STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

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Standards Board for Alternative Investments

Private Market Valuations: Governance, Transparency, & Disclosure Guidelines

A Guide for Allocators and Investment Managers

1. Introduction

This Standards Board for Alternative Investments (SBAI) paper on 'Transparency & Disclosure Guidelines for Private Market Valuations' reaffirms the standards and guidance included in the SBAI's Alternative Investment Standards, reviews other industry guidance specific to the valuation of private market investments, inclusive of private equity, private debt, venture capital, real estate, and infrastructure, among others, clarifies areas where there is no industry wide consensus around the valuation of these assets, and suggests questions that investors may wish to ask when assessing an investment manager.

Private markets have grown significantly since the Financial Crisis in 2009 and have become an important source of capital for companies and a significant allocation in many institutional investor portfolios.[1]

By their very nature, private markets lack public transparency, and there are material differences in how the value of private assets are formed, compared to public markets. The process for acquiring or disposing of private market assets usually requires significant time and resources and can be very costly.[2]

This fundamental difference between how public and private assets/securities are priced, results in a much higher reliance by the investors on the investment manager (and service providers) for the valuation of such assets. In recent years, investors have raised concerns about the reliability of valuations of private market investments, including:

- Conflicts of interest (Involvement in valuation processes by those who stand to benefit financially from managing the asset)
- Accuracy/manipulation of marks, including smoothed volatility, disconnect with public market valuations, lagging prices, inflation of prices during managers' fund-raising periods
- Inconsistency of marks (for identical assets) by different fund managers due to lack of standardisation and subjectivity of valuation inputs
- Lack of transparency for investors to conduct due diligence on valuations

What is Valuation?

For any type of fund, valuation is the process of determining the values ascribed to each of the funds 'units of account' (assets/instruments) which makes up the **Net Asset Value ("NAV")** for the fund.

Why is it important?

Institutional investors usually require NAVs to be stated on a fair value **("Fair Value")** basis, to satisfy their own accounting requirements. Fair Value is commonly defined as: *"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."*

[1] McKinsey Global Private Markets Review 2024: Private markets in a slower era. https://www.mckinsey.com/industries/private-capital/our-insights/mckinseys-private-markets-annual-review

[2] Additional costs associated with private market transactions include transaction costs, due diligence, negotiations, legal, financial and tax structuring, governance reviews/approvals, etc.

Inaccurate valuations of private market funds can have far-reaching consequences for investors, including:

- Unfair treatment of:
    - *Investors* relative to other investors in the same fund where the investment fund is open-ended or can provide liquidity at certain points in time
    - *Pensioners* (beneficiaries) where redemptions or pension payments are based on fair value at plan level[3]
- Overpayment of fees (when overvaluations occur, and where fund fee calculations are based on NAV[4])
- Portfolio rebalancing and FX hedging based on inaccurate valuation information[5]
- Inaccurate performance assessments of investment teams

More broadly, large variations in quality of industry practices can allow bad actors to go undetected, undermining confidence in the asset class and harming investors. Hence, the industry should have an interest in addressing these concerns.

In this guidance paper, we review existing accounting standards, industry standards, fund manager regulations, and the role of third-party service providers in helping address the concerns raised. We highlight areas where the SBAI will provide further industry standards and guidance to help managers better cater to investors and provide investors with key questions to ask to assess the valuations of their private market funds (see Appendix A).

This document is complemented by a consultation paper where we set out the specific proposed amendments to the SBAI's Alternative Investment Standards.

2. Valuation of Private Market Assets

The valuation practices for private market assets are governed by accounting standards, industry standards (such as the SBAI's Alternative Investment Standards), and other industry regulations (for example for fund managers). The following sections provide an overview of existing standards and regulations and identify potential gaps. We will also review the role of service providers who support the valuation process (auditors, valuation service providers), and provide investors with a list of questions to ask to assess the valuation approach of investment managers.

2.1 Accounting Standards

Investment vehicles will be subject to accounting standards which will determine how certain investments will be valued. The two most widely adopted accounting standards are US Generally Accepted Accounting Principles (GAAP)[6] and International Financial Reporting Standards (IFRS)[7].

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[3] For example, some Australian Superannuation System funds provide daily liquidity to savers, where redemption and subscription payments are based on the daily NAV.

[4] Management fees are typically based on committed capital during the pre-investment period and net invested capital during the investment period.

[5] When values of other portfolio elements decline, private equity or credit may exceed the investor's target allocation due to the denominator effect. Depending on the prevailing investment guidelines, the investor may be forced to sell some private finance positions (to the extent possible, as they are typically illiquid) to rebalance the portfolio. However, valuations of private assets in the portfolio may lag public market valuations considerably; situations may occur where rebalancing is triggered without full knowledge of changes in the underlying private asset pricing and adjustments could be premature. Source: The Board of the International Organisation of Securities Commissions - Thematic Analysis: Emerging Risks in Private Finance (Final Report) – September 2023

[6] US GAAP is a set of accounting principles, standards, and procedures that public companies in the United States must follow when compiling their financial statements. These principles are established and administered by the Financial Accounting Standards Board (FASB), a private sector body.

[7] IFRS is an international set of accounting standards that is developed and maintained by the International Accounting Standards Board (IASB). The goal of IFRS is to make international comparisons of financial statements

In the United States, funds registered with the Securities and Exchange Commission (SEC) are required to follow US GAAP for their financial reporting (some Foreign private Issuers may be exempt and are permitted to report using IFRS).[8] This includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and others.[9] US-based private funds, such as private equity funds, venture capital funds, or hedge funds, which are not registered with the SEC, also typically use US GAAP for financial reporting, primarily because their investors are accustomed to that standard.[10] Specific guidance is available for investment companies through the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 946 Financial Services-Investments Companies. It covers a variety of special rules for both recognition and measurement of typical transactions entered into by investment companies, as well as financial reporting requirements. There are several factors that need to be considered to ascertain which accounting standards will apply, including the registration status of the fund, what type of assets it holds, and the number of investments and investors.

In the European Union, the use of IFRS is mandatory for consolidated financial statements of publicly listed companies. This requirement extends to investment funds that are publicly listed. However, non-listed investment funds can choose between IFRS and local GAAP, although IFRS is commonly used due to its international recognition, especially by funds with international investors or aspirations.[11]

Under IFRS, fair value measurement is mandated for investment funds. IFRS 13 provides guidance on fair value measurement. Similarly, US GAAP requires investment funds to measure their assets at fair value. ASC 820 (formerly FAS 157) outlines the framework for fair value measurement.

The definitions of fair value under both IFRS[12] and US GAAP[13] are near identical, as they are both based on the exit price notion i.e., the price which would be received at the valuation date to sell the asset or paid to transfer a liability.

Fair Value: 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 (an 'exit price').

ASC 820 and IFRS 13 both establish a three-level hierarchy for fair value measurement:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets.
- Level 3: Unobservable inputs based on the reporting entity's own assumptions and estimates.

Most unlisted, private market assets will fall under Level 3. As such, investment managers may use various valuation techniques to determine fair value, including the **market approach**, **cost/replacement approach**, and **income approach**. The choice of technique depends on the availability of market data and the nature of the investment.

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easier for businesses and investors. It is used in more than 140 countries around the world, including those in the European Union, Australia, and Canada. Some countries, like India and Japan, have their own accounting standards that are converging towards IFRS.

[8] Good Faith Determinations of Fair Value, SEC, see: https://www.sec.gov/files/rules/final/2020/ic-34128.pdf

[9] Fund Valuation Under the SEC's New Fair Value Rule, ICI (2021), see: https://www.ici.org/system/files/2021-12/21-ppr-fund-valuation-primer.pdf

[10] Starting a Private Fund, SEC, see: https://www.sec.gov/education/capitalraising/building-blocks/starting-a-private-fund

[11] Review of Fair Value Measurement in the IFRS financial statements, ESMA (2017), see: https://www.esma.europa.eu/sites/default/files/library/esma32-67-284_report_on_ifrs_13_fair_value_measurement.pdf

[12] About IFRS 13, *Fair Value Measurement*, see: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-13-fair-value-measurement/#about

[13] 820 Fair Value Measurement, FASB, see: https://asc.fasb.org/820/showallinonepage

Assessment of valuation techniques for Level 3 assets

Approach	Market	Cost / Replacement	Income
Definition *(As per IFRS 13)*[14]	The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets or liabilities, or a group of assets and liabilities such as a business.	The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).	The income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.
Method	Uses comparable sales data to estimate value.	Estimates value based on replacement or reproduction cost.	Estimates value based on discounted future cash flows.
Use Cases	Commonly used in real estate and for assets with active markets.	Often used for specialised assets with no active market.	Commonly used for income-generating assets and businesses.
Advantages	Reflects current market conditions and buyer-seller interactions.	Provides a tangible, cost-based approach.	Accounts for the earning potential of the asset.
Disadvantages	May not be accurate in inactive or volatile markets.	Does not consider market demand or future income potential.	Relies heavily on accurate income projections and discount rates.
Data Required	Comparable sales data, market trends	Construction/production costs, depreciation factors	Income statements, cash flow projections, discount rates
Subjectivity	Less subjective if good comparables are available. Although, finding examples of truly representative peer companies or assets can be very difficult.	Can be subjective due to estimating depreciation and functional obsolescence.	High subjectivity in estimating future income and selecting discount rates.

