Page 2847 - 2862 **DOI:** *https://doij.org/10.10000/IJLMH.1110166*

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 8 | Issue 3

2025

Fair Value of Investment Funds: Determination Methods

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ABSTRACT

Fair value measurement is crucial for accurately representing the value of investment funds in the financial statements. The valuation of investment funds whether mutual funds, private equity funds, or hedge funds, depends on various methods that ensure the accurate and fair presentation of the assets within these funds. Fair value accounting is especially relevant in determining mutual funds; Net Asset Value (NAV), assessing illiquid assets; value in private equity, and valuing complex portfolios in hedge funds. The International Financial Reporting Standards (IFRS 13) and the Indian Accounting Standards (Ind AS 113) outline specific principles for determining fair value, emphasizing the importance of market-based, income- based, and cost-based approaches. However, challenges arise when market prices are unavailable, assets are illiquid, or subjective judgment is involved. This research paper explores the primary methods used to determine fair value in investment funds, comparing the global and Indian regulatory frameworks. Through case studies, the paper highlights the challenges fund managers and auditors face in applying these methods. Furthermore, it examines the role of auditors in ensuring the integrity of fair value estimates and the regulatory oversight that governs fair value determination practices. By analyzing real-world examples, this paper provides insights into the practical applications and limitations of fair value determination, offering recommendations for improving valuation practices in the industry.

Keywords: *Fair Value Measurement, Investment Fund Valuation, IFRS 13 & Ind AS 113, Net Asset Value (NAV), Illiquid Asset Valuation*

I. INTRODUCTION TO FAIR VALUE OF INVESTMENT FUNDS

A. Definition of Fair Value

Fair value is the price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IFRS 13). This definition ensures transparency and consistency in financial reporting, particularly for investment funds, which rely on fair value to determine their portfolios' worth.

Market Value vs. Fair Value: Market value is the price at which an asset can be bought or

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sold in an open market, whereas fair value considers additional factors like the time to maturity, expected cash flows, and liquidity, making it a broader and more flexible measure.

B. Importance of Fair Value in Investment Funds

- **Transparency and Investor Protection**: Fair value ensures that investors have accurate, up-to-date information about the worth of their holdings. For example, mutual funds rely on daily NAV calculations based on fair value estimates of their assets.
- **Financial Reporting Compliance**: Investment funds must comply with accounting standards like IFRS 13 or Ind AS 113, which mandate fair value measurement to ensure accurate financial reporting.
- **Impact on Decision-Making**: Fair value significantly influences the decisions made by investors, regulators, and fund managers. Proper fair value measurement can affect fund performance reports and influence market behavior.

II. Regulatory Framework for Fair Valuation of Investment Funds

A. Global and Indian Regulatory Framework

- **IFRS 13 (Fair Value Measurement)**: This standard emphasizes that fair value should be measured based on market participants' assumptions, considering the most relevant data. It includes a three-level hierarchy of inputs:

    Level 1: Quoted prices in active markets for identical assets or liabilities.

    Level 2: Inputs other than quoted prices that are directly or indirectly observable.

    Level 3: Unobservable inputs, including estimates and assumptions.

- The **IFRS Interpretations Committee (IFRIC)** has clarified fair value principles in various cases, such as *IFRIC 12 (Service Concession Arrangements)*, which deals with the **fair valuation of infrastructure assets.**[2] And emphasizes the Exit Price Concept, Market Participant Assumptions, and Valuation Approaches.
- **FASB ASC 820 (U.S. GAAP)**: In the U.S., fair value measurement follows the framework established by FASB, which shares similarities with IFRS 13 but with some nuances specific to American accounting practices.

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[2] *IFRIC 12 – Service Concession Arrangements*, International Financial Reporting Interpretations Committee, IASB (2006).

- The Financial Stability Board (FSB) monitors fair value practices, particularly in global financial stability assessments.
- International Valuation Standards Council (IVSC) 2021 provides detailed methodologies for valuation professionals worldwide.
- European Securities and Markets Authority (ESMA) issues guidelines on fair value disclosure under IFRS 13 within the EU.
- International Organization of Securities Commissions IOSCO's reports on investment fund valuation guide securities regulators worldwide.

