DIRECT INVESTMENT TECHNICAL EXPERT GROUP (DITEG)

OUTCOME PAPER (DITEG) # 1(A)

August 12, 2004

1. **Topic:** Valuation of direct investment equity

2. **Issues:** See DITEG Issue Papers # 1(A) by the US, ECB, and Australia

3. **Recommendations:**

(i) The group agreed that market valuation is the preferred concept for the measurement of direct investment equity, and that this concept needs to be maintained and stressed in the updated standards.

(ii) The group agreed that the international organizations (IMF and OECD) should provide more guidance and information on options for measuring market values, particularly for measuring the market value of equity in unlisted companies.

(iii) Several background papers were presented to the group, and these papers described numerous different methodologies for estimating the market values of direct investment equity:[1]

a. Actual prices at which recent transactions were conducted. These prices would almost always exist for listed companies (based on stock exchange quotations) and would sometimes exist for unlisted companies whose shares had recently traded.
b. Methods based on stock market indexes (see background documents provided by the United States and by Australia).
c. Methods that applied capitalization ratios (market value divided by book value) for listed companies to unlisted companies.
d. Methods that revalued just tangible assets of direct investment enterprises, including land and other property, plant, and equipment, and inventories (see background document provided by the United States).
e. Methods based on net asset values, including identified intangibles and goodwill, reflecting current period prices.[1]
f. Methods based on net asset values, but excluding goodwill, reflecting current period prices.

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[1] A description of these methods, including details on topics such as how to identify and value goodwill (item (iii)e), may be clarified in compilation guides or annexes to the standards rather than in the body of the updated standards themselves.

g. Methods based on the volume of own funds of the direct investment company, i.e. "Own Funds at Book Value" (see background documents provided by the ECB)[2]

(iv) Some practical issues were raised about the continued existence of asymmetries due to differences in valuation methods and differences in accounting rules followed by different countries. It was believed that the extension of fair value accounting principles to additional balance sheet items by the organizations that establish accounting standards may narrow these differences over time.

4. **Rejected Alternatives:**

(i) The group also identified some methods that it considered to be unacceptable.

a. The group rejected the broad use of historic cost or acquisition price (same as in *BPM5*).
b. The group rejected accumulating balance of payments flows to estimate direct investment equity on an annual basis.

5. **Questions for the IMF Committee on Balance of Payments (the Committee) and the OECD Workshop in International Investment Statistics (WIIS)**

(i) Do the Committee and the WIIS agree that market valuation is the preferred concept for the measurement of direct investment equity, and that this concept needs to be maintained and stressed in the updated standards?

(ii) *Do the Committee and the WIIS agree that the use of historic cost/acquisition price, and the accumulation of flows over a long period of time, should not be acceptable methods for valuing direct investment equity? (See 4(i) above.)*

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[2] In addition to other components (paid-up capital, investment grants, shares premium accounts) the OFBV method incorporates cumulative reinvested earnings (including current-year results). It was reported that, in the future, in calculating OFBV, most assets of some companies will have to be written up or down at least once a year to reflect their fair or current values.