When using the **market approach**, it is important to identify comparable assets that have recently sold or are currently on the market. These comparables should be similar in terms of size, location, age profile, condition, and other relevant attributes to increase confidence in the valuation. It is important to ensure a

[14]IFRS 13 Fair Value Measurement, see: https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2022/issued/part-a/ifrs-13-fair-value-measurement.pdf?bypass=on#:~:text=The%20fair%20value%20hierarchy%20gives,inputs%20(Level%203%20inputs)

sufficient[15] number of comparable transactions are used, which may be difficult in inactive or niche markets. Therefore, this approach may not be suitable for unique or specialised assets with no active market.

Valuers must assess whether adjustments to the comparables are necessary, while being mindful of the subjectivity involved and potential of introducing bias. Typical adjustments often account for factors such as time of sale (reflecting changing market conditions), physical differences, and legal or economic circumstances.[16] For example, in real estate, appraisals may only occur annually, leading to systematic price lags ("appraisal error").[17] Furthermore, there may be periods where comparable transaction volume is highly limited. For example, a manager may own an industrial building in a Tier 3 city, where the most recent comparable sale occurred two to three years prior. All these limitations make it difficult to formulate valuations. **Appendix B includes an overview of challenges with the use of valuation multiples.**

The **cost / replacement approach** requires valuers to estimate the cost to replace the asset with a new one of similar utility using modern materials and standards. Depreciation factors, such as physical wear and tear, as well as functional[18] and economic[19] obsolescence, must be considered. Accurate cost estimates based on current market conditions are essential to ensure the valuation reflects true replacement costs. This approach can offer a tangible, objective basis for valuing unique or specialised assets. However, assessing depreciation, especially functional and economic obsolescence, can be subjective and complex. If indirect costs and depreciation are not accurately accounted for, the approach may lead to overvaluation.

When using the **income approach**, valuers estimate current ('discounted') value of the future income an asset is expected to generate. Identification of an appropriate discount rate is paramount, with common methods including the weighted average cost of capital (WACC), the capital asset pricing model (CAPM), or industry benchmarks. Income forecasts must be realistic and consider potential risks and uncertainties to form a range of potential outcomes. The discount rate must accurately reflect the asset's risk profile and current market conditions. This approach is highly sensitive to changes in key assumptions, such as growth and discount rates, whereby even small changes can result in significant variations in valuations. As result, it is often more complex than other valuation methods. **Appendix C provides examples of mistakes and challenges that arise in discounted cash flow models.**

Key takeaways:

- The assessment of valuation techniques for Level 3 assets under US GAAP and IFRS highlights that while there are well-defined techniques and methods, many of the valuation inputs will be subjective and influenced by the assumptions taken by the valuation professional / service provider.
- From an investor perspective, it will be difficult to assess the specific assumptions used in the valuation of individual assets in a fund, and the consistency of the approach over time.
- Investors should focus on the governance structures and procedures that managers (and their valuation service providers) implement to oversee and manage the valuation process in order to understand how the conflicts of interest associated with the subjectivity and flexibility of valuation methodologies are addressed and managed.

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[15] There is no clear guidance what a 'sufficient' number of comparable transactions is. Some commentators suggest 3-5 to gain confidence, but valuation practitioners should also question whether these values are broadly similar or if some represent outliers from the mean.

[16] Regulatory or legal factors that may affect the value of the asset, such as zoning laws, environmental regulations, or pending legislation.

[17] Cannon, Susanne E. and Cole, Rebel A., How Accurate are Commercial Real Estate Appraisals? Evidence from 25 Years of NCREIF Sales Data (May 20, 2011). Journal of Portfolio Management, Vol. 35, No. 5, 2011, Available at SSRN: https://ssrn.com/abstract=1824807

[18] Functional obsolescence refers to loss in value due to outdated design, technology, or layout.

[19] Economic obsolescence refers to external factors such as changes in market conditions or regulations that reduce the asset's value.

2.2 SBAI Standards

The valuation section of the Alternative Investment Standards[20] complements the fair value frameworks and valuation techniques included in the accounting standards (US GAAP, IFRS), by setting out the key features of a robust valuation framework, focussing on:

- *Governance arrangements:* providing an overarching framework to establish and manage the valuation process (including documentation, segregation of functions) with a view to addressing conflicts of interest and ensuring fair treatment of investors.
- *Investor disclosure:* ensuring that investors can inspect the valuation process and arrangement, as well as monitor the ongoing valuation of assets through regular reporting requirements.
- *Robustness in approach:* ensuring consistency in valuation approach when dealing with hard-to-value (Level 3) assets (where typically many valuation challenges arise).

Summary of the Valuation Section of the *Alternative Investment Standards*

Area	Standard	
Governance	5.1	Put in place arrangements aimed at mitigating conflicts of interest
	5.2	Where manager has inhouse valuation – separate valuation function
	6.1	Valuation policy document to cover all material aspects of the valuation process, controls, and monitoring processes
	8.4	Escalation of material valuation issues to the fund governing body
Disclosure	6.1	Disclosure of valuation policy document to investors
	6.2	Disclosure of portfolio manager involvement in valuation process
	8.1	% percentage of portfolio in “liquidity” buckets
	8.2	Investor notification of material increases in hard-to-value assets
	8.3	Periodic reporting of value of side pockets
	8.4	Disclosure of other material issues to investors
Hard-to-value assets	7.1	Where in-house valuation of hard-to-value assets is performed, valuation procedures should be aimed at ensuring a consistent approach (with detailed guidance for use of pricing hierarchies, broker quotes, and pricing models)
	7.2	Use of side pockets (incl. eligible assets, timing, fees)

The Standards enable investors to assess the arrangements the manager has put in place as part of their pre-investment due diligence, as well as the ongoing monitoring of valuations post-investment. The starting point in due diligence is the manager’s *Valuation Policy Document*, which covers all material aspects of the valuation process and controls in respect of the fund.[21]

[20] See Appendix D for overview, the Standards are available at https://www.sbai.org/standards/
[21] Disclosure upon request on a confidential basis (since Valuation Policy Documents can contain sensitive intellectual capital about the manager’s procedures, models, etc. and can be seen a competitive differentiator)

Standard 6.1: Contents of the *Valuation Policy Document*

- *The responsibilities of each of the parties involved in the valuation process;*
- *The processes and procedures in place that are designed to ensure that conflicts of interest are managed effectively;*
- *The relevant material provisions of any service level agreements (SLAs) entered into with third parties responsible for or involved in the valuation process (excluding details of commercial aspects of any such SLAs); and*
- *The controls and monitoring processes in place that are designed to ensure that the performance of any third party to whom the valuation function is outsourced is satisfactory.*

(…)

While the Standards had originally been developed with liquid market (hedge fund) managers in mind, the section on hard-to-value assets provides detailed guidance on the arrangements that ensure a consistent approach (i.e. minimising subjectivity / cherry picking) to determining fair value.

Standard 7.1 Guidance

The SBAI envisages that such procedures would in most circumstances include:

- *Details of a hierarchy of pricing sources and models to be used for each asset type in a fund's portfolio (where relevant);*
- *If using broker quotes:*
  - *Making reasonable efforts to identify and draw upon multiple (typically 2-3) price sources (where available);*
  - *Specifying the acceptable tolerance ranges when multiple pricing sources are used and the approach to handling "outliers";*
  - *Ensuring consistency and avoiding "cherry picking" of favourable price sources by using the same brokers at each valuation point; and*
  - *Where the fund manager arranges the provision of broker prices (as opposed to the administrator or other third-party valuation service provider), the fund manager should instruct brokers to send the prices directly to the administrator (or other third-party valuation service provider);*
- *If using pricing models, a process specified in the Valuation Policy Document for:*
  - *Approving pricing models including back-testing, documentation and approval by the fund governing body or its valuation committee;*
  - *Monitoring and verification against observed market prices; and*
  - *Governing manual overrides of the model inputs or results, including approval, documentation and reporting to the fund governing body or its valuation committee.*

While the procedures are geared towards (less liquid) OTC markets, some of them equally apply to private market valuations, including "avoiding 'cherry picking'", "specifying the acceptable tolerance ranges… and the approach to handling of 'outliers'" (e.g., in relation to valuation inputs), "approving pricing

models… by the fund governing body or its valuation committee”, and “governing manual overrides of the model inputs or results”.

The SBAI acknowledges that the Valuation section of the Standards should be expanded to better reflect the specific issues that arise in private market valuations. A separate Consultation Document has been published that addresses key issues in relation to private market valuations, including:

- GP-Led secondaries transactions (Governance Standards and Guidance)
- Valuation methodology: selection, changes to the methodology, aggregation
- Valuation: Inputs, adjustments, and assumptions
- Valuation Service Providers: Disclosure Standards and Guidance
- Financial Statements – Disclosure Standards and Guidance
- Valuation Process and Procedure Evaluation – Disclosure Standards and Guidance

Appendix D includes the SBAI’s Valuation Standards

Appendix E contains an overview of the proposed Standards and Guidance.

2.3 Other Industry Standards and Professional Bodies

The main influence on how private market valuations are conducted will be driven by internationally recognised accounting standards (US GAAP, IFRS). However, other standard setting and professional bodies can also have an influence. For investors, understanding how these standards impact how valuation processes are conducted is important.