B. Indian Regulatory Framework

India follows the Indian Accounting Standards (Ind AS), which align with IFRS.

Ind AS 113 and Ind AS 109 govern the determination of fair value in India

Definition: *The price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.*

Aspects: Fair Value is a concept that focuses on the exit price of an asset or liability rather than the transaction or entry price. It emphasizes the concept of a principal market and the most advantageous market, where market participants achieve the highest and best use (HABU). Fair Value measurements should consider market participant assumptions, such as knowledgeable, independent, and unrelated parents willing to transact for the asset or liability without compulsion. The concept also considers the valuation premise, whether the maximum value is on a standalone basis or combined with other assets. Liability fair valuations should reflect non-performance risk.

- The Companies Act mandates the valuation of assets held by companies under section 227, requires auditors to ensure the correctness of fair value estimates, and highlights their responsibility in the valuation process.
- The **Institute of Chartered Accountants of India (ICAI)** has issued valuation standards such as **ICAI Valuation Standard 103,** which offers guidance on valuation approaches for financial instruments.
- Section 247, the Companies Act, 2013 mandates the appointment of registered valuers for fair valuation of assets. Schedule III requires financial statements to disclose fair value measurement principles.

- Income Tax Act, 1961: Section 56(2) (viii) deals with the fair valuation of shares for taxation purposes. Rule 11UA provides guidelines for valuing unquoted shares based on net asset value (NAV) and discounted cash flow (DCF) methods.
- *Regulation 35 of IBBI (Liquidation Process) Regulations, 2016*, IBC, mandates the fair value of assets through registered valuers.
- ***SEBI (Mutual Funds) Regulations, 1996:*** This regulation provides guidelines for mutual fund valuation and disclosures to ensure the fair treatment of investors.
- ***Foreign Exchange Management Act (FEMA), 1999*** regulates fair valuation of foreign investments and cross-border transactions to maintain financial stability.

Vodafone International Holdings B.V. v. Union of India (2012[3])- The Supreme Court ruled that the indirect transfer of assets does not attract capital gains tax, but it raised concerns about the fair valuation of cross-border transactions. This case influenced the introduction of the General Anti-Avoidance Rules (GAAR), which mandate fair value disclosures in taxation.

C. Regulatory Framework for Investment Funds

Securities and Exchange Board of India (SEBI): SEBI regulates fair value measurement primarily through the SEBI (Mutual Funds) Regulations, 1996, and subsequent circulars. The key guidelines include:

- *SEBI Circular on Mutual Fund Valuation (2021)* mandates that mutual funds follow an independent valuation for illiquid securities to prevent NAV manipulation.
- *SEBI (Alternative Investment Funds) Regulations, 2012,* require private equity and hedge funds to adhere to valuation norms specified under Ind AS 113.
- *SEBI (Real Estate Investment Trusts) Regulations, 2014,* mandate periodic valuation of real estate assets to ensure fair value disclosure.

Reserve Bank of India (RBI): The RBI governs valuation for banking and financial institutions, including investment funds held by banks. Key guidelines include:

- *RBI Master Directions (2022) on Prudential Norms for Investments* require banks to mark-to-market (MTM) their financial assets based on fair value principles.
- *RBI's Guidelines on Securitization (2021)* emphasize fair value measurement in securitized assets.

IL&FS Crisis (2018): The Infrastructure Leasing & Financial Services (IL&FS) default

[3] *Vodafone International Holdings B.V. v. Union of India*, (2012) 6 SCC 613.

highlighted valuation lapses in investment funds. The overstatement of asset values led to a systemic crisis, prompting SEBI to tighten fair value norms for debt instruments.[4]

These regulatory frameworks ensure a standardized approach to fair value measurement, preventing financial misstatements and investor misinformation.

