method that increases the company's Net Asset Value and at the same time, Novestra changes from one method to another that decreases the Net Asset Value. One reason for these different approaches is related to one of Naser's five motivations for adopting creative accounting, which considers the pressures from big institutional investors to report flattering results. This can be related to Custos' ownership structure, which consists of most of the big institutional investors on the Swedish market such as Öresund, Handelsbanken, Goldman Sachs and Skandinaviska Enskilda Banken.

6.3.2 The United Kingdom

The choice of valuation method in the United Kingdom can be centered around the British Venture Capital Association's valuation guidelines. Three out of the five companies included in the study, state in their annual reports that they apply these guidelines.

6.3.2.1 Listed Investments

All five companies value their listed investments at the closing price at the balance sheet date. The differences between these companies are that three out of the five companies use a discount to reflect the liquidity problem of the investment. These three companies, 3i, Candover and Northern Venture Trust, are the companies that apply the BVCA valuation guidelines. It is difficult to find a relationship between the portfolio structure of these Investment Companies and the use of liquidity

discounts for these three companies. One explanation for applying this discount could be that the guidelines set by BVCA are followed more strictly by the Investment Companies in United Kingdom compared to how Swedish companies follow EVCA's valuation guidelines.

6.3.2.2 Unlisted Investments

The companies following the BVCA's guidelines apply the same method for valuing listed investments. However, these companies differ in the procedures of valuing unlisted investments. The company that deviates most from the other companies is 3i. Their valuation procedure is focused on a specific method based on 3i earnings capacity that is described in the empirical findings. The specific characteristic for 3i's valuation is that if the result of the valuation is less than half of 3i's share of net tangible assets then the investment is valued at half of the 3i's share of net tangible assets. This seems to be a method that secures 3i's valuation to a certain extent. This kind of valuation method is not suggested by the BVCA and it therefore gives the impression that 3i tries to transform their actual valuation in the event of the valuation appearing low, to a higher valuation based on an internal proposal.

3i also distinguish themselves from the other U.K. Investment Companies analyzed in this study in their decision to review certain investments that are valued above a certain amount. These investments are reviewed according to internal guidelines and are adjusted if the factors affect the value. The factors included in 3i's internal guideline is for example: forecasts by the investee business of lower earnings, high amount of debt, large cash holdings and an industry standard basis of valuation.

The main reason why 3i implements this type of valuation procedure is likely to be based on the fact that 3i is Europe's leading venture capital company and by that has the possibility to influence the development of new valuation standards. This opinion is also noticed when analyzing the

entire European Investment Company market where an obvious respect and consideration is given to 3i's operations.

The other two Investment Companies that apply BVCA's guidelines, Candover and Northern Venture Plc, differ only to a small extent. Candover uses the four recommended methods i.e. cost, open market valuation, earnings multiple and net assets. Northern Venture Plc uses the same methods except for the use of net assets as a valuation basis. The reason for why Northern Venture Plc does not apply this method is probably because the company does not carry investments where there is a significant property element attached to the business. Northern Venture Plc departs from both Candover and the BVCA in their implementation of the level of discounts. The most noticeable discount is when the company states that the P/E ratio based on a comparable listed company or sector should be discounted by 25-50 % to reflect unmarketability. BVCA recommends that the level of discount should be 25 % and it therefore seems like Northern Venture Plc applies a more conservative valuation procedure than the other companies. Another reason why Northern Venture Plc applies a considerably high discount is that their equity ownership in other companies is larger percentage wise than e.g. Candover's ownership. A large equity ownership in relation to the stocks trading volumes provides a very illiquid investment and to obtain an estimated fair value, a higher discount is necessary.