Standard	Areas of focus
International Valuation Standards (IVS) *Set by the International Valuation Standards Council (IVSC)*	The IVS are comprised of seven ‘General Standards’ and eight ‘Asset-specific Standards’. • The General Standards set requirements for the conduct of all valuation assignments, including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting. • The Asset Standards include requirements related to specific types of asset valuation, including background information on the characteristics of each asset type that influence value, and additional asset-specific requirements regarding common valuation approaches and methods used. An IVS-compliant valuation must follow both the General and Asset standards.
International Private Equity and Venture Capital Valuation (IPEV) Guidelines	The IPEV Guidelines set out recommendations, intended to represent current best practice, on the valuation of private market investments. The objectives of these valuation guidelines are to set out best practice where private market investments are reported at ‘fair value.’
Royal Institution of Chartered Surveyors (RICS) Valuation Global Standards	RICS is a global professional body dedicated to advancing standards in the property, land, and construction sectors. Its core purpose is to ensure that its members adhere to high ethical and professional standards, promoting confidence and integrity in the built environment. RICS focuses on areas such as property

	valuation, building surveying, quantity surveying, and land management. RICS sets and maintains professional valuation standards that apply to RICS members and regulated firms globally. The main global valuation standards are published in the RICS Valuation Global Standards (Red Book), which also fully incorporates the IVS.
National Council of Real Estate Investment Fiduciaries (NCREIF) and Pension Real Estate Association (PREA) Reporting Standards	NCREIF is a provider of investment performance indices and transparent data for US commercial properties. Data contributor members submit data to NCREIF for inclusion in its various indices and data products. The NCREIF PREA Reporting Standards (Reporting Standards) is an industry initiative co-sponsored by NCREIF and the Pension Real Estate Association (PREA) with a mission to establish, manage and promote transparent and consistent reporting standards for the real estate industry to facilitate informed investment decision-making. The Reporting Standards provide specific manuals related to fair value accounting, performance and risk reporting, and valuation.

2.4 Regulations

Asset management regulations have also set out requirements for asset valuation, including the EU's Alternative Investment Fund Managers Directive (AIFMD), the US SEC's Rules 2a-5 and 31a-4 of the Investment Advisers Act of 1940, and the Private Fund Adviser Rules (vacated in June 2024) as set out in the table below.

EU AIFMD (Valuation)[22]	▪ Requirement for "appropriate and consistent procedures so that independent valuation of assets can be performed" ▪ Rules applicable to the valuation function (either external valuer independent of the AIF/AIFM, or the AIFM itself) ▪ External valuer must be subject to mandatory professional registration ▪ The directive emphasises that AIFMs are held liable for ensuring the accuracy and integrity of the valuation process.
US SEC's Investment Advisers Act of 1940	▪ Rule 2a-5 requires the performance of certain functions in order to determine in good faith the fair value of a fund's investments. These functions include periodically assessing and managing material risks associated with fair value determinations, selecting, applying and testing fair value methodologies, and overseeing and evaluating any pricing services used. ▪ Rule 31a-4 requires funds or their advisers to maintain appropriate documentation to support fair value determinations and, where applicable, documentation related to the designation of the valuation designee.

[22] FCA Handbook FUND (Chapter 3.9) implements the AIFMD in the UK content: LINK

	▪ These rules apply to registered investment companies and business development companies (BDCs). Most private equity and venture capital funds are structured as private funds and fall outside this rule.
US SEC's proposed Private Fund Adviser Rule	▪ The Private Fund Adviser Rule, since vacated, would have required GP-Led Secondary deals to have an independent valuation or fairness opinion provided before the deal was executed.

2.5 The role of third-party service providers

Service providers play an important role in private markets – providing audit and valuation services to the fund. It is important for investors to understand the exact types of services provided, and the conflicts of interest that arise, to determine the level of comfort that they can take from such arrangements.

Fund Administrators

Fund administrators can play an important role in the valuation of assets in private funds. In traditional, liquid hedge fund strategies, responsibility for valuation of fund assets is typically delegated to the fund administrator. In private markets, this is not normally the case where there is still a reliance on the investment manager to value private market assets.

They are often responsible for overseeing the valuation process, ensuring that valuations are performed at regular intervals (e.g., quarterly, annually) and in line with the fund's valuation policy (e.g. consistent application of procedure and use of pricing sources). While they may not perform the valuations themselves (which is often done by external valuation experts or the portfolio managers), administrators should ensure that the process follows agreed-upon methodologies and is aligned with the fund's investment strategy and regulatory requirements. Fund administrators who independently receive valuation statements from valuation service providers in the process of calculating a fund's NAV, can represent an additional level of control.

In many cases, fund administrators will work with valuation service providers to perform the actual asset valuations, especially for complex or illiquid assets where independent expertise is required. They can also support the annual audit process by providing reporting and data that auditors need to assess whether the valuation policies and procedures have been performed as intended. They should also ensure that the fund complies with regulatory requirements regarding asset valuation and reporting, which may vary depending on the jurisdiction and type of asset.

As with any service provider, investors should always scrutinise whether that service provider has the right resources, scale and sophistication to adequately perform its responsibilities.

Auditors

The auditor plays a crucial role in auditing the financial statements of an investment fund. Their primary responsibilities include ensuring the accuracy, completeness, and fairness of the financial statements, and providing assurance to investors and stakeholders about the fund's financial health and adherence to relevant accounting standards and regulations. In addition, the auditor should verify the existence of the fund's investments and other assets.

Auditors communicate their findings to the fund's management and governance bodies, such as the board of directors or audit committee. This includes discussing any identified misstatements, control deficiencies, or areas for improvement. They issue an audit report that provides an opinion on the fairness of the financial statements. The opinion can be unqualified (clean), qualified, adverse, or a disclaimer, depending on the findings.

Prior to the inception of a relationship, auditors should begin by understanding the investment fund's structure, strategies, and objectives. This should include reviewing the types of investments intended to

be held in the fund. Auditors should review the fund's valuation policy and ensure that the methodologies and valuation approach are deemed appropriate for the assets in scope. The assessment performed by the prospective auditor should consider the operational controls and checks and balances within the manager's process.

Crucially, in relation to valuation of private market assets, the auditor will not typically underwrite the accuracy of the valuation. Their role is simply to assess whether the valuation policy has been followed, and that the assumptions and inputs used are reasonable. Differences of opinion regarding assumptions and inputs will not typically be raised unless the auditor believes them to be materially false or misleading. In such a scenario where an auditor fundamentally disagrees with the actions of the manager, they will have the opportunity to raise concerns to the fund's board of directors, or they can resign from their position if they feel that their concerns are not being adequately addressed.

The approach taken by auditors can be described as risk based. Dependent on criteria such as the manager's capabilities, experience, and resources, or the fund's complexity, liquidity, and leverage, an auditor may decide how to approach year-end review of valuations. Funds deemed to be low risk may have ~30-40% of their valuations reviewed, while extremely complex or high-risk funds may have all their valuations reviewed. However, **investors should be aware that the auditor is not endorsing the accuracy of the valuation, but only that the process to reach the valuation is deemed reasonable based on the evidence presented.**

A common response to a lack of confidence in manager derived valuations and the lack of underwriting by auditors, is for investors to apply a discount or haircut to the valuations on their books. Whilst this may appear a prudent thing to do, it does not actually improve outcomes for investors, nor instil confidence in the industry. In fact, dependent upon jurisdiction, some endowments and foundations are required to take the values reported in financial statements – not allowing for any adjustments by the investor.

Any prospective investor in a private market fund should, as part of their due diligence process, confirm how an auditor will engage with a manager and the fund's board.

Valuation Service Providers

The presence of Valuation Service Providers[23] can provide comfort to investors that there is some degree of independence or oversight of the valuation process. However, investors should understand the:

- Type of valuation service provided, and how the valuations are being used in the manager's valuation process
- Qualifications and competency of the valuation service provider
- Conflicts of interest present through the contractual arrangements between the valuation service provider and the fund / GP

Valuation Service Providers offer a spectrum services, including valuation opinions and general support services to GPs:

Valuation Opinions	General Support Services
Transaction Opinions: Third-party valuation may be a regulatory requirement for non-arms-length transactions or determining solvency and may improve transparency for limited partners as deal participants.	**Valuation Policy Review:** Third-party valuers create or consult on new or existing valuation policies and procedures to ensure fund managers have sound, transparent, comprehensive, and appropriately documented valuation processes.

[23] We purposely utilise the term Valuation Service Provider as 'external valuer' can imply specific regulatory obligations such as those under AIFMD, whereby an external valuer is independent from the AIF/AIFM and may have responsibility to value fund assets delegated to them. A useful summary of these distinctions can be found here: https://www.linklaters.com/en/insights/publications/aifm/valuation

Positive Assurance: The Valuation Service Provider will generally perform its own valuation and critically review key input assumptions the manager then uses to compare its own fair value calculations.	**Stress Testing & Risk Reporting:** Valuation Service Providers can assist with periodic reporting requirements by performing stress testing or measures of sensitivity of key inputs on asset values.
Independent Ranges of Values: Valuation Service Providers provide their conclusion of a range of fair values for each investment, from which the manager selects the mark that is used to calculate the net asset value of the fund.	

In addition to clarifying the exact service provided, investors need to understand how externally calculated marks will be used in the valuation process. Depending on the contractual relationship between the external valuer and the fund, the manager may not be obliged to accept an externally calculated mark.

Investors should also conduct thorough due diligence on the external valuer to ensure that they have the competency and skill to adequately service the fund. This can include commitment to professional or industry standards (such as RICS in the UK).

Finally, investors need to keep in mind the conflicts of interest that arise from the commercial arrangements between the external Valuation Service Provider and the client (the fund or often multiple funds of the same investment manager). The Valuation Service Provider undertakes a "valuation for third-party consumption where the valuer's firm has other fee-earning relationships with the client".[24]

A series of useful questions that investors should ask Valuation Service Providers is included in Appendix A.

