Fair Value in the Financial Reporting of Investment Funds in Poland – Dilemmas and Challenges

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Introduction

This article presents the primary challenges associated with fair value measurement in investment funds in Poland, as well as the methods employed in accounting practice, with particular emphasis on international standards and industry best practices. Key conclusions regarding fair value measurement processes in investment funds are presented based on a literature review and case studies from inspections conducted by the Polish Agency for Audit Oversight.

Fair value measurement constitutes one of the key aspects of the financial reporting of investment funds. In accordance with international accounting standards, fair value reflects the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (IASB, 2022). The accuracy and reliability of this process are of critical importance for the transparency of financial information, influencing investor decisions and the stability of the financial market.

The fair value measurement process is particularly significant for investment funds managing diverse asset portfolios with varying levels of liquidity and risk. In practice, this necessitates the application of advanced valuation techniques that incorporate both market data and valuation models (Hońko, 2012; Stępień, 2010). The measurement of liquid assets, such as equities or bonds, relies primarily on market data, which provides current and objective information regarding their value. However, in the case of less liquid or non-market assets, such as real estate, derivatives, or holdings in private companies, the process requires the application

of more complex valuation models, such as Discounted Cash Flow (DCF) methods or market-based comparable methods (Lev, 2016).

In the measurement process, investment funds often face challenges related to the lack of complete and reliable data, which affects the precision of estimates. In such instances, it is necessary to adopt assumptions based on expert judgement and statistical models that enable the estimation of asset values. Situations involving sudden market shocks, such as global pandemics, armed conflicts, or financial crises, are exceptionally difficult, as they significantly impact data availability and the stability of valuation models (Pęksyk et al., 2023).

The role of fair value in financial reporting gains particular significance in the context of international regulations, such as:

1. International Financial Reporting Standards (IFRS) – Specifically IFRS 13, which defines fair value, sets out a framework for measuring fair value, and requires disclosures about fair value measurements, introducing a fair value hierarchy (three levels of inputs) used to determine fair value;

2. UCITS Directive (Undertakings for Collective Investment in Transferable Securities) – This EU regulation, aimed at harmonising the operation of investment funds in Europe, requires that fund assets be valued reliably and transparently, and mandates the use of methods consistent with fair value for non-market assets (e.g., real estate, long-term capital investments);

3. MiFID II (Markets in Financial Instruments Directive II) – Introduces standards regarding transparency and reliability in the valuation of financial instruments, imposing an obligation on fund managers to disclose details regarding asset valuation methods and associated risks;

4. AIFMD (Alternative Investment Fund Managers Directive) – Regulates the management of alternative investment funds in Europe (e.g., hedge funds, real estate funds), mandating the use of independent valuation processes to determine the value of fund assets in accordance with the fair value principle;

5. IVS (International Valuation Standards) – Standards developed by the International Valuation Standards Council (IVSC), defining principles for the valuation of financial assets, real estate, derivatives, and other assets in the context of fair value and other bases of value;

6. SEC and FASB Regulations – US guidelines regarding fair value measurement (ASC 820 - US GAAP), which are substantially aligned with IFRS 13 (Deloitte, 2026); investment funds operating in the USA must comply with

valuation standards developed by the Financial Accounting Standards Board (FASB) and regulations of the Securities and Exchange Commission (SEC);

7. Global Investment Performance Standards (GIPS) – International standards developed by the CFA Institute, setting out principles for asset valuation in investment funds, particularly in the context of presenting investment performance, containing guidelines on the application of fair value and comparative standards in valuation.

In the context of the international regulations cited above, it can be stated that market regulators require funds to apply appropriate valuation procedures that minimise the risk of erroneous estimates and manipulation of asset values (Barth, 1994; Damodaran, 2012; Romano 1998; Zyla, 2020).