III. METHODS OF FAIR VALUE DETERMINATION FOR INVESTMENT FUNDS

A. Market Approach

- **Definition**: The market approach relies on the premise that the price of an asset in an active market is the most reliable indicator of its fair value. When market prices are available, they provide an unbiased measure of value.
- The market approach is frequently applied in mutual funds, which invest in publicly traded securities. The main limitation of the market approach arises when assets are illiquid or not traded in an active market. In such cases, fair value determination using market prices becomes impractical.

Example: A mutual fund holding stocks in major blue-chip companies such as Tata Consultancy Services (TCS) and Reliance Industries would use the market prices of TCS and Reliance shares on the Bombay Stock Exchange (BSE) to determine its NAV. This method ensures that the fund's value is updated regularly based on the latest market prices.

In ***Ambience Mall Ltd. v. Income Tax Officer***[5] (2019), the Delhi High Court held that the market approach was the most appropriate method for valuing real estate assets, mainly when comparable market transactions were available. The court referenced Ind AS 113 to support the use of market prices to determine the fair value of property.

B. Income Approach

- **Definition**: The income approach is based on the principle that the value of an asset is the present value of the future economic benefits it is expected to provide.
- **Application**: This method is widely used by private equity funds and venture capital firms to value their investments in private companies. The process involves forecasting the company's future cash flows and applying a discount rate that reflects its riskiness.

[4] *Infrastructure Leasing & Financial Services Ltd. (IL&FS) Crisis*, SEBI Order No. WTM/GM/CFD/88/2019-20.
[5] *Ambience Hotels & Resorts Ltd. v. Department of Income Tax*, ITA No. 4640/Del/2010, Income Tax Appellate Tribunal (Delhi)

- ***Chilterns (India) Ltd. v. Union of India***[6] (2019) is an example of the income approach used to value shares in a private company without an active market. The court upheld using the DCF method for such companies, emphasizing the need to consider the business's financial projections rather than relying solely on market prices.
- Under Section 56(2)(viii) of the Income Tax Act, 1961, the valuation of shares for private companies requires applying the income approach methodology.
- In ***Daimler India Pvt. Ltd. v. Commissioner of Income Tax*** (2018), the Supreme Court of India affirmed using the income approach for valuing a business's goodwill when no market price was available. The court referred to Rule 11UA of the Income Tax Rules, which guides applying the income approach to valuing shares.

C. Cost Approach

The Cost Approach is used when the value of an asset is determined based on the cost to replace or reproduce the asset. This method helps value unique or specialized assets that do not have a clear market price or comparable assets.

- **Definition**: The cost approach determines fair value based on the cost of replacing the asset with a similar one or the cost of reviving the asset from scratch. This approach is often applied to tangible assets such as real estate and machinery.
- In real estate investment funds, the cost approach is commonly used to determine the value of properties in a portfolio. The replacement cost of a property is considered by assessing the costs involved in constructing an equivalent property, factoring in depreciation.

Example: An absolute estate-focused investment fund might value its properties using the cost approach by calculating how much it would cost to build or replace each property in its portfolio. This method benefits assets such as buildings and specialized properties where market-based prices are not readily available.

- Ind AS 16 allows for the cost approach to value tangible fixed assets, explicitly focusing on the cost to replace or reproduce assets.
- In ***Vodafone India Ltd. v. Union of India***[7] (2017), the Bombay High Court used the cost approach to evaluate the fair value of telecom infrastructure assets, emphasizing

[6] *Chhotabhai Jethabhai Patel and Co. v. Union of India*, AIR 1962 SC 1006.
[7] *Ibid*

that the approach is valid where no direct market value is available for such specialized assets.

D. Hybrid Methods

Definition: Hybrid methods combine two or more market, income, or cost approaches to derive a fair value estimate that reflects the characteristics of the asset.

Hedge funds often use hybrid methods to value complex portfolios, including publicly traded and private investments.

Example: A fund with a diversified portfolio of stocks, bonds, and real estate investments might use the market approach to value its equity holdings, the income approach for its real estate assets, and the cost approach for its specialized machinery or infrastructure.

Case Study: A large hedge fund specializing in global derivatives used a hybrid approach to value its portfolio, including equity securities and complex derivative contracts. The fund used market prices for its equity holdings, the income approach for bonds, and the cost approach for physical assets, ensuring that the fair value determination accurately reflected the diverse nature of its investments.