The Third-Party Valuation Dispersion Conundrum

Valuation Service Providers have been criticised for attributing or affirming different prices to the same asset if held by different private equity managers. However, this anomaly can occur for several reasons:

1. Each manager will have a different underlying valuation policy which will drive the methodological selection and the determination of various inputs and assumptions. This can lead to managers having different views regarding fair value.
2. Dependent on the level of service the Valuation Service Provider has been engaged to provide, the valuer, for example, may only be asked to affirm that a procedure or policy has been followed correctly or that the value calculated by the manager falls within a defined range of values. In this scenario, a valuer could have two different values for the asset but could argue that either are reasonable.
3. Due to confidentiality reasons, where Valuation Service Providers are engaged to provide valuation services to a fund, they can often be precluded from sharing information between different third parties. That would include 'sensitive' information like assumptions, inputs, and valuations.
4. Listed and unlisted credit from the same issuer can sometimes be valued differently, even where the instruments have some commonality (tenor, yield, etc.). In this scenario,

[24] RICS Valuation – Global Standards (Red Book Global Standards), PS2 paragraph 3.9 (https://www.rics.org/profession-standards/rics-standards-and-guidance/sector-standards/valuation-standards/valuation-conflict-of-interest-case-studies)

practitioners should question why there are differences. Additional analysis may unveil that some instruments may have different underlying structures, covenants, convertibility, or warrants embedded within the product which will all have an impact on valuation.

3. Liquidity Management Tools

Investing in private markets can be difficult in changing macroeconomic environments, such as when interest rates and inflation increase, deal activity can slow as a result.[25] For example, the amount of money returned to investors at the end of 2023 was the lowest since 2009. Distributions were 11.2% of net asset value, making it the second-lowest rate recorded in the last 25 years.[26] The trend towards invocation of fund extensions are a clear sign that it is not a favourable environment for GPs to attempt to sell assets to return capital to their investors. and that implicitly implies that valuations may be too rich at this time.

Declines in GP distributions have significant impacts for LP's ability to meet their planned liabilities – from pension funds meeting their drawdown requirements, to endowments and foundations finding it harder to meet funding objectives to meet their goals. It may also mean less funds available to meet existing future commitments to new private market fund vintages.

These challenges can be addressed through various 'solutions' to create liquidity for investors – which may also contribute to the overall level of risk in this asset class.

Net Asset Value (NAV) Lending

NAV lending is an increasingly popular financing strategy in private equity. This method allows private equity funds to take out loans and access liquidity secured against the value of the underlying assets in their portfolios. These funding facilities provide flexibility to generate liquidity when exit opportunities (such as the secondary market) are not favourable.

Unlike revolving credit facilities, which are typically used during a fund's investment period, NAV finance is usually provided either during a fund's value creation phase or very late in the investment period when most of the LP's capital has been called.[27]

NAV lending usually features bespoke loans that are structured based on the specific needs of the lender and borrower. However, there are some features which are common across most NAV loans:

- They are usually senior-ranking instruments that are collateralised by a diverse portfolio of private equity investments.
- They typically have long-dated maturities and floating-rate coupons.
- The payments to the NAV lender are funded via cash flows from the underlying investments.
- The loan-to-value ratios are typically low – only 5-30% compared to 35-60% for a typical middle-market direct lending deal.
- Many of the assets in the underlying portfolio are expected to be monetised before the NAV loan matures.[28]

[25] Private Equity Outlook in 2023: Anatomy of a Slowdown, Bain & Company, see: https://www.bain.com/insights/private-equity-outlook-global-private-equity-report-2023/
[26] Private equity fund distributions at lowest level in 15 years, Citywire (2024), see: https://citywire.com/wealth-manager/news/private-equity-fund-distributions-at-lowest-level-in-15-years/a2436016
[27] Oaktree Insights - NAV Finance 101: The Next Generation of Private Credit – 2024, see: https://www.oaktreecapital.com/docs/default-source/default-document-library/nav-finance-101.pdf?sfvrsn=6e1e5766_2
[28] ibid

Whilst this mechanism may be beneficial for some investors, there is generally discomfort amongst LPs regarding usage of NAV financing – with a recent study showing only 7% of LPs being very comfortable with the practice and happy for GPs to use as they see fit.[29]

This discomfort is not entirely unwarranted and there are several concerns that investors should be aware of. For instance, NAV lending increases leverage in what could be an already highly leveraged scenario. Further, overvaluation can lead to loan defaults, while undervaluation might limit the available credit. Funds usually repay the loan with interest over a specified term, which may involve regular payments or a lump sum at maturity.

Adverse market movements can impact the value of the underlying assets, affecting both the loan terms and the fund's ability to repay. The overall performance of the fund and its investments directly influences the lender's risk, potentially leading to more stringent loan terms or higher interest rates. If the value of the fund's assets declines significantly, it may trigger a margin call and require the fund to provide additional collateral or repay part of the loan to maintain the agreed loan-to-value ratio.

Private Market Secondaries

Private equity secondaries involve the buying and selling of existing investor commitments in private equity funds. These transactions typically occur in the secondary market, where investors can acquire or sell stakes in private equity funds before the underlying investments mature. For investors, participating in secondaries offers several benefits.

These transactions can provide liquidity, by enabling them to exit investments earlier than expected, offer opportunity to diversify their portfolio, and potentially reduce risk exposure. Additionally, it allows investors to acquire interests in established funds with known performance records. Overall, private equity secondaries serve as a strategic tool to efficiently manage capital and liquidity.

However, while private equity secondaries offer liquidity and diversification benefits, they also come with certain downsides and risks.[30] One major concern is pricing uncertainty, as valuing illiquid assets can be challenging and there may lead to discrepancies between buyer and seller expectations. Additionally, transaction costs can be significant, including fees for due diligence and legal processes. There is also the risk of inheriting underperforming assets or funds with undisclosed liabilities, which could diminish returns. Furthermore, market conditions and economic downturns can impact the secondary market, affecting the availability and pricing of assets. Overall, investors must carefully assess these risks and conduct thorough due diligence before engaging in private equity secondaries.

Dividend Recapitalisation

Dividend recapitalisation, also known as dividend recap, is another potential financing technique employed by GPs, involving an underlying portfolio company issuing new debt to fund a special dividend payment to shareholders (the GP). This allows the private equity firm to quickly recoup much of its equity investment without selling its ownership interest in the company. In the United Kingdom, dividend recaps are legal if the company is still solvent after paying the dividend. However, if the company is insolvent, or rendered insolvent by paying the dividend, the transaction may be set aside as a fraudulent conveyance.[31]

One of the primary risks of dividend recapitalisations is that they can increase the overall leverage of the company, potentially making it more vulnerable to economic downturns or changes in interest rates. If the amount of debt taken on in the recapitalisation is excessive this can increase the risk of financial distress or bankruptcy, especially if the company encounters operational challenges or faces a downturn in its

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[29] Coller Research Institute – 40th Edition - Global Private Capital Barometer - Summer 2024 https://www.collercapital.com/wp-content/uploads/2024/06/Coller-Capital-Global-Private-Equity-Barometer-Summer-2024_Digital.pdf

[30] JP Morgan - The rising tide of secondaries: investors seek private market liquidity – April 2024, see: https://www.jpmorgan.com/content/dam/jpm/cib/complex/content/securities-services/fund-services/rising-tide-secondaries-private-market-liquidity.pdf

[31] Dividend Recapitalization, Thomas Reuters Glossary, see: https://uk.practicallaw.thomsonreuters.com/6-383-2176?transitionType=Default&contextData=(sc.Default)&firstPage=true

industry. Higher debt levels resulting from a dividend recapitalisation could also negatively impact a company's credit rating. This may lead to higher borrowing costs in the future or difficulty accessing credit markets. Importantly, dividend recapitalisations can sometimes create conflicts of interest between different stakeholders. For example, while private equity firms may benefit from immediate cash returns, other investors or creditors may become concerned about the increased financial risk to the company.

GP-Led Secondaries

GP-led secondaries refer to transactions where the GP of a private equity fund initiates the sale or restructuring of assets within the fund's portfolio. Unlike traditional secondary transactions initiated by LPs, GP-led secondaries are driven by the fund manager seeking to optimise portfolio management or extend the life of the fund. This process often involves negotiating with existing LPs to restructure the fund, selling specific assets, or providing liquidity options.

GP-led secondaries can also be used to raise liquidity for investors who wish to exit their investments, but this requires selling those particular assets to investors in other fund vintages overseen by the GP. However, they also present complexities related to transparency, conflicts of interest, and ensuring fairness to all investors involved in the transaction.

Valuation of the assets to be exchanged is a key concern and accuracy is vital. The US SEC believed this scenario to be such a risk to investors, that as part of the Private Fund Adviser Rules (struck down in June 2024), they called for all GP-led transactions to be subject to an independent valuation or fairness opinion prior to sale to help protect investors (*Rule 211(h)(2)-2 under the Advisers Act*).

Payment-in-kind

Payment-in-kind (PIK) is a financial mechanism often used by private equity funds to manage liquidity, sometimes when addressing redemptions requested by LPs. PIK can be particularly beneficial during times of market volatility or when the fund's underlying assets are not easily liquidated without significant loss. By using PIK, private equity funds can maintain their investment strategies and avoid forced sales of assets, thus protecting the interests of remaining investors. Instead of providing cash, the fund may offer alternative forms of payment, such as additional equity stakes or other assets. This approach allows the fund to preserve its cash reserves while still meeting the needs of LPs seeking liquidity. However, it may lead to higher interest assessments added to the principal.

In cases where PIK takes the form of equity or preferred shares, it can dilute shareholder equity. The risk for lenders is that the accrued interest is never received.[32]

4. Looking Forward: Alternative Valuation Solutions

So what viable solutions are there for investors who wish to take a more active approach to performance measurement and valuation estimation? Beyond traditional metrics, alternative approaches such as proxy benchmarks, public market equivalents (PMEs), and listed private equity managers are worth consideration.