1. Research Methodology

The objective of this study is to evaluate the activities and procedures applied in the fair value measurement process within the financial reporting of investment funds in Poland. The research approach adopted in this article was based on a multi-dimensional analysis of literature, regulations, accounting standards, and inspection documentation from the Polish Agency for Audit Oversight (PANA) regarding practices applied in the fair value measurement process of investment funds in Poland. The research was conducted in the following stages:

Stage 1 – Analysis of inspection, regulatory, and reporting documentation (Flick, 2022). This stage involved a detailed review of PANA inspection documentation. The analysis included, inter alia:

1) audit documentation files regarding investment fund financial statements,

2) guidelines and recommendations regarding fair value measurement,

3) methodological documentation and accounting standards applied in investment funds.

Stage 2 – Identification of problems and dilemmas (Kuckartz, 2014). The second stage involved the systematic identification of documented difficulties and ambiguities related to fair value measurement practices in the financial reporting and audit of investment fund financial statements. Discrepancies in the applied approaches were analysed, as well as compliance with national and international regulations (including National Auditing Standards [KSB] and International Financial Reporting Standards [IFRS]).

Stage 3 – Expert interviews (Mezmir, 2020). The document analysis was supplemented by interviews with experts and PANA inspectors involved in the inspection of investment fund financial statement audits. The interviews aimed to deepen knowledge regarding the valuation methods applied within these funds, practical challenges, and applied practices.

Stage 4 – Comparative analysis (Yin, 2018). In this stage, the approaches applied in Poland were compared with international practices in the area of fair value measurement. The comparison concerned differences in standards, procedures, and regulatory interpretation.

2. Research Results

As a result of the applied research methodology, five groups of problems related to fair value measurement in the process of auditing investment fund financial statements were selected. Each of the individual problems and dilemmas is described below.

2.1 Basis for Fair Value Measurement in Investment Fund Reporting

In the case of measuring the fair value of investment fund assets, the result obtained should be identical regardless of whether the valuation documentation refers to the Accounting Act, IFRS or IAS, or specific regulations (decrees) concerning accounting principles and the valuation of financial instruments. The study revealed that audit documentation often cited received indicative bids for investment fund assets, or even executed buy/sell transactions in fund assets, as a justification for dispensing with the preparation of a fair value measurement report.

Interviews indicate that some statutory auditors (SAs) are reluctant to use handbooks or guides based on best practices for fair value measurement in the IFRS/IAS environment (IFRS Foundation, 2013) or US GAAP (American Institute of Certified Public Accountants, 2019) during the estimate verification process. It is worth noting that the International Private Equity and Venture Capital Valuation Board (2022) emphasised that the aforementioned publications are consistent with both IFRS/IAS and US GAAP regarding fair value measurement. Given that fair value was one of the first jointly developed topics within the IFRS/IAS and US GAAP convergence project (Deloitte, n.d.), the observed "reluctance" of SAs to use well-developed, practical materials may generate risks regarding the quality of the performed financial statement audits. The impact of fair value measurement practice, especially regarding unquoted instruments, has been raised since the beginning of work on the current standards. Carroll et al. (2003), comparing fair value measurement with historical cost accounting in relation to closed-end investment funds, concluded that the effectiveness of the former method would depend not so much on the availability of market data for all instruments (which cannot be guaranteed), but on the comprehensive implementation of recommended practices.

Particular attention is required regarding the issue of data mismatch in models in terms of currency and the selection of comparable companies for the valuation model. Agarwal et al., in the publication "Private company valuations by mutual funds" (2023), point to the role of the quality of available information about the valued entity and the resulting differences in the estimated values. Funds with a larger share in the first financing round of a given entity rely more on the private information available to them in their subsequent valuations. Funds basing their valuation more on selected market data treated as a comparative sample may arrive at different valuation results. The effects of this are visible at the level of

Cumulative Abnormal Returns (CAR). Funds with greater access to private information update their valuations more frequently, which results in no abnormal increase or decrease in the estimated value of a given portfolio being observed in subsequent financing rounds. The situation is different for funds relying on comparative data, where an abrupt change in portfolio value can be observed. Therefore, the role of the quality of comparative data and assumptions adopted for the valuation model should be emphasised. The selection of comparable companies, their sectoral comparability, size, and market position is significant. In the valuations analysed during the inspections, the selection of this population indicated a number of difficulties. Sectoral identity as determined by statistical classification codes did not always correspond to sectoral identity as reflected in primary revenue sources. Thus, the scale of operations of entities adopted for comparison, or the value of debt securities issued by them, often exceeded the values observed in the valued entities by significant multiples. The application of comparable valuation methods to value relatively small limited liability companies operating in Poland based on data originating from "giants" of the US or Asian markets is not necessarily an appropriate approach.