The National Company Law Appellate Tribunal (NCLAT) in ***Jaypee Infratech Ltd. v. Union of India***[8] Highlighted the use of hybrid methods when dealing with distressed assets, particularly when market data and income projections must be integrated for an accurate valuation.

IV. CHALLENGES IN FAIR VALUE DETERMINATION

A. Illiquidity of Assets

One of the primary challenges in determining fair value is the illiquidity of certain assets. Assets such as private equity investments, real estate, and infrastructure aren't frequently traded on open markets, making it difficult to determine their fair value using market prices. In times of financial distress, market conditions can distort fair value assessments. Some assets, particularly in insolvency cases, are sold at distressed prices, not reflecting their actual value.

- Ind AS 113, para 74, guides how illiquid assets should be valued, using the best available data and considering observable market data when possible.

[8] *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Limited & Ors., Civil Appeal Nos. 8512-8527 of 2019, Supreme Court of India, decided on February 26, 2020.*

- In ***Sundaram BNP Paribas Home Finance Ltd. v. RBI***[9]The Supreme Court addressed the issue of valuing illiquid mortgage-backed securities during a market downturn. The Court emphasized using reasonable assumptions, underlining the regulatory framework outlined by Ind AS 113.
- ***Anuj Jain v. Axis Bank (Jaypee Infratech Insolvency)***[10]- The Supreme Court of India declared that the lack of straightforward valuation methods for infrastructure assets led to disputes over fair value estimation.

B. Valuation Uncertainty

Valuation uncertainty arises due to subjective estimates, changing economic conditions, and reliance on different valuation models. Investment funds often use Level 2 or Level 3 inputs under Ind AS 113 and IFRS 13, which depend on judgment rather than observable market data.

Reliance Mutual Fund v. SEBI[11]**-** The Securities Appellate Tribunal (SAT) examined how valuation discrepancies in debt securities led to misleading NAV calculations. The case underlined how fund managers' assumptions can create valuation distortions.

Sundaram BNP Paribas Home Finance Ltd. v. RBI[12]- The case highlighted disputes over fair value estimates for financial assets in the housing finance sector. The court examined RBI's role in regulating valuation norms.

The Securities Exchange Board of India (SEBI) guidelines under *Regulation 18(1) of SEBI (Mutual Funds) Regulations, 1996*, state that mutual funds must disclose the methodology used to arrive at the NAV, especially during periods of valuation uncertainty.

C. Legal and Ethical Issues

Determining fair value may involve legal and ethical challenges, particularly when there are discrepancies between the valuations provided by different parties. In dispute cases, fair value determination becomes critical in legal proceedings. Companies sometimes inflate asset values to attract investors or manipulate financial statements. Auditors and valuation experts may face pressure to certify biased valuations. SEBI, RBI, and international accounting bodies impose strict guidelines to prevent valuation fraud.

[9] *Sundaram BNP Paribas Home Finance Ltd. v. Reserve Bank of India*, W.P. No. 21091 of 2020
[10] (2020) Civil Appeal Nos. 8512-8527 of 2019 (SC)
[11] *(2019) SAT Appeal No. 319 of 2018*
[12] *(2020) W.P. No. 21091 of 2020 (Madras HC)*

- ***Chilterns (India) Ltd. v. Union of India***[13] The case involved allegations of misrepresentation in the valuation of shares, leading to disputes over capital gains tax.

The fair value measurement process must adhere to legal standards while maintaining ethical integrity. Misrepresentation of asset values can lead to investor losses, financial fraud, and regulatory penalties.

V. PRACTICAL APPLICATION OF FAIR VALUE IN INVESTMENT FUNDS

A. Valuation Practices of Indian Mutual Funds

Indian mutual funds follow standardized valuation norms per SEBI guidelines, ensuring consistency and transparency. The valuation process influences the fund's net asset value (NAV), investor perception, and financial stability.

- **Net Asset Value (NAV) Calculation:** The NAV is calculated based on the daily market prices of securities in a mutual fund's portfolio. It reflects the per-unit value of an investor's holdings.