These methods offer insights into valuations by comparing private equity performance to public market benchmarks or analysing listed entities' performance in a manner akin to their private counterparts. Each method requires careful consideration and an understanding of the various issues inherent in these types of comparison exercises.

Public Market Equivalents (PMEs)

Public market equivalents (PMEs) are a valuable tool for investors seeking to assess the performance of private equity investments relative to public market benchmarks. These metrics adjust for the unique

[32] https://www.brookfieldoaktree.com/insight/credit-payment-kind-explained#:~:text=PIK%20helps%20a%20business%20facing,accrued%20interest%20is%20never%20received.

characteristics of private equity, such as the timing and size of cash flows, which can differ significantly from those of public market investments.

By comparing the returns of a private equity fund to a corresponding public market index using PME methodologies, investors can gain insight into how well their private investments have performed relative to what they might have achieved in public markets. This comparison helps investors evaluate the value added by private equity managers through active management, assess risk-adjusted returns more accurately, and make informed decisions about portfolio allocation.

The table below (provided by the British Private Equity & Venture capital Association[33]) sets out a summary of several well-known public market equivalent performance measures, including their relative strengths and weaknesses. Note, there are many more PMEs available. Choosing the appropriate method depends on the specific context and the characteristics of the private equity fund being evaluated.

Methodology	LN PME (Long-Nickels)	KS PME (Kaplan-Schoar)	Capital Dynamics PME+
Metric	Annualised Rate	Ratio	Annualised Rate
Private Equity Outperformance if:	Estimated PME IRR < PE Fund IRR	Value > 1	Estimated PME IRR < PE Fund IRR
Description of Calculation	Contributions to PE fund are converted to an equal purchase of shares in the public index. Distributions represent liquidation of share in public index. IRR calculation uses same contributions and distributions as PE fund, but with a different final period remaining value.	Calculated by discounting the private equity fund cash flows by the public market index value. The discounted distributions plus the current remaining value are divided by the discounted contributions to obtain the ratio.	Uses a fixed scaling factor (lambda) to modify each distribution to ensure the PME final period remaining value is the same as the PE fund remaining value. IRR calculation uses modified distributions but same contributions and final period remaining value.
Strengths	LN PME IRR is directly comparable to the PE Fund IRR, allowing an apples-to apples comparison.	The calculation looks at the ratio of outflows versus inflows as opposed to generating an IRR, which is time dependent and is easily manipulated. Easy to interpret.	As for LN PME, with the added benefit of avoiding a final period negative remaining value, making PME IRR calculation possible in more cases.
Weaknesses	IRR sensitive to early distributions. Large distributions could cause a negative PME final period remaining value, making PME IRR calculation computationally impossible.	The multiple is neither a return nor return spread which makes it difficult to compare against other models which produce annualised rates.	PME+ does not match the cash flows perfectly.

Source: Information in the above table provided by Preqin.[34]

[33] BVCA - Performance and Public Market Equivalent Report 2020, see: https://www.bvca.co.uk/Portals/0/Documents/Research/Industry%20Performance/BVCA-Performance-and-Public-Market-Equivalent-Report-2020.pdf

[34] Preqin Special Report: Public Market Equivalent (PME) Benchmarking - July 2015 - https://docs.preqin.com/reports/Preqin-Special-Report-PME-July-2015.pdf

Private Equity Benchmark Indices

Private equity benchmark indices are customised benchmarks designed to track the performance of specific private equity investments or portfolios over time. These indices can serve as valuable tools for investors and fund managers seeking to evaluate the performance of their private equity holdings against a tailored benchmark that reflects their unique investment strategy, sector focus, or geographical exposure.

When selecting a bespoke private equity index for benchmarking purposes, considerations typically include defining the index composition based on the types of investments held (e.g., venture capital, buyouts, distressed), investment vintage, and geographic scope. Moreover, factors such as the inclusion criteria for funds or assets, weighting methodologies, and rebalancing frequency are critical in ensuring the index accurately represents the investment universe and provides meaningful performance comparisons.

Challenges in using bespoke private equity benchmark indices include data availability, reliability, and the need for transparency in index construction. Additionally, constructing a robust benchmark that appropriately reflects the risk-return profile of the underlying private equity investments requires sophisticated modelling and methodology, often involving complex calculations and adjustments for cash flows, valuations, and performance metrics. Nonetheless, private equity benchmark indices can offer investors a useful benchmark in evaluating GP performance as well as an indication of where industry pricing and valuation may be at any given point in time.

Publicly Listed Private Equity Managers

Publicly listed private equity managers serve as proxies for assessing the performance and market sentiment towards the broader private equity industry. Investors often use these firms to gauge trends in private equity activity, fund performance, and investor sentiment. Selecting a publicly listed private equity manager as a benchmark involves considerations such as the firm's investment strategy (e.g., venture capital, buyouts, growth equity), geographic focus, size, and track record. These firms' stock prices provide insights into market expectations regarding future earnings and growth prospects in the private equity sector.

Challenges include the volatility of stock prices, which may not always reflect underlying fund performance accurately due to market sentiment, liquidity considerations, and the influence of external market factors. Furthermore, differences in accounting practices and financial reporting between public firms and private equity partnerships can complicate direct comparisons. Despite these challenges, publicly listed private equity managers offer a useful proxy for assessing market trends, investor sentiment, and broad industry performance within the private equity space.

5. Conclusion: Delivering better industry outcomes

What Investors can do

Investors must recognise that they wield incredible influence and have the power to achieve better outcomes in the industry. Investors should set minimum standards for investing with private market managers, and failure to meet these standards in terms of process, disclosure, or transparency should result in allocations flowing to those managers who have a desire to align better with investors.

Investors should be mindful of the risks involved in investing in unlisted private market assets. As private markets are not public markets, it should not be surprising that they operate and perform differently. Investors should avoid asset liability mismatches where possible and consider how their approach to allocation (Strategic Asset Allocation vs Total Portfolio Approach, etc.) may impact their portfolio through different business cycles.

Investors should continue to invest in their due diligence resources, including having staff experienced in private market investing. Investment in training and exchange of best practices between peers should be

undertaken. The SBAI has provided a forum for such exchanges over the years and will continue to offer opportunities for investors to engage with their peers through workshops, forums, and other small-scale interactions.

What Investment Managers can do

Private market managers can play a pivotal role in fostering better trust and confidence among investors through enhanced transparency and disclosure practices. Managers should consider implementing comprehensive frameworks that outline the methodologies, assumptions, and key inputs used in valuation processes. Clear and consistent communication of these aspects helps investors understand the rationale behind valuations and builds transparency.

Establishing a mechanism for routine reporting of valuation updates to investors, coupled with thorough explanations of changes and their implications, could foster trust by keeping investors informed and engaged throughout the investment lifecycle. Embracing independent third-party validations of valuations to provide an unbiased perspective on asset values would enhance credibility with investors.

Initiating educational programs or workshops aimed at investors to familiarise them with the nuances of private market valuations may be worth considering. Better investor understanding leads to more informed decisions and reduces misunderstandings or misinterpretations.

By adopting these proactive measures, private equity managers can not only strengthen their relationships with investors but also contribute to a more transparent and informed investment environment.

Appendix A

Key questions institutional investors should ask private market managers

	GP-Led Secondaries and Related Party Transactions
1.	What is the rationale for the transaction? Why is an internal transaction between funds the most appropriate course of action?
2.	What independent valuation or fairness opinion processes are in place for GP-led secondaries and related party transactions?
3.	If a GP-Led Secondary transaction is initiated, will the GP provide: • Declaration of any potential conflicts of interest? • Details of how external valuation costs will be paid.
4.	What are some examples of past transactions where independent valuations were utilised, and what were the outcomes of these transactions?

	Valuation Methodology Disclosure
1.	Does the valuation policy outline in detail the range of valuation methodologies or techniques that will be reasonably used by the GP during the life of the fund?
2.	How do you communicate changes in valuation methodologies to LPs during the life of the fund?
3.	Can you provide an example of when a change in methodology was communicated and the rationale behind it?
4.	Are changes in methodologies documented or reported to a governance body such as a valuation committee, LPAC etc.?
5.	Does the GP typically combine multiple valuation techniques to reach a valuation? If so, how do you determine and apply weightings to different valuation methodologies?
6.	Can you explain a recent instance where multiple methodologies were weighted to reach a valuation?
7.	What are the significant inputs, adjustments, and assumptions used in the valuation process? How do you ensure these inputs are transparent and justifiable to LPs?
8.	What sensitivity analysis do you perform on major inputs, adjustments, and assumptions?
9.	Are changes in valuation methodology reported to the fund's auditor?
10.	Can you share an example of sensitivity analysis performed on a key valuation?