Another aspect concerns financial instruments. For the Polish market, there is a lack of empirical and theoretical research concentrating on the impact of the mismatch of issuer characteristics originating from different markets on the valuation of their instruments, especially debt instruments. Research available for other markets indicates that significant differences in credit spreads may occur within the same investment grade of a given instrument, measured by its rating, depending on the issuer's country. For example, Berg (2022), analysing the causes of the difference in credit spread between high-yield bonds originating from the Eurozone and bonds issued in Nordic countries, concluded that only 50 per cent of the variance in valuation could be directly attributed to the results of the structural model (in this case, the Merton model). The other half of the variance stemmed from the mismatch of compared issues and market conditions. For our analysis, a very important conclusion emerges from this: basing the valuation of bonds on credit spreads of instruments adopted as comparable but originating from other markets may be subject to significant uncertainty regarding the correctness of the results thus obtained.

2.2 Fair Value and Entity Liquidation Value

Financial statements are usually prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Therefore, it is assumed that the entity has neither the intention nor the need to enter into liquidation or to cease operations. If such an intention or need exists, the financial statements may be prepared on a different basis. However, in the case of investment funds, which are obliged to report at fair value, it appears that the only reasonable solution in the event of the cessation of business activity is to write

down assets to their fair value less costs of disposal (Grant Thornton International Ltd., 2017). In such a scenario, the entity measures its assets to reflect the amount of cash or other consideration it expects to receive from the settlement or disposal of those assets in carrying out its liquidation plan. It should be noted, however, that in some cases, fair value may not differ from the amount the entity expects to realise (KPMG, 2025).

The fundamental dilemma in the aspect discussed above is the question: is it possible to speak of estimating fair value at all in a situation involving an investment fund's liquidation value? The problematic issue here is the condition regarding an "orderly transaction" between market participants, as opposed to a "forced transaction". It could be argued that liquidation value is, in principle, not fair value; however, if liquidation is the only possible and, moreover, rational economic scenario for an investment fund, then the valuation context changes, not merely the purpose of the valuation itself.

A key example of the dilemma in the case described above is delineating the boundary between an "orderly" sale and a "forced" sale of fund assets. If the fund is able to identify that a market exists, that it is possible to dispose of the assets in an orderly manner over a period of time, and that there is no pressure for an immediate sale, it can then be assumed that the value received will be fair value. If, however, the assets are illiquid, an immediate sale is necessary, and there is no alternative, then the fund's liquidation value does not satisfy the definition of fair value.

2.3 Price of Recent Investment

In 2018, the Price of Recent Investment (PORI) concept was removed from the list of valuation techniques under the Market Approach set out in the IPEV Guidelines (IPEV, 2018, p. 67) – techniques considered to guarantee fair value measurement. This change was driven by the observation that PORI was being misinterpreted (and at times misapplied) for the purpose of recognising fair value, subsequently leading to the abandonment of fair value determination at subsequent measurement dates. The price of a recent investment or transaction serves as an appropriate starting point; however, consideration must be given to facts and circumstances occurring between the PORI date and the measurement date, including any potential changes in the financial condition of the investee. The passage of time between the transaction date and the measurement date reduces the relevance and reliability of the recent transaction regarding the measurement of the instrument's fair value at the measurement date. According to best practices, the equity value of an entity derived from the most recent transaction in the investee's instruments serves to calibrate inputs used in other valuation techniques. It considers recent transactions to derive information regarding control benefits and the return expected by investors, taking into account the illiquidity of the given

position. At each measurement date, the valuer should assess whether changes or events subsequent to the relevant (recent) transaction imply a change in the fair value of the investment. The price of a recent transaction (recent investment) should not be considered a standalone valuation technique. Such a position is found in the principal bodies of best practice guidelines.