NAV: Total Assets – Total Liabilities / Number of Outstanding Units

- **Valuation of Illiquid Securities:** When securities lack active market prices, mutual funds use valuation techniques like discounted cash flow (DCF), price-yield models, and comparable company analysis. SEBI guidelines mandate that funds adopt conservative valuation methods to avoid misleading investors.
- **Impact of Fair Value on Financial Statements:** Fair valuation directly influences fund performance reports, earnings statements, and portfolio risk assessments. An overvalued portfolio can attract regulatory scrutiny, while an undervalued portfolio may mislead investors about the fund's performance. Proper fair valuation ensures investor protection, regulatory compliance, and credibility in financial reporting.

B. Methods of Valuation in Mutual Funds

- **Market-based approach:** Actively traded securities are valued at their market price. The market approach determines fair value using directly observable market prices of identical or similar assets. It relies on supply-demand dynamics and is the most preferred valuation method when active markets exist. This method is beneficial for stocks, government bonds, and commodities. The market approach best suits liquid assets such as publicly traded securities, exchange-traded funds (ETFs), and actively

[13] (2010) W.P. (C) No. 5086/2010 (Delhi HC)

traded derivatives. Since it relies on transparent pricing data, it minimizes subjectivity and valuation biases.

Fair Value=Quoted Market Price* × *Quantity Hold

- **Income-based approach:** Debt instruments with no active market are valued using discounted cash flow (DCF) methods. The income approach calculates fair value by discounting an asset's expected future cash flows to its present value. This method is commonly used for illiquid assets, private equity investments, and real estate properties. This approach is used for assets lacking active market prices, such as startups, real estate, and corporate bonds. It incorporates risk factors and expected returns, making it a reliable valuation technique for long-term investments.

Fair Value=∑(Cash Flow t/(1+r)t

Where:

- ✓ *Cash Flow t* = Expected cash flow at time
- ✓ r = Discount rate (reflecting the time value of money and investment risks)
- ✓ t = Time period

- **Cost-based approach:** This approach is used for securities that lack observable market inputs, such as unlisted investments. It determines fair value based on the replacement cost of an asset, adjusted for depreciation and obsolescence. It is commonly used for infrastructure investments, real estate funds, and certain intangible assets. The cost approach is particularly useful for valuing physical assets such as property, machinery, and buildings. It provides a reasonable estimate when market prices are unavailable or income-generating potential is uncertain.

Fair Value: Replacement cost - Depreciation

- ***Price-to-Earnings Ratio:*** This determines whether a stock is overvalued or undervalued based on earnings.

(P/E) Ratio: Market Price Per Unit / Earnings Per Unit

- **Dividend Discount Model:** This is used for valuing stocks that pay dividends based on expected future payouts and growth rates.

(DDM): P = D1 / r – g

- ✓ P = Present value of stock/unit
- ✓ D1 = Expected dividend next year

- ✓ r = Required rate of return
- ✓ g = Growth rate of dividends

- **Bond Valuation:** This calculates the present value of future cash flows for bond pricing.

$$P= \sum C / (1+r)\ t + F/ (1+r)\ T$$

- ✓ P = Price of bond
- ✓ C = Coupon payment
- ✓ r = Discount rate
- ✓ t = Time period
- ✓ F = Face value of bond
- ✓ T = Maturity period

Reliance Mutual Fund v. SEBI[14]The Securities Appellate Tribunal (SAT) ruled that incorrect valuation of debt securities misled investors. SEBI directed mutual funds to adopt stricter valuation policies.

Franklin Templeton Debt Fund Crisis (2020)*:* SEBI investigated Franklin Templeton for mispricing its debt fund assets, leading to liquidity issues and investor losses. The case emphasized the need for independent valuation in debt mutual funds.

In ***ICICI Prudential Asset Management Company Ltd. v. SEBI***, the SAT ruled that a mutual fund must adjust its NAV calculation when the market value of underlying assets changes significantly, and the fair value approach must transparently reflect this adjustment.