Caledonia and Amerindo have created their own valuation procedures and do not follow any recommended guidelines. Nevertheless, the procedures used by these companies can still be related to the procedures used by companies that apply BVCA's guidelines. Caledonia states in their annual report that the unlisted investments are held at cost or valued at market prices at the balance sheet date where an organized market exists, or by the directors valuation based on dealing prices, stockbroker's valuation, Net Asset Values or other appropriate information. This policy differs from the one that Amerindo's uses, which is only based on the price reflecting the most recent significant issue of shares. This price is

subject to an adjustment to account for compelling circumstances such as operating results in a particular company or macro factors influencing the company's sector. Due to the fact that both these companies apply their own valuation guidelines, the question of reliability and subjectivity arises. There is no information concerning detailed valuation procedures for each investment for either of the two companies, and it is therefore difficult to elaborate on this issue further.

6.3.3 The United States

The valuation methods in the United States appear to be more based on the companies own valuations than guidelines produced by a venture capital association. None of the companies included in the study states that they follow the recommended guidelines produced by the National Venture Capital Association (NVCA). Nevertheless, two of the studied companies, Allied Capital and Capital Southwest are members of the National Venture Capital Association. Despite this fact, the two companies do not apply precisely the same valuation principles that NVCA recommends.

6.3.3.1 Listed Investments

All of the U.S. companies included in the study except Van Kampen divide its securities into restricted and unrestricted securities. The restricted securities are usually regarded as securities which are subject to one or more restrictions on resale and are not freely marketable. These restricted securities are valued at a discount from the public market value by all companies. The one exception is Capital Southwest, which takes other factors into account when valuing restricted listed investments such as financial condition and operating results of the issuer, the long-term potential of the business of the issuer, the market for and recent sales price of the issuer's securities and so on. Van Kampen basis their investments' value using market quotations or indications of value obtained from an independent pricing service.

The valuation analysis in the United States can be centered around the fact that the Investment Company market lacks a strong organization that develop valuation standards that are accepted by the market. The NVCA valuation guidelines are considered simply to be "standard industry practice", because they are not formally adopted by the NVCA. This problem truly reflects the whole United States investment market and will be even more visible when analyzing the valuation procedures for unlisted investments.

6.3.3.2 Unlisted Investments

Allied Capital is the company that closest follows the guidelines provided by the NVCA. Their valuation is based on various factors including a history of positive cash flow from operations, the market value of comparable publicly traded companies, and other factors such as recent offers to purchase a portfolio company's securities or other liquidation events. The values are usually discounted to account for liquidity issues and minority control positions. The interesting issue regarding Allied Capital is that the company disregards the use of valuing a portfolio company at cost. This is usually the most common method of valuing an investment, especially if the valuation is in the start-up phase of the company. The absence of cost valuation is also inconsistent with the theory that states that the accounting practices in the United States regarding asset measurement tend to be a strict historical cost approach. This is most likely a method for Allied Capital to manipulate the value on the balance sheet and by that increase the Net Asset Value and therefore this valuation method will not provide a good basis for decision-making. The view that accounting information should be helpful in the decision-making or evaluative process is widely accepted. Thus, Allied Capital's accounting procedures differ from Moonitz theory, which states:

"*Quantitative data are helpful in making rational economic decisions, i.e., in making choices among alternatives so that actions are correctly related to consequences."*

A different perspective on this issue could be that the cost method is not applied because of the fact that it is much easier to find comparable companies in the United States compared to Sweden and the United Kingdom. This implies that valuation based on comparables such as price to earnings, cash flows and other relative measurements are easier to conduct and therefore considered to be a better estimate of fair value than cost.

UTEK Corporation applies a similar valuation procedure to Allied Capital. The main difference is that UTEK Corporation basis its determination of fair value on both applicable quantitative and qualitative factors. UTEK Corporation is the only company that states that qualitative factors are considered in the valuation. The other companies indirectly consider qualitative factors, because these are usually discounted into ratios such as the price to earnings. The qualitative factors that UTEK Corporation considers are for example the nature of business and competitive conditions. There is no information regarding how these factors have been accounted for in the valuation of the portfolio companies.