2.4 The Adjusted Net Asset Method and Fair Value

When applying the adjusted net asset method, valuers sometimes use different standards of value for individual components of both assets and liabilities, while expecting the output to represent the fair value of the equity of the entity being valued. This is possible, but only where the valuer's specific role is to demonstrate that, for example, a property appraisal report incorporated into the adjusted net asset method valuation, one that establishes the market value of the real estate, also satisfies the requirements applicable to fair value estimates, i.e. that the outcomes are equivalent. Our review of the inspection documentation did not identify any such case. Nor did it reveal adjusted net asset method valuation reports that included a reassessment of both recognised and unrecognised liabilities. Valuers also often assume that recognised and unrecognised liabilities presented in the statement of financial position are already stated at fair value – an assumption that, in many instances, is not corroborated by the audit documentation. It is worth noting that the adjusted net asset method derives the fair value of an investee's equity instruments by reference to the fair values of its assets and liabilities, whether recognised or unrecognised (IFRS Foundation, 2013). The adjusted net asset method is used relatively frequently in investment funds because it more faithfully reflects the structure of a fund's portfolio: the fund is not a conventional operating enterprise, and its purpose is to hold, dispose of, and acquire assets. A fundamental issue when using the adjusted net asset method in investment funds to estimate fair value is the potential emergence of "cascading" risk: for instance, if real estate is measured using subjective assumptions and equity interests in companies are measured using Level 3 inputs, an error in a single measurement can propagate into the fund's overall net asset value. In this area, the decisive factors include, among others, assumptions embedded in the real estate valuation, the discount for lack of liquidity, and the timeliness of comparable data.

Given IFRS 13, which, in substance, does not impose the adjusted net asset method for measuring statement-of-financial-position items in investment funds, attention must remain on a market participant perspective, observable market data, the exit price notion, and the asset's highest and best use. This raises a practical dilemma: does the adjusted net asset method in fact capture an exit price, or does it merely reflect an "internal" valuation of the investment fund's portfolio?

2.5 Active markets and the fair value measurement of investments in participation units in collective investment undertakings, or investment certificates of investment funds

Difficulties may arise where an entity that has acquired participation units in collective investment undertakings, or investment certificates of investment funds, is required to measure those instruments at fair value but no active market exists for them. This challenge also affects statutory auditors, who must assess the appropriateness of the fair value measurement of such instruments in circumstances where valuations of the underlying assets, used to compute the net asset value per participation unit or investment certificate, are unavailable or only accessible to a limited extent.

Polish accounting standards

Where the financial instruments referred to in the preceding paragraph are recognised in the statement of financial position of an entity preparing financial statements under Polish accounting standards, the Regulation of the Minister of Finance of 17 November 2024 on the recognition and measurement methods, and the disclosure and presentation, of financial instruments (Journal of Laws 2024, item 1750) applies (hereinafter: the "IF Regulation"). In accordance with § 4 of the IF Regulation, the classification of such instruments as financial assets classified as held for trading triggers the requirement to measure them, under § 13, at reliably estimated fair value. Pursuant to § 14(1) of the IF Regulation, a reliably estimated fair value is deemed to be:

1) a market price from an active market for identical financial instruments (Level 1 of the fair value hierarchy). Where more than one active market exists for financial instruments, the entity identifies the most advantageous market in which it would, under normal conditions, enter into a transaction to sell the asset or transfer the liability, and applies the price from that market;

2) a value obtained using a valuation model in which significant inputs are observable, either directly or indirectly (Level 2 of the fair value hierarchy) – where the price referred to in point 1 is unavailable;

3) a fair value determined using a valuation model based on unobservable inputs (Level 3 of the fair value hierarchy) – where the price or value referred to in points 1 and 2 is unavailable.