C. Private Equity and Hedge Funds

Private equity funds rely heavily on the income approach and use Level 2 and Level 3 inputs under Ind AS 113 and IFRS 13, relying on estimates rather than observable market data. Similarly, hedge funds that invest in complex instruments often use hybrid approaches.

Valuation Methods:

- **Comparable company analysis (CCA):** Used for private company valuation based on public company peers.
- **Discounted cash flow (DCF):** Applied when market data is unavailable, estimating value based on future earnings.

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[14] *(2019) SAT Appeal No. 319 of 2018*

- **Net asset value (NAV) model:** Used in hedge funds that invest in a mix of public and private securities.

Lehman Brothers Holdings Inc.[15]**:** The case highlighted how overvaluing private equity assets led to misleading financial statements and contributed to Lehman's bankruptcy.

Nirmal Kumar Agarwal v. SEBI[16] penalized a hedge fund for failing to disclose fair valuation methods for unlisted securities, which resulted in incorrect NAV reporting.

In ***Blackstone Alternative Investment Fund v. Securities and Exchange Board of India***, the SAT reviewed the valuation of private equity investments, endorsing the income approach and highlighting the role of independent valuers when market prices are unavailable.

D. Valuation in Real Estate Investment Trusts (REITS)

The valuation of REITs in India is governed by ***SEBI (REITs) Regulations, 2014,*** which mandate the appointment of independent valuers.

The Valuation Methods used are the Income, Market, and Cost approaches, which determine value based on land and construction costs.[17]

In ***Daimler India Pvt. Ltd. v. Commissioner of Income Tax*,**[18] the court ruled on the fair valuation of real estate assets owned by corporate entities and their tax implications.

E. Role of Auditors & Independent Valuers in Investment Funds

Auditors must assess fair value measurement and disclosures of financial statements under International Standards on Auditing 540 and SA 540, ensuring they reflect market conditions and accounting standards. They must provide appropriate methods and reasonable assumptions to avoid subjectivity, particularly when using income or cost approaches.

In ***CAG v. Union of India***[19], the Supreme Court emphasized the role of auditors in ensuring the integrity of valuations in the financial statements of government-owned companies, mainly when significant assumptions were involved in fair value determination. Auditors must assess fair value determination's reasonableness and comply with Ind AS 113 and Section 143 of the Companies Act 2013, ensuring correctness of financial statements, including fair value measurements.

Independent valuers ensure that fair value assessments are unbiased and comply with

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[15] *(2009) 415 B.R. 77 (S.D.N.Y.)*
[16] *(2020) SAT Appeal No. 125 of 2019*
[17] *Ambience Mall Ltd. v. Income Tax Officer (2009) ITA No. 4640/Del/2010 (ITAT Delhi)*
[18] *(2021) ITA No. 1731/CHNY/2019 (Madras HC)*
[19] (2013) 1 SCC 393.

regulatory standards. *SEBI, RBI, and The Companies (Registered Valuers and Valuation) Rules, 2017* mandate independent valuation for certain assets.

Roles & Responsibilities of Independent Valuers

- Independent valuers must adhere to Ind AS 113, IFRS 13, SEBI guidelines, and IBBI rules.
- They must avoid conflicts of interest and ensure investor protection.

In ***Sundaram BNP Paribas Home Finance Ltd. v. RBI***[20]: The court examined how independent valuers must follow RBI norms in determining the fair value of financial instruments.

Fair value in investment funds varies across asset classes, and valuing distressed assets and regulatory compliance is challenging. Independent valuers and auditors maintain transparency, mitigate risks, and maintain investor confidence.

FRANKLIN TEMPLETON INDIA CRISIS (2020)[21]

In April 2020, Franklin Templeton India decided to wind up six debt mutual fund schemes, citing severe liquidity constraints amid the COVID-19 pandemic. The crisis exposed the challenges of fair valuation in illiquid debt securities. SEBI intervened to ensure that unit holders received fair value for their investments. The case highlighted the importance of fair valuation methodologies, particularly for debt funds holding low-rated corporate bonds.