Valuation Service Providers

1.	What due diligence and selection process is followed when appointing external valuation providers? Is the due diligence process recorded or documented anywhere?
2.	Can you provide evidence of this due diligence process?
3.	How can the GP be certain that the appointed valuer has the correct size, scale, and complexity to deal with the type of assets being valued?
4.	Is the valuation service provider a member of a globally recognised standard setting body or professional body which requires commitment to minimum professional and technical standards and/or behaviour?
5.	Are there any conflicts of interest between the manager and valuation service provider such as: • Over reliance by the valuation service provider for revenue from these relationships? • Is the valuation service provider connected to the manager in any way through equity ownership, related parties, private equity backers etc.? • Familial relationships.
6.	What services do your external valuation providers deliver, and what are the limitations of these services? How do you communicate these limitations to LPs?
7.	What proportion of the valuations does the manager perform itself? Do those internal valuations satisfy the definition of fair value? How often is an external valuer consulted?
8.	Are there any legal or contractual requirements to accept or implement valuations provided by external third parties?
9.	How do you ensure these requirements are transparent to LPs?
10.	What is the payment structure for third-party valuation agents?
11.	How do you ensure that valuation agents are not influenced by parties who might benefit from higher or lower valuations?
12.	Does the GP require any external valuation agent to be a member of a globally recognised representative body or standard setter?
13.	To what extent are internal valuations performed by individuals outside of deal teams who are not compensated based on investment performance? How often do internal valuation committees review fair value conclusions?
14.	How are standard methodologies applied across all valuations consistently? What technical expertise and data resources are available to the valuer in the performance of its work? In times of stress, has the valuer maintained a consistent approach?
15.	How frequently does the external valuer review its valuation processes? Does the valuer incorporate peer review into its valuation processes? Are independent technical reviews conducted to confirm valuation conclusions?
16.	To what extent are key assumptions identified, cross-referenced against external comparables, and sensitised in the assembly of valuation? Have critical inputs been queried for accuracy and reliability?

17.	If the valuer provides a valuation range, does the valuation policy state if the middle or upper or lower boundary will be used?
18.	In the case of disagreement between the manager and the external valuer does the valuation policy describe how such issues would be resolved? Are these disagreements recorded or documented anywhere?
19.	If an external valuer is not utilised, what is the rationale for not doing so?

Financial Statements

1.	What accounting standards are declared at the establishment of the fund?
2.	How are any deviations from industry-recognised accounting standards justified?
3.	If you operate in a jurisdiction without globally recognised accounting standards, what alternative standards do you adopt?
4.	How do you ensure these standards are as robust as US GAAP or IFRS?

Valuation Process and Procedure Review

1.	What periodic stress testing and scenario analysis do you conduct on portfolio valuations?
2.	Can you provide results from recent stress testing or scenario analysis?
3.	How do you compare prior valuation estimates to actual outcomes?
4.	Can you share an example of such a comparison and the insights gained?
5.	For investments held at cost, what is the rationale for doing so? Does the holding period extend beyond established good practices (longer than one reporting period – IPEV)?

Liquidity Considerations

1.	How does liquidity, or the lack thereof, impact the valuation of specific assets in your portfolio?
2.	What special considerations or discounts for lack of marketability (DLOM) or offsetting control premiums do you apply?

Auditors

1.	How do you ensure that auditors selected are competent and experienced in auditing funds with illiquid or non-listed assets?
2.	Can you provide details of the criteria used for selecting these auditors?
3.	Are there any conflicts of interest between the manager and auditor such as: • Over reliance by the auditor for revenue from these relationships? • Is the auditor connected to the manager in any way through equity ownership, related parties, private equity backers etc.? • Familial relationships.
4.	Is the auditor a member of a globally recognised standard setting body or professional body which requires commitment to minimum professional and technical standards and/or behaviour?
5.	What is the role of external auditors in your valuation process? Where do their responsibilities begin and end?
6.	Will the auditor engage any internal, specialised resources to assess valuations as part of the audit process?
7.	To what extent do auditors independently gather and assess underlying asset data?
8.	Does the GP provide auditors with access to data and information required to perform their role in an unrestricted manner?
9.	How do you disclose any qualifications, comments, or concerns raised by auditors regarding valuations?
10.	Can you provide an example of such a disclosure and the subsequent actions taken?
11.	Will the auditor review all portfolio asset valuations prior to year-end or perform a sample review?

Appendix B

Challenges with the use of valuation multiples (Source: Mauboussin[35])

The numerator of the multiples that analysts use most frequently is the current price of the equity (P of P/E) or the enterprise value of the firm (EV of EV/EBITDA). These sums seek to capture the present value of the relevant cash flows for the life of the business. Stock prices generally reflect company cash flows that extend decades into the future. The denominator is earnings (E of P/E) or cash flow (EBITDA of EV/EBITDA) that the company has recently earned or is expected to earn in the near future. We can see that we are comparing a numerator that represents the long term with a denominator that considers only the short term.

The central determinants of corporate value include the level and sustainability of return on invested capital (ROIC), growth, and risk. Multiples provide no direct insight into the magnitude of a firm's investments or whether they will generate sufficient return. This is the main consideration that multiples miss. The ability of multiples to capture the underlying economics of a business has degraded over time. This is mainly the result of a shift in how companies invest. In prior generations, businesses invested primarily in tangible assets such as factories and machines. These investments were recorded on the balance sheet and expensed on the income statement through depreciation.

Today it is quite common to have investments that are in intangible assets which are not recorded on the balance sheet (unless acquired via a transaction), including customer acquisition costs and branding. But companies commonly expense these investments on the income statement as they incur them. Accountants record these investments as selling, general, and administrative (SG&A) and research and development (R&D) expenses. This reduces current earnings. The below summarises how valuation multiples can be affected by a range of factors:

Factors That Contribute to Differences in P/E and EV/EBITDA Multiples

What	Why	How
Method of Investment		
Tangible	Higher depreciation lowers net earnings but has no effect on EBITDA	Physical capital-intensive businesses have a high ratio of depreciation to operating income
Intangible	High SG&A expense that reflects internal intangible investment	Lowers EBIT, earnings, and EBITDA relative to tangible intensive business
Capital Structure		
Leverage	Interest expense reflected in P/E but not in EV/EBITDA	Increasing debt to equity results in: - Higher P/E when unlevered P/E is greater than 1/cost of debt - Lower P/E when unlevered P/E is less than 1/cost of debt
Cash holdings	Interest income reflected in P/E but not in EV/EBITDA	Can increase or decrease P/E ratio
Non-operating expenses	Reduce earnings but have no effect on EBITDA	Increase P/E relative to EV/EBITDA
Tax rate	Taxes reduce net income but have no effect on EBITDA	A higher rate increases P/E relative to EV/EBITDA

Source: Counterpoint Global

[35] Morgan Stanley Investment Management – Counterpoint Global Insights – Valuation Multiples: What they miss, why they differ and the link to fundamentals – April 2024, see: https://www.morganstanley.com/im/publication/insights/articles/article_valuationmultiples.pdf?1737114470111

Factors That Contribute to Differences in P/E and EV/EBITDA Multiples

	A	B	C	D	E
	No Invested Capital	Invested Capital			
	No Debt, No Taxes	No Debt, No Taxes	Debt, No Taxes	No Debt, Taxes	Debt, Taxes
Sales	1,000	1,000	1,000	1,000	1,000
COGS	800	800	800	800	800
SG&A ex. DA	100	100	100	100	100
DA	0	40	40	40	40
EBIT	100	60	60	60	60
Financing	0	0	18	0	18
Taxes	0	0	0	10	7
Net income	100	60	42	50	35
EBITDA	100	100	100	100	100
Debt	0	0	300	0	300
Equity	1,500	1,500	1,200	1,500	1,200
EV	1,500	1,500	1,500	1,500	1,500
P/E	15.0	25.0	28.6	30.0	34.3
EV/EBITDA	15.0	15.0	15.0	15.0	15.0
Financing cost			6.00%	6.00%	6.00%
Debt/Total Capital			20%		20%
Tax rate				16.67%	16.67%
EV/Sales	1.5	1.5	1.5	1.5	1.5
Asset life		12.5	12.5	12.5	12.5
Invested Capital		500	500	500	500
ROIC		12.0%	12.0%	10.0%	10.6%

Source: Counterpoint Global

EV/EBITDA Multiples Based on Depreciation Factor, ROIC, and Growth

Depreciation factor=1.2 (EBIT to EBITDA=83.3%)

Earnings Growth	Return on Invested Capital 4.0%	7.6%	8.0%	16.0%	24.0%
4.0%	5.3x	8.8x	9.0x	10.8x	11.4x
6.0%	2.8	8.8	9.1	12.2	13.3
8.0%	NM	8.8	9.3	14.0	15.6
10.0%	NM	8.8	9.5	16.3	18.6

Depreciation factor=1.4 (EBIT to EBITDA=71.4%)

Earnings Growth	Return on Invested Capital 4.0%	7.6%	8.0%	16.0%	24.0%
4.0%	4.5x	7.5x	7.7x	9.3x	9.8x
6.0%	2.4	7.5	7.8	10.5	11.4
8.0%	NM	7.5	7.9	12.0	13.4
10.0%	NM	7.5	8.1	14.0	15.9

Depreciation factor=1.6 (EBIT to EBITDA=62.5%)

Earnings Growth	Return on Invested Capital 4.0%	7.6%	8.0%	16.0%	24.0%
4.0%	3.9x	6.6x	6.7x	8.1x	8.6x
6.0%	2.1	6.6	6.8	9.2	10.0
8.0%	NM	6.6	7.0	10.5	11.7
10.0%	NM	6.6	7.1	12.2	13.9

Source: Counterpoint Global; Note: Earnings=NOPAT; Assumes 20% debt-to-total capitalisation, 7.6% WACC, and 15-year forecast period

Appendix C

Examples for Common Mistakes and Key Challenges in Discounted Cash Flow Valuation (Mauboussin[36])

- Forecast horizons that are too short – models tend to place too much emphasis on the short-term cash flows and ignore the fact that equity prices include value from long-term cash flow generation. This requires analysts to compensate for this by adding value elsewhere in the model as "terminal value" beyond the discrete projection period. Analysts often calculate it using either a formula reflecting growth in perpetuity (generally determined as (free cash flow/ [cost of capital – growth])) or an EV/EBITDA multiple.[37] As a result, the model ends up having hybrid features which also injects more subjectivity into the outcome.