Under § 14(3) of the IF Regulation, for investments in participation units in collective investment undertakings, or investment certificates of investment funds, where no active market exists, the fair value of the investment is deemed to be the most recent net asset value per participation unit or investment certificate published

by the collective investment undertaking or investment fund, provided that no more than 31 days have elapsed since its publication.

However, particular attention should be paid to § 14(4), which provides that where valuation is suspended, or a valuation publication required under applicable law is not made, where **restrictions or suspensions apply to the redemption of** participation units in collective investment undertakings or to the repurchase of investment certificates of investment funds at the price referred to in § 14(3), or where it is not possible to determine fair value in accordance with § 14(1)–(3), the fair value of investments in such participation units or investment certificates must be estimated at the reporting date (or another date at which the fair value of the investment is determined) using a model-based valuation. When applying a valuation model, the composition of the investment fund's asset portfolio and its liabilities, as well as potential impairment, must be taken into account.

Investors that carry participation units in collective investment undertakings, or investment certificates of investment funds, in their accounting records often treat as fair value the valuation published for a given date by the entity responsible for managing the pooled assets and valuing them (e.g. an investment fund management company).

The mere publication of an investment fund's net asset value by the investment fund management company managing that fund does not, in itself, determine that the conditions for recognising that valuation as fair value are satisfied. In particular, it is necessary to assess whether restrictions or suspensions apply to the redemption (odkup) of participation units in collective investment undertakings or the repurchase (wykup) of investment certificates of investment funds at the published price. This requires an analysis of the investment fund's constitutional documents, as well as the terms imposed on investors upon redemption/repurchase, for example:

- how the redemption/repurchase date is defined;
- whether the redemption/repurchase date is segmented and set at a relatively remote point in time (e.g. 180 days) from the date on which a redemption/repurchase request is submitted;
- whether the redemption/repurchase price equals the price published as at the date of the redemption/repurchase request (or a price close to that date); separating and deferring the repurchase/redemption date from the valuation date means that the unit-holder/investor does not know the price at which redemption/repurchase will occur;
- whether redemptions/repurchases are processed in a prescribed sequence of requests;
- whether redemption/repurchase may be effected in instalments;
- whether a material reduction in redemption/repurchase is possible and probable (e.g. based on historical requests), for instance in the case of less liquid assets.

The presence of any of the above illustrative circumstances, or a combination thereof, appears to constitute a limitation that may require the fair value of the investment to be determined using a model in accordance with § 14(4) of the IF Regulation.

Specific accounting rules for investment funds

Where the acquirer of participation units in collective investment undertakings or investment certificates of investment funds is itself an investment fund, measurement of its assets is governed by the Regulation of the Minister of Finance of 24 December 2007 on specific accounting rules for investment funds (Journal of Laws 2007 No. 249, item 1859, as amended) (hereinafter: the "FI Regulation"). Pursuant to § 23(2) of the FI Regulation, as a general rule the fund's assets and liabilities are measured at a reliably estimated fair value. Under § 24(1), a reliably estimated fair value of an investment item is deemed to be:

1) a price from an active market (Level 1 of the fair value hierarchy);

2) where the price referred to in point 1 is unavailable, a price obtained using a valuation model in which all significant inputs are observable either directly or indirectly (Level 2 of the fair value hierarchy);

3) where the price referred to in points 1 and 2 is unavailable, a fair value determined using a valuation model based on unobservable inputs (Level 3 of the fair value hierarchy).

Treating as the fair value of an investment the most recent net asset value per participation unit or investment certificate published by an investment fund management company is tantamount to assuming that the price is derived from an active market (Level 1 of the fair value hierarchy). Under § 2(19) of the FI Regulation, an active market is a market in which transactions in a given asset or liability occur with sufficient frequency and volume to provide ongoing information about prices for that asset or liability; this includes exchange markets, dealer markets, brokered markets, and principal-to-principal markets that exhibit such frequency and volume. Statutory auditors auditing the financial statements of investment funds should ensure that an active market exists for participation units or investment certificates (as investment assets) if they intend to base their conclusions as to the appropriateness of fair value measurement solely on valuations published by the investment fund management company.

International Financial Reporting Standards (IFRS)

In accordance with paragraph 72 of IFRS 13 (Fair Value Measurement), a fair value hierarchy is established to enhance consistency and comparability in fair value measurements and related disclosures by classifying, across three levels (see paragraphs 76–90), the inputs to valuation techniques used to measure fair value. The hierarchy assigns the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

For financial instruments measured at fair value, such as participation units or investment certificates, an analysis of IFRS 13 suggests that treating the net asset value figure published by an investment fund management company (hereinafter: TFI) as a fair value valuation technique is, in substance, an approach that is reserved for Level 1 classification within the fair value hierarchy. Pursuant to paragraph 76 of IFRS 13, Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. Accordingly, accepting TFI-published prices (from the perspective of the fund's investments) as fair values requires both assuming and demonstrating that the market mechanism established by the TFI constitutes an active market; that is, a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Assessing market activity necessarily entails verifying:

- whether subscription transactions and the redemption of participation units / repurchase of investment certificates occur at all (and, if so, at what volumes and whether around the reporting date);
- whether a secondary market exists (i.e., transactions in which the TFI is not a counterparty) – whether price levels are observable and whether they differ from the published valuation;
- whether material issues arise in relation to restrictions on the redemption of participation units or the repurchase of investment certificates.

If it is concluded that no active market exists for the published NAV-based valuation, it becomes necessary to demonstrate that the published valuation has been prepared in accordance with IFRS 13 principles in order for it to be regarded as a fair value measurement (for example, whether a market participant perspective has been applied in the assumptions used to assess risk).

Conclusions

The study's findings indicate that, notwithstanding an extensive body of domestic and international regulation, fair value estimation in investment funds remains, to a substantial extent, reliant on subjective assumptions and professional judgement. Subjectivity is not inherently problematic, provided it is properly justified, documented and grounded in a market participant perspective. In practice, however, it is precisely in these areas that material deficiencies most frequently arise.

In particular, persistent issues were observed in valuation processes and their verification, including:

- misalignment of valuation model inputs, including in respect of currency, reference market, and the time horizon of comparable data;
- inappropriate selection of comparable companies, insufficiently reflecting differences in scale, risk profile, financing structure, and the actual sources of revenue generation;
- overreliance on the adjusted net asset method as a substitute for measuring the fair value of equity, without demonstrating alignment of the relevant bases of value across individual assets and liabilities;
- improper or inconsistent specification of entity-specific risk, in particular in valuations driven by unobservable inputs (Level 3 of the fair value hierarchy);
- constrained application of statutory auditors' professional judgement, manifested in excessive reliance on the formal correctness of valuation documentation rather than a substantive economic assessment of key assumptions and their consistency with a market participant perspective;
- a default presumption that NAV valuations published by TFIs represent fair value in circumstances where no active market exists for the relevant financial instrument.

A further important conclusion is that market practice continues to exhibit a tendency to simplify fair value measurement by resorting to proxies that fail to meet the definitional criteria of fair value, such as the price of a recent transaction (PORI) or the mechanical adoption of NAV published by a TFI as if it were a price from an active market. Such an approach may result in unwarranted classification of measurements as Level 1, despite the absence of evidence supporting the existence of an active market within the meaning of IFRS 13 and domestic accounting regulations.

Moreover, the analysis of the relationship between fair value and an investment fund's liquidation value indicates that, in extreme situations, such as cessation of operations or severe liquidity constraints, the valuation context changes fundamentally. In such cases, the distinction between an orderly sale and a forced sale becomes pivotal. The lack of unambiguous operational criteria for drawing

this boundary in investment fund practice creates additional risks of financial information distortion and undermines the comparability of financial statements.

A limitation of this study is its reliance on inspection documentation relating to a selected subset of the investment fund population and a specified time horizon. Nevertheless, the issues identified appear systemic and may provide a foundation for further empirical research, particularly on how fair value measurement quality affects investor decision-making and the stability of the investment fund market under heightened market uncertainty.

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