NEW YORK (Dow Jones)--The debate among venture capitalists over company valuations is sure to intensify after an industry group reaffirmed a key guideline on the topic.

At the heart of the matter is a simple question: How do venture capitalists determine the dollar value of the companies they invest in? Generally Accepted Accounting Principles say they must assign a "fair value" to their companies, but considering these start-ups often lack measurable profits, products or customers, what exactly is fair value?

(A version of this story appeared in Private Equity Analyst, a monthly newsletter published by Dow Jones & Co.)

To try to answer the question, a group of venture capitalists and investors formed the Private Equity Industry Guidelines Group in 2002, and issued a set of comprehensive valuation recommendations in 2003.

The 4-year-old group published Monday an amended set of recommendations but upheld one guideline that has ruffled many feathers. This is "Paragraph 30", which states that venture capital firms should be able to write up their companies' values between financing rounds.

In other words, if a firm invests in a start-up at $1 a share and the company's prospects later improve, the firm can tell investors that the company is worth $1.50 or $2 a share, even though no one has invested in the company at that price.

PEIGG says private equity firms should be open to conducting write-ups and write-downs outside of financing rounds. "If the firms say: 'We don't do non-round write-ups,' - that policy is not GAAP," argued David Larsen, a PEIGG member and managing director of the financial advisory firm Duff & Phelps.

Some venture capitalists feel that "non-round" write-ups help them assign more precise company values when reporting to their investors. Jeanne Henry, chief financial officer of Atlas Ventures, said she conducts a write-up when a company has matured in the months or even years since the last financing round.

"From time to time, we write up a company without an external event," she said. "As companies mature, they're generating revenue, and they become cash-flow
positive." But most venture investors object to such write-ups, and as a result have elected not to adopt the guidelines.

According to a 2005 survey conducted by the Center for Private Equity & Entrepreneurship at Dartmouth's Tuck School of Business, only 19% of fund managers said they follow the PEIGG recommendations.

"By definition, there is a lot of subjectivity," said Stephen Holmes, CFO of venture capital firm Interwest Partners and a founding member of PEIGG. "There's no set of guidelines that will give you an equation that automatically dumps out a value."

Venture capitalists oppose non-round write-ups primarily because such tactics also bring non-round write-downs back to the table. Too many VCs remember having to slash the values of their Internet and technology companies after the bubble, and nowadays prefer to boost a company's value only when a formal financing round dictates it.

"In the venture world, we see a high degree of volatility and we want to maintain conservative valuations," said Brian Jacobs, co-founder of Emergence Capital, which has created its own guidelines.

Many limited partners agree. Because young companies are so unstable, investors want venture fund managers to report only the most realistic values, to keep their investment portfolios from becoming too volatile.

"I think most investors are pretty conservative and would prefer not to see interim mark-ups," said Stephen Huber, director of alternative investments at State Teachers' Retirement System of Ohio.

Given the complexity of the issue, venture capital firms may not ever be able to get on the same page regarding company valuations. "You can't expect a general partner to nail a valuation exactly," said Colin Blaydon of the Tuck School. "It's part art and part science."