- Cost of capital – Most companies finance their operations largely through debt and equity. The cost of debt, especially for large companies, is generally transparent (it is more common for larger companies to publicly traded debt than smaller ones) because companies have contractual obligations to make coupon payments and return principal on a timely basis. Some yield premium over risk-free securities is appropriate, with the size of the premium reflecting the company's creditworthiness.

  The large and generally liquid corporate bond market makes comparisons between fixed-income securities relatively straightforward, to the extent credit ratings for private securities or companies is available (although there are methods for estimating synthetic ratings as well). Estimating the cost of equity is more challenging.

  The cost of equity is higher than the cost of debt because equity's claim is junior to that of debt. But no simple method exists to estimate the cost of equity. By far the most common approach to estimating the cost of equity is the capital asset pricing model (CAPM). The CAPM says a company's cost of equity equals the risk-free rate plus the product of the equity risk premium and beta. Government-issued notes generally provide a good proxy for the risk-free rate (but may need to be adjusted for non-AAA rated countries). Estimates for the equity risk premium and beta prove more challenging.

- Mismatch between assumed investment and earnings growth – DCF models commonly underestimate the investment necessary to achieve an assumed growth rate.

- Improper reflection of other liabilities – Most liabilities, including debt and many pension programs, are relatively straightforward to determine and reflect in the model. Some other liabilities, like employee stock options, are trickier to capture.

- Modelling Errors/Double counting – Models should not count a dollar of value (or liability) more than once. Unwittingly, DCF models often double count the same source of value.

- Scenarios – The most-often-cited criticism of a DCF model is that minor changes in assumptions can lead to large changes in the value. Accordingly different scenarios reflecting various assumptions such as growth, margins, discount rates, etc. can lead to a wide range of outcomes.

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[36] Morgan Stanley Investment Management – Counterpoint Global Insights – Valuation Multiples: What they miss, why they differ and the link to fundamentals – April 2024, see: https://www.morganstanley.com/im/publication/insights/articles/article_valuationmultiples.pdf?1737114470111

[37] Doron Nissim, "Terminal Value," Columbia Business School Research Paper No. 18-12, January 4, 2018, see: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3095564

Appendix D

Existing SBAI Standards and Guidance - Valuation

5. Segregation of Functions in Valuation – Governance Standards and Guidance		
5.1	Valuation arrangements aimed at addressing and mitigating conflicts of interest in relation to asset valuation should be put in place.	The SBAI believes that the most satisfactory way to achieve this is the appointment of an independent and competent third-party valuation service provider. The SBAI acknowledges, however, that in some cases it will not be possible in practice to achieve both independence and the required level of competence by appointing a third-party valuation service provider, in which case the involvement of the fund manager in the asset valuation process will, to a greater or lesser extent, be unavoidable.
5.2	Where a fund manager determines the value of any of the fund's assets (whether by performing valuations in-house or providing final prices to a valuation service provider), it should operate a valuation function which is segregated from the portfolio management function and should explain its approach to investors. If a smaller or start-up manager considers it impractical to do so, it should disclose this in its marketing documents. This should also be disclosed in the fund's offering documents.	It is envisaged that this will, amongst other things, entail: – ensuring that the relevant employees operate independently of the portfolio management team and that potential conflicts of interest are minimised; – ensuring that the remuneration of the valuation team is not directly linked to fund performance; – in instances where the portfolio management team has necessary expertise and understanding, ensure that information provided by that team in connection with the valuation process is properly documented and recorded; and – assisting fund governing bodies to satisfy themselves regularly that in-house valuations are handled appropriately. Ways to achieve this might include: – ensuring that valuation staff provide periodically a report on the valuation process to the fund governing body; – the formation of a designated "valuation committee" (no member of which is involved in investment decisions); and – employing the services of an appropriate external party to evaluate the effectiveness and robustness of the valuation procedures in place and report to the fund governing body (or its valuation committee).
6. Segregation of Functions in Valuation – Disclosure Standards and Guidance		

6.1	A document (a "Valuation Policy Document") covering all material aspects of the valuation process and valuation procedures and controls in respect of the fund should be prepared. The Valuation Policy Document (which it is acknowledged will contain information which is proprietary to the fund manager) should be reviewed regularly by the fund manager, in consultation with the fund governing body, and be made available to investors upon request on a confidential basis.	The SBAI envisages that in most circumstances the Valuation Policy Document will describe: – the responsibilities of each of the parties involved in the valuation process; – the processes and procedures in place that are designed to ensure that conflicts of interest are managed effectively; – the relevant material provisions of any service level agreements (SLAs) entered into with third parties responsible for or involved in the valuation process (excluding details of commercial aspects of any such SLAs); and – the controls and monitoring processes in place that are designed to ensure that the performance of any third party to whom the valuation function is outsourced is satisfactory.
6.2	Where a fund manager is involved in the valuation process, it should disclose in its own marketing materials any actual or likely material involvement of the portfolio management team in the valuation process. Such disclosure should also be included in the fund's offering documents. Investors should then be informed, for example via manager newsletters, of any material changes to such level of involvement.	This could be satisfied by disclosing an estimate of the percentage of the fund's assets which have been, or are expected to be, valued with some input from the portfolio management team or a description of components of the portfolio for which the portfolio management team usually makes a contribution to the valuation process.
7. Hard-to-Value Assets – Governance Standards and Guidance		
7.1	Where a fund manager performs in-house valuations of hard-to-value assets or is otherwise involved in providing final prices to the valuation service provider, valuation procedures for such assets which are aimed at ensuring a consistent approach to determining fair value should be adopted and such procedures should be set out in the Valuation Policy Document.	The SBAI envisages that such procedures would in most circumstances include: - details of a hierarchy of pricing sources and models to be used for each asset type in a fund's portfolio (where relevant); – if using broker quotes: • making reasonable efforts to identify and draw upon multiple (typically 2-3) price sources (where available). • specifying the acceptable tolerance ranges when multiple pricing sources are used and the approach to handling "outliers." • ensuring consistency and avoiding "cherry picking" of favourable price sources by using the same brokers at each valuation point; and • where the fund manager arranges the provision of broker prices (as opposed to the administrator or other third-party valuation service provider), the fund manager should instruct brokers to send the prices directly to the administrator (or other third-party valuation service provider); – if using pricing models, a process specified in the Valuation Policy Document for:

	• approving pricing models including back-testing, documentation and approval by the fund governing body or its valuation committee. • monitoring and verification against observed market prices; and • governing manual overrides of the model inputs or results, including approval, documentation and reporting to the fund governing body or its valuation committee.
7.2 If using side pockets, a fund manager should ensure that the fund governing body has been consulted on, and consented to, the circumstances in which side-pockets may be used. Furthermore; – The types of assets eligible for side pocketing should be described in the Valuation Policy Document and the side pocketing process should be disclosed in the fund's offering documents. – Side-pocketing should occur either on or about the time the relevant asset is purchased or on or about the point at which the relevant asset becomes hard-to-value. The initial valuation of an asset on entering a side-pocket should be at cost, the last available market price (as appropriate) or a lower number or nil. – Where a limit to the total amount of assets which may be included in side-pockets is disclosed in the fund's offering documents, such limit should not be breached. – Management fees, for the side pocketed assets, if charged, should be calculated on no more than the lower of cost (or last available market price in the case of a previously liquid asset) or fair value. – Any performance fees should accrue for the duration of the existence of the side pocket and should be paid only at the point at which the asset is finally disposed of, or a liquid market price is available.	
8. Hard-to-Value Assets – Disclosure Standards and Guidance	
8.1 The percentage of the fund's portfolio that falls into each of the three “levels” prescribed by ASC 820 or IFRS 7, or equivalent account standards or recognised definitions (and, where meaningful and applicable, the extent to which internal pricing models or assumptions are used to value certain components of the fund’s portfolio invested in hard-to-value assets) should be periodically disclosed (e.g. via newsletters).	

8.2	Notification of any material increase (as determined by the fund governing body) in the percentage of a fund's portfolio invested in hard-to-value assets should be disclosed to investors in a timely manner, e.g. via the manager's newsletters.	
8.3	The value of side pockets should be reported periodically in the fund's audited annual accounts in accordance with applicable accounting standards.	
8.4	A fund manager conducting valuations in-house should discuss with the fund governing body any material issues in relation to the valuation of hard-to-value assets (e.g. unavailability of a sufficient number of pricing sources or dispersion of broker quotes beyond tolerance levels). Such material issues in relation to the valuation of hard-to-value assets should be disclosed to investors.	

Appendix E

Proposed Standards and Guidance for Private Asset Valuation

Exhibit 1: Proposed new Standard and Guidance - Manager-led secondaries, crossed-investments, or related party transactions

Standard - Manager-led secondaries, crossed-investments, or related party transactions, i.e., assets bought and sold between two vehicles managed by the same manager or transacted between related party entities, should be executed in accordance with managers' fiduciary obligations, disclosures to regulators and investors, and compliance policies and procedures governing the transactions.

Managers transacting in private market assets should commission an independent valuation or fairness opinion prior to the deal closing.