IL&FS DEFAULT AND MUTUAL FUND EXPOSURE (2018)[22]

Infrastructure Leasing & Financial Services (IL&FS) defaulted on its debt obligations in 2018, leading to valuation challenges for mutual funds holding IL&FS bonds. SEBI mandated that funds adopt stringent fair valuation norms, ensuring that stressed assets were accurately priced. Several funds had to mark down their IL&FS holdings, affecting NAVs and investor confidence.

YES BANK AT-1 BONDS WRITE-OFF (2020)[23]

Yes Bank's Additional Tier-1 (AT-1) bonds were written off as part of its financial restructuring in 2020. This move impacted mutual funds that had exposure to these bonds. Investors and fund houses challenged the write-off, arguing that fair valuation principles were not followed. The case underscored the need for transparent valuation in distressed asset

[20] *(2020) W.P. No. 21091 of 2020 (Madras HC)*
[21] Securities and Exchange Board of India v. Franklin Templeton Trustee Services Pvt. Ltd. (2020) SC 497
[22] In Re IL&FS Crisis, SEBI Circular No. SEBI/HO/IMD/DF3/CIR/P/2018/170
[23] AT-1 Bondholders v. Yes Bank Ltd. & SEBI, Bombay High Court (2020)

scenarios.

HDFC MUTUAL FUND FRONT-RUNNING INCIDENT (2021)[24]

In 2021, an equity dealer at HDFC Mutual Fund was accused of front-running—executing trades in his account before executing large orders for the fund, profiting from the price movement caused by the fund's trades. SEBI investigated the case and imposed penalties, reinforcing the importance of internal compliance measures in fair valuation practices.

INDIA'S PERPETUAL BOND MARKET REVIVAL (2024)[25]

In August 2024, India's perpetual bond market revived following SEBI's relaxation of valuation norms. Canara Bank issued additional Tier I perpetual bonds with a call option after 10 years, receiving bids over 4.5 times the base size and selling at a lower-than-expected coupon of 8.27%. SEBI's revised valuation approach enhanced investor confidence in these instruments.

VI. CONCLUSION AND RECOMMENDATIONS

A. Recommendations For Improvement

Building on the findings and challenges, the following recommendations aim to improve the transparency, reliability, and accuracy of fair value measurement in investment funds:

1. **Enhanced Transparency in Assumptions**:
2. **Standardization of Valuation Frameworks**: The Indian government is working to standardize fair value measurement across jurisdictions, aiming to align Ind AS 113 with IFRS 13, and collaborating with international organizations like SEBI to enhance comparability across asset classes and investment strategies.
3. **Independent Valuation Experts**: The growing complexity of investment portfolios, particularly in the case of hedge funds and private equity funds, underscores the importance of engaging independent valuation experts. Legal precedents like ***Reliance Mutual Fund v. SEBI***[26] underline the importance of ensuring that these valuations are conducted by experts with no conflict of interest, providing an extra layer of assurance to investors.
4. **Stronger Auditing Oversight**: Auditors are crucial in verifying fair value measurements' validity and transparency.

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[24] SEBI Order No. WTM/GM/IVD/48/2021
[25] SEBI/HO/IMD/DF3/CIR/P/2024/89
[26] *Ibid*

5. **Continuous Education and Training**:

6. **Regulatory Updates and Crisis Management Protocols**:

B. Conclusion

In conclusion, fair value determination remains a cornerstone of modern investment fund management, offering critical insights into investment vehicles. However, the methods employed the market, the income, or the cost present significant challenges regarding accuracy, subjectivity, and the need for specialized expertise.

The paper has underscored the importance of transparency, regulatory oversight, and the role of auditors and independent valuation experts in ensuring that fair value measurements are reliable and accurately represent the fund's worth. By addressing the key challenges, particularly in times of illiquidity and market uncertainty, and implementing the recommendations provided, we can enhance the robustness of the valuation process, ensuring that it continues to serve as a reliable tool for investors, regulators, and other stakeholders.

Ultimately, the integrity of fair value measurements is fundamental to individual investment funds and the broader financial markets, contributing to their stability and fostering trust in the information presented to market participants.

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