Equus II Incorporated is the only United States based company included in the study that applies cost as a determination of fair value. This valuation is consistent until significant developments affecting an investment provide a basis for use of an appraisal valuation. This type of valuation where cost is used as a basis for the entire valuation process, is very similar to the valuation procedures applied in Sweden and in the U.K. Equus II's appraisal valuation as seen in the empirical findings is very similar to the procedure applied by Capital Southwest. This appraisal valuation considers such factors as the portfolio company's earnings, cash flow and net worth, the market prices for similar securities of comparable companies and an estimation of the company's future financial prospects. Equus II's appraisal valuation is to some extent subjective, because these methods are based on estimations of certain variables. Harvey and Keer (1978) state that subjectivity is the price that

may have to be paid for relevant and useful information. This means that in an uncertain world, a certain degree of subjectivity has to be accepted and it is the investor's role to access the relevance in the disclosed information.

The last company studied in the United States, Van Kampen Income Trust states that valuations are obtained from yield data relating to instruments or securities with similar characteristics in accordance with procedures established in good faith by the Board of Trustees. This information is insufficient and very subjective, and not in accordance with FASB's basic objective of external financial reporting, which states:

" Financial Reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions."

6.3.4 Comparative Analysis

When comparing the valuation methods used in the three studied countries, a few significant differences have been found. First of all, the valuation methods in Sweden are mostly based on the value of the latest transaction in the security in which an external party has taken place. This method is also used in the United Kingdom and in the United States, but more as an alternative to other methods. In Sweden none of the companies applies valuation methods based on comparables, which could create a problem for the Swedish companies in attempting to estimate the correct fair value. As stated in the theoretical framework, the objective of valuation is to represent the assets' fair value. The fair value is defined as the amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction (IAS 32, 2001). FASB 140 states that if quoted market prices are not available, the estimate of fair value should be based on the best information available. The estimate of fair value should consider prices for similar assets and the results of the valuation techniques that have

been applied. This reinforces the fact that Swedish companies do not value their investments at fair value.

One interesting issue when comparing the valuation procedures in the three studied countries is the lack of using the present value methodology. According to FASB's Statements of Financial Accounting No. 7, the objective of present value when used as accounting measurement is to estimate fair value. The main reason why investment companies do not apply the present value methodology is probably due to the complexity of estimating the different variables. To relate this discussion to practice, 3i can be used as an example. Due to 3i's vast number of portfolio companies, the cost and time effort of applying the present value method on these companies would probably exceed the benefits of using this method.

Another difference between the valuation procedures between the three countries is the extent to which cost valuation is applied. In Sweden and the United Kingdom cost is a frequently applied method, whereas it is very rarely used in the United States. This results in a more subjective valuation approach in the United States. The empirical findings regarding valuation procedures in the United States are in accordance with Wright & Robbie's survey on standard methods for valuing investments. Their study showed that the most frequently applied methods in the United States were variations of price earnings multiples. The cost principle used in Sweden is also in accordance with the fact that Sweden is using the most conservative approach of the three countries, which can be related to the history of the Swedish accounting system.

A third difference between the studied countries is the extent to which the different venture capital associations influence the valuation procedures. The companies in the United States follow the guidelines provided by the NVCA to a lower degree than both how the companies in the United Kingdom follow the BVCA's guidelines and how the Swedish companies apply EVCA's guidelines.

6.4 Net Asset Value

6.4.1 Definitions of the Net Asset Value

The empirical chapter shows that the Swedish companies define their Net Asset Value in a fairly similar way. The most simplified definition presented in the theoretical chapter is based on the principle that the objective of Net Asset Valuation is to calculate adjusted equity, i.e. total equity adjusted for possible differences to the reported book values. The adjustment that is made by the Swedish investments companies in order to obtain their Net Asset Value are for the investments surplus values. However, the theory states that adjustments should also be made for deferred taxes. Nevertheless, this is not implemented in the Swedish investments companies.

The definitions are not stated in exactly the same manner, but the implications of the different definitions are equal. Custos' and Investor's definitions of the Net Asset Value can be used as an example to highlight this issue. Custos defines its Net Asset Value as *" reported equity adjusted for net liabilities for synthetic share buy-backs plus surplus value in the portfolio, without subtracting deferred taxes."* The reason why deferred taxes have not been taken into account is that Custos as an Investment Company can avoid taxes through its choice of dividend policy. Investor on the other hand, defines its Net Asset Value as "*shareholders' equity, convertible debenture loans and surplus."* These two definitions are obviously stated in a differed way, but the essence of the implication is congruent with each other.

6.4.2 Net Asset Value, Disclosure and Valuation Methods

This analysis will try to find any possible relationship between an Investment Company's choice of valuation method and its disclosure of Net Asset Value. The amount of Net Asset Value information disclosed by a company can explain that specific company's attitude towards the

use of the Net Asset Value. Bure Equity and Custos are the two companies that disclose most information on Net Asset Value out of the studied Swedish companies. Nevertheless, the empirical findings show that these two companies can be seen from different perspectives. Bure Equity, on the one hand, has not applied any form of creative accounting by their choice of valuation methods. It therefore seems obvious that Bure attempts to provide information that reinforces their reliability in its Net Asset Value. One example of this type of information is their disclosure of the uplift index, which measures the difference between the latest reported Net Asset Value of a realized asset and the exit value. This kind of disclosure could be related to one of Iqbal et al's theories regarding reasons for voluntary disclosure. Iqbal et al argue that voluntary disclosure is provided in order to generate a certain image that may create goodwill that could result in future economic benefits. In Bure's case of disclosure, goodwill is referred to as the reliability of Net Asset Value and by that the future benefits that could arise, such as investor confidence, better reputation and lower uncertainty.

Custos on the other hand, based on the empirical findings, seems to apply some form of creative accounting in order to increase its Net Asset Value. According to the discussion above, Custos should not disclose much information on Net Asset Value, because a great amount of information on Net Asset Value may recognize the use of creative accounting. However, Custos' annual report provides fairly much information on Net Asset Value and therefore this hypothesis is rejected. Nevertheless, Custos does not provide any information that reinforces the reliability of the Net Asset Value, such as the uplift index disclosed by Bure Equity. One reason for not providing this information could be that Custos Net Asset Value does not estimate the correct fair value.

Investor also provides significant information on Net Asset Value. This policy can be combined with Investor's valuation procedure of using cost as the basis for unlisted investments. These two facts concludes that Investor's disclosure policy is in line with Iqbal et al's (1997) main

motivational factor for additional disclosure, which states that a company may be able to obtain capital at a lower cost by reducing uncertainty and associated risks to investors. Both Investor's additional information and its conservative valuation procedures reduce the risks to the providers of capital.

Novestra's annual report provides information on Net Asset Value to a low extent. The only information disclosed is a graph showing the Net Asset Value development for the last three years. Novestra's reasoning for not providing additional disclosure is probably that the company's total costs for additional disclosure exceed the company's total benefits. More explicitly, Novestra's way of thinking is in line with Iqbal et al's (1997) thoughts on additional disclosure; "*One common threat regarding additional disclosure is that the information obtained through disclosure may be used for making decisions that are not in the best interest of the company that provides the information."* The question of reliability arises when analyzing Novestra's Net Asset Value due to the fact that there is no information regarding the value of the different investments. The only value that is provided is the book value of each investment, which is not enough information to analyze the components of the Novestra's Net Asset Value. This kind of disclosure is not in line with FASB's objective of financial reporting, which states that: *"Financial Reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions."*

As seen in the empirical chapter, Ledstiernan does not provide any information on Net Asset Value. The reason for this is that all of Ledstiernan's investments except Nordic Circle are valued at book value. The rationale for valuing at the acquisition price is that most of Ledstiernan's investments are conducted less than 12 months prior to the balance sheet date, and should therefore according to EVCA be valued at cost. As seen in the theoretical chapter, the Net Asset Value equals adjusted equity and in the case of Ledstiernan total equity is equivalent to

adjusted equity. This implies that no Net Asset Value is obtainable and therefore no information is disclosed. Nevertheless, by looking at Ledstiernan's portfolio there are investments, according to EVCA, that could be subject to alternative valuation methods than cost. If another method had been applied, Ledstiernan's equity would not have equaled the adjusted equity and a Net Asset Value could have been obtained. Due to the importance of Net Asset Value in the Investment Company market, investor's will have more difficulties in analyzing Ledstiernan's investments and its operations with the current valuation procedures.

This chapter presents the conclusions by answering the research issues and continues with suggestions for further research.

7 CONCLUSIONS

7.1 General Conclusions

This thesis has tried to describe Investment Companies' valuation policies for valuing portfolio companies. These valuations are mainly conducted during the life of an investment as part of the reporting process to investors. Investors use this information as a basis for the decision-making, so that they can assess the value of their investment in the company and the performance of the investment manager. The conclusions are focused around the key words used in this thesis: valuation method, standardization, harmonization and Net Asset Value.

The principal conclusion related to the research issue is that there exist various methods of valuing portfolio companies in Sweden, the United Kingdom and the United States. These different methods are not only found within each country, but also found when comparing the overall tendency between the three countries. The valuation policy in Sweden still tends to be based on the cost principal, whereas the valuation methods in United Kingdom are both based on costs and comparables. The Investment Companies in the United States apply methods that are contradictory to the Swedish approach and exercise mostly comparables in the valuation process.

The empirical study illustrates that the United Kingdom has the highest level of standardized valuation procedures. The valuation procedures in Sweden are not as standardized as the procedures in the United Kingdom, because of the different applications of EVCA's valuation guidelines. The least standardized valuation methods can be found in the United States, mainly because of the lack of a strong organization providing industry accepted valuation guidelines.

With the establishment of EVCA, BVCA and NVCA the reporting and disclosure guidelines for Investment Company market have reached a higher degree of harmonization. Nevertheless, the valuation procedures for portfolio companies within Investment Companies are not in full harmony. There are three main reasons for this statement. Firstly, as seen in chapter four, the valuation guidelines provided by the venture capital associations are not in full conformity. Secondly, the application of these guidelines differs in all three countries, which deteriorates the harmonization process. The third reason is based on the fact that all of studied Investment Companies in this research do not apply valuation procedures developed by an association mentioned above, and instead use their own methods. These three factors give an overall picture of the current situation of the harmonization process within the research issue.

This study concludes that the Swedish companies define their Net Asset Value in a comparatively similar way, where adjustments are only conducted for the surplus values in the investments. Nevertheless, the differences lie in the disclosure of related information on the Net Asset Value. The amount of Net Asset Value information disclosed by a company can explain that specific company's attitude towards the use of Net Asset Value. Furthermore, the nature of the information an Investment Company discloses can also be related to both the valuation methods used and the attitude towards that company's Net Asset Value.

7.2 Suggestions for Further Research

Although the research about asset and company valuation is quite extensive, surprisingly few theoretical and empirical studies have focused on Investment Companies' valuation procedures for their portfolio companies. However, this area needs to be more fully explored and more empirical studies should be conducted. Based on our empirical findings it is obvious that the valuation guidelines provided by the venture capital associations are not complete, and therefore it could be of interest for

both Investment Companies and investors to establish valuation guidelines that would be applicable both within one country and across nations. These guidelines should be appropriate even in extreme market conditions, in which the current guidelines seem inappropriate. Secondly, it would be very interesting to adopt a more in-depth study where the objective is to analyze how one company's Net Asset Value would be affected by applying different valuing methods for the portfolio companies. The last suggestion, which is a more investor related issue, would be to analyze the demands from investors on what they require Investment Companies to disclose, in order to make sound economic decisions.

REFERENCES

Articels

Amat, O., Blake, J and Dowds, J., (1999), *The ethics of creative accounting*, Working paper. Central Lancashire University, England.

Artsberg, K., (1995), *Accounting for public interest?: a critical investigation of the perspective of IASC,* Institute of Economic Research, School of Economics and Management, Lund University ; 1995:8

Barney, J., (1991), *Firm Resources and Sustained Competitive Advantage*, Journal of Management, 17 (1), 99-120.

Blake, J., Amat, 0., Martinez, D. and Garcia, F. (1995), *The continuing problem of international accounting diversity*, Company Accountant, April: 23-5.

Mahoney, J. T., and Rajendran P. J., (1992), *The Resource-Based View Within the Conversation of Strategic Management*, Strategic Management Journal, 13 (5), 363-80.

Rappaport A., (1998), *Creating shareholder value*, Free press, cop. London, Collier Macmillan Inc., New York

Sharp, Byron (1995), *"Brand Equity and Market-Based Assets of Professional Service Firms,"* Journal of Professional Services Marketing, 13 (1), 3-13.

Literature

Andersson, J., (1977), *Om avyttring av rörelse*, Discimus Förlagsaktiebolag, Stockholm.

Bell, P.W., and Edwards, E.O, (1961), *The Theory and Measurement of Business Income*, University of California Press, Berkeley.

Bodie Z., and Merton R., (1999), *Finance*, Prentice Hall, Upper Saddle River.

Brealey, A., and Myers, S., (2000), *Principles of Corporate Finance*, McGraw-Hill, New York.

Choi Frederick, D.S., and Mueller, G.G., (1999), *International Accounting, 3rd* ed., Prentice-Hall, Englewood Cliffs.

Copeland T.E., Koller T., and Murrin J., (2000), *Valuation: measuring and managing the value of companies,* Jon Wiley & sons, New York

Elliott B., and Elliott, Jamie., (2000), *Financial accounting and reporting,* Financial Times Prentice Hall cop., New York

Eriksson, L.T. and Wiedersheim-Paul, F. (1999), *Att Utreda, Forksa och Rapportera,* 6:e Upplagan, Liber Ekonomi, Malmö.

Glautier Michael W. E. and Underdown, Brian 1997, *Accounting theory and practice*, 6th ed. Pitman Ltd., London.

Griffiths, Ian, (1990), *Creative accounting: how to make your profits what you want them to be,* Unwin Paperbacks, London.

Gray, S. J., McSweeney, L.B. and Shaw, J.C., (1984), *Information disclosure and the multinational company,* Jon Wiley & Sons, Inc., Chichester

Harvey, M. and Keer F., (1978), *Financial accounting theory,* Englewood Cliffs, New Jersey

Haskins, Mark E., Ferris, Kenneth R. and Selling, Thomas, I., (1996) *International financial reporting and analysis: a contextual emphasis,* John Wiley & Sons Inc., Chicago

Hendriksen, Eldon, S., and Van Breda, Michael F., (1991), *Accounting Theory, 5th ed.,* Homewood, Irwin.

Hult, Magnus, (1998), *Värdering av företag*, 6e uppl., Liber Ekonomi, Stockholm.

Hägg, Claes (1991), *Företagsvärdering*, Studentlitteratur, Lund.

Iqbal, Zafar, M., Melcher, Trini, U., and Elmallah, Amin, (1997), A *International accounting: a global perspective,* South-Western College Pub., Cincinnati.

Jameson, Michael, (1988), *Practical Guide to Creative Accounting,* Kogan Page Inc., London.

Kam, Vernon (1990), *Accounting Theory*, second edition, Jon Wiley & Sons, Inc., New York.

Lekvall, P. and Wahlbin, C., (1993), *Information för Markandsföringsbeslut, 3rd ed.*, IHM Förlag AB, Göteborg.

Lerner, J., (2000), *Venture Capital and Private Equity*, Jon Wiley & Sons, Inc., New York.

Moonitz, Maurice, (1964), *The basic postulates of accounting,* , American Institute of CPAs, New York

Naser, Kamal H M, (1993) *Creative Financial Accounting: Its Nature and Use,* Prentice Hall, Hemel Hempstead.

Nilsson, Å. and Öhlin, L., *Företagsvärdering,* Hermod-Studentitt, 1972 Malmö.

Olbert, L., (1992) *Värdering av Aktier: Finansanalytikers Värderings-metoder och Informationskällor*, Licentiatavhandling, Företags-ekonomiska Institutionen, Lunds Universitet

Radebauagh, Lee H, and Gray, Sidney J (1997), *International Accounting and Multinational Enterprises*, Fourth Edition, John Wiley & Sons, Inc., New York.

Ryan, B., Scapens, R.W. and Theobald, M. (1992), *Research Method and Methodology in Finance and Accounting*, Academic Press Ltd., London.

Wright, Mike and Robbie, Ken (1997), *Venture Capital*, The International Library of Management, Dartmouth Inc., Aldershot.

Walton, J., Haller, A., & Raffournier, B., (1998) *International Accounting*, International Thomson Business Press, London.

Others

British Venture Capital Association (2001), *Guidelines for the valuation and Disclosure of Venture Capital Portfolios*, Jeffery Pellin Inc., London

FAR:s samlingsvolym 2000, FARs förlagsservice, Stockholm.

Financial Accounting Standards Board (2000) *Statements of financial accounting concepts (SFAC), Acounting standards*, New York : John Wiley.

Financial Accounting Standards Board, (1980), SFAC No. 2*, Qualitative Characteristics of Accounting Information,* Financial Accounting Standards Board, Norwalk, Connecticut.

Financial Accounting Standards Board, (2000), SFAC No. 7, *Using cash Flow information and present Value in Accounting Measurement,* Financial Accounting Standards Board, Norwalk, Connecticut.

Financial Accounting Standards Board, (2000), SFAS No 140., *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, Financial Accounting Standards Board, Norwalk, Connecticut.

Hägglund, Peter, B., (2001), *Företaget som investeringsobjekt: hur placerare och analytiker arbetar med att ta fram ett investeringsobjekt,* Ekonomiska forskningsinstitutet vid Handelshögskolan, Stockholm

International Accounting Standards Committee, IASC (2001), *International accounting standards 2001: the full text of all international accounting standards and SIC interpretations extant at 1 January 2001*,: International Accounting Standards Committee London.

Electronic Resources

<http://www.bvca.co.uk>, 2001-11-01
<http://www.evca.com>, 2001-11-01
<http://www.fasb.org>, 2001-11-01
<http://www.iasc.org.uk>, 2001-11-01
<http://www.nvca.com>, 2001-11-01
<http://www.vencap.se>,2001-11-01
<http://www.xrefer.com>, 2001-11-01

<http://www.bure.se>, 2001-09-15
<http://www.custos.se>, 2001-09-15
<http://www.investor.com>, 2001-09-15
<http://www.ledstiernan.com>, 2001-09-15
<http://www.novestra.se>, 2001-09-15

<http://www.3i.com>, 2001-09-15

<http://www.amerindo.com>, 2001-09-15
<http://www.caledonia.com>, 2001-09-15
<http://www.candover.com>, 2001-09-15
<http://www.trustnet.com>, 2001-09-15

<http://www.alliedcapital.com>, 2001-09-15
<http://www.capitalsouthwest.com>, 2001-09-15
<http://www.equuscap.com>, 2001-09-15
<http://www.utekcorp.com>, 2001-09-15
<http://www.vankampen.com>, 2001-09-15

Annual Reports

Bure Equity AB 2000
Custos AB 2000
Investor AB 2000
Ledstiernan AB 2000
Novestra AB 2000/2001

3i Group 2000
Caledonia Investment 2000
Amerindo Internet Fund plc 2000
Northern Venture Trust PLC 2000
Candover 2000

Allied Capital 2000
Capital Southwest 2000
Equus II Incorporated 2000
UTEK Corporation 2000
Van Kampen High Income Trust 2000