Guidance

When Managers initiate a sale process, they should be mindful of the following:

- Managers should disclose to investors about the possibility of cross trades in their fund documents and provide transparency in regular communications. This includes clear disclosure about how cross trades will be handled and what protections are in place to ensure fairness and proper pricing.
- There should be a reasonable and plausible logic for the proposed transaction.
- The process should be efficient and transparent, consideration could be given to any additional external competitive bids or auctions.
- Investors should be engaged as soon as reasonably possible and have adequate time to consider the proposal.
- Formal Investor consent, if required, should be sought.
- Managers should be transparent regarding any potential conflicts of interest.
- Managers should strive for best execution in all cases.
- Cross trades for listed securities should be executed at a fair market price (typically the last traded price or the midpoint of the bid-ask spread of the current market price).
- For listed securities, if there is low liquidity or low trading volumes, there is a heightened risk that the cross trade could negatively affect market prices. In such cases, careful consideration should be given to how the trade is structured and executed.
- Limited Partner Advisory Committees (LPAC) should be engaged where any Limited Partner Agreement requires some form of affirmative action or approval.
- Investors should be given access to the independent valuation report and should be given time to engage with the external valuer. Noting that Investors may wish to engage on an arms-length basis so not to breach any contractual or regulatory presumption that they are a passive investor.
- Managers should be clear who will bear the cost of any external valuation or opinion. Noting that current market practice is for advisory services to be paid from the proceeds of the transaction.
- Ongoing monitoring of cross trades should be conducted, and proper records should be maintained to ensure that the trade was executed in compliance with established policies and in the best interest of both funds.

Exhibit 2.1: Proposed new Standard and Guidance - Valuation Methodology

Standard - Methodology Selection

Managers should disclose in their Valuation Policy the valuation methodologies reasonably expected to be used during the life of the fund. Disclosure should be sufficiently detailed, wording such as 'any reasonable or justifiable methodology that the Managers chooses or sees fit' etc., should be avoided.

Guidance

The selection of methodologies should be driven by the facts and circumstances of the investment and the market in which it would be transacted. Managers should give consideration to the appropriateness of the selection, ensuring that is does not differ materially from market or industry norms without good reason.

Managers should determine an appropriate valuation methodology for an asset upon acquisition and if it is likely that a change in methodology will be required in the future, to indicate what those methodologies may be, ahead of time.

Potential future changes of methodologies could include venture capital investments whereby an option pricing model may be appropriate when the asset is not yet revenue generating. If the business then evolved to generate revenue, then transitioning to an income-based valuation technique may be appropriate.

Exhibit 2.2: Proposed new Standard and Guidance - Valuation Methodology

Standard - Methodology Change

During the life of the fund, should the Manager depart from valuation methodologies outlined in the fund's Valuation Policy then Investors should be notified.

Guidance

Managers should be prepared to provide a rationale for the introduction of any new methodology.

Managers should be prepared to provide scenarios or describe market conditions under which a change in methodology may be appropriate.

Exhibit 2.3: Proposed new Standard and Guidance - Valuation Methodology

Standard - Methodology Aggregation

Managers should be prepared to provide details where a valuation is reached that includes a weighting of several methodologies or valuation components. Managers should be prepared to explain the process to calculate and apply weightings to each selected methodology.

Guidance

Aggregation of valuation methodologies should be considered to be an appropriate mechanism for valuing an asset, as long as Managers are transparent about the weightings ascribed to each methodology and the logic for methodology selection and aggregation.

Exhibit 2.4: Proposed new Standard and Guidance - Valuation Methodology

Standard - Valuation - Inputs, Adjustments & Assumptions

Managers should be prepared to provide details on significant inputs, adjustments and assumptions used in the valuation process that could have a material impact upon the outcome. i.e., discount factor, growth rate, EBITDA adjustments, future, or unrealized cash flows etc.

Guidance

Managers should be prepared to provide transparency and disclosure related to key or material inputs, adjustments and assumptions used to reach an asset valuation. Managers should be prepared to engage with Investors on this topic and allow for discussion. Managers should be prepared to defend their assumptions and inputs and be able to provide evidence to back up their assertions.

Managers should be mindful that assumptions and inputs not grounded in any sense of commercial or economic reality, undermine the confidence in private market valuations and raise doubts about the subjectivity inherent in the process.

Care should be given to portfolio level positions that have an outsized impact on NAV or are so significantly large that concentration is elevated.

Exhibit 2.5: Proposed new Standard and Guidance - Valuation Methodology

Standard - Valuation - Inputs, Adjustments & Assumptions - Sensitivity Analysis

Managers should be prepared to provide details of any sensitivity analysis undertaken regarding major inputs, adjustments, and assumptions in the valuation modelling process.

Guidance

Managers should be prepared to discuss the sensitivity analysis with Investors.

Exhibit 3.1: Proposed new Standard and Guidance - Valuation Service Providers

Standard - External Valuer - Selection and Competency

Managers should be prepared to provide evidence that appropriate due diligence and vendor selection has taken place before appointing an independent valuation provider.

Guidance

Managers should provide notice to the full partnership when the fund has engaged counsel or third parties to provide specialized advice, e.g., valuations experts.

Appropriate due diligence may include, but not be limited to:

- review and consideration of a range of possible providers
- assessment of the provider to be able to provide accurate and timely valuations of the type of assets in scope
- the resources available to the provider in terms of staffing
- the experience of the provider's staff
- industry references and feedback
- whether the provider is a member of a standard setting body such as the International Valuation Standards Council
- ensuring that vendor selection has been conducted independently of the investment team

Exhibit 3.2: Proposed new Standard and Guidance - Valuation Service Providers

> **Standard - External Valuer - Contractual Engagement**
>
> **Managers should disclose to Investors details of the service that will be delivered by any external provider such as externally calculated valuations, including what limitations in service provision may exist.**
>
> *Guidance*
>
> This should include whether the independent valuation provider will, for example:
>
> - value all portfolio positions, a sample of positions or materially large portfolio positions.
> - provide defined valuations, a range of possible values, or verification that they see no material issue with the managers calculated mark.
> - provide any verification of manager valuation models.
>
> The above examples are not intended to be an exhaustive list of possible disclosures.

Exhibit 3.3: Proposed new Standard and Guidance - Valuation Service Providers

> **Standard - External Valuer - Obligation to adopt or implement valuation mark**
>
> **Managers should disclose to Investors the legal or contractual requirement to accept or implement, independent valuations, when provided by an external third party. Managers should further disclose where independently derived valuations have been altered or ignored.**

Exhibit 3.4: Proposed new Standard and Guidance - Valuation Service Providers

> **Standard - External Valuer - Conflicts of Interest**
>
> **Managers should disclose to Investors the payment structure agreed with third party valuation agents and provide assurance that the individuals or groups determining the valuations are not unduly influenced by those who might benefit from a higher or lower valuation.**

Exhibit 3.5: Proposed new Standard and Guidance - Valuation Service Providers

> **Standard - External Valuer - Conflicts of Interest**
>
> **Managers should disclose to Investors where a valuation service provider is owned, partly or wholly, by private market investors. Disclosure of procedures to manage conflicts of interest related to such relationships should be made.**

Exhibit 4.1: Proposed new Standard and Guidance - Financial Statements

> **Standard - Accounting Standards - Implementation**
>
> **Managers should disclose to Investors at the point of establishment of the fund or vehicle the accounting standards to be followed.**
>
> *Guidance*
>
> Explanation of any deviations from these standards should be explained to Investors with supporting evidence or materials provided.

Exhibit 4.2: Proposed new Standard and Guidance - Financial Statements

> **Standard - Accounting Standards - Divergence from recognised standards**
>
> **Managers should be prepared to provide justification for not valuing assets in line with an industry recognised accounting standard.**
>
> *Guidance*
>
> Where a valuation process does diverge from recognised accounting standards, Managers should also provide guidance as to the circumstances or market conditions that would allow a recognised accounting standard to be implemented in the future.

Exhibit 4.3: Proposed new Standard and Guidance - Financial Statements

> **Standard - Accounting Standards - Alternative Standards**
>
> **If Managers oversee an asset or a fund in a jurisdiction that does not recognise or require globally recognised accounting standards such as US GAAP or IFRS, then Managers should adopt alternative standards such as the International Valuation Standards maintained by the International Valuations Standards Council.**

Exhibit 5.1: Proposed new Standard and Guidance - Selection, appointment, and engagement with Auditors

> **Standard - Auditor - Selection and Competency**
>
> **Managers should select auditors who are competent, capable and with sufficient experience in the auditing of financial statements for funds which invest in illiquid or non-listed assets.**
>
> *Guidance*
>
> Managers should provide notice to the full partnership when the fund has engaged a new Auditor.
>
> Appropriate due diligence may include, but not be limited to:
>
> - review and consideration of a range of possible providers
> - assessment of the provider to be able to provide appropriate accounting scrutiny of the fund
> - the resources available to the provider in terms of staffing
> - the experience of the provider’s staff, including specialist internal teams that may review valuations
> - industry references and feedback
> - whether the provider is a member of a standard setting body such as the Association of International Professional Accounts

Exhibit 5.2: Proposed new Standard and Guidance - Selection, appointment, and engagement with Auditors

> **Standard - Auditor - Contractual Engagement**
>
> **Explanation of the role of external auditors in the valuation process should be provided to Investors, including to the extent the auditors will independently gather and assess underlying asset data and perform underwriting of asset valuations.**

Exhibit 5.3: Proposed new Standard and Guidance - Selection, appointment, and engagement with Auditors

Standard - Auditor - Investor Disclosure
Managers should disclose to Investors any qualifications, comments, or concerns raised by auditors regarding valuations in a timely manner.

Exhibit 6.1: Proposed new Standard and Guidance - Valuation Process and Procedure Evaluation

Standard - Valuation - Stress Testing
Managers should conduct periodic stress testing and scenario analysis in relation to portfolio valuations.
Guidance
Managers should be prepared to provide a summary of stress tests or scenario analyses performed to understand potential changes in asset values under different market conditions.
Stress testing and scenario analysis is intended to be primarily a risk management exercise. Results of these reviews may or may not lead to a revaluation of a fund asset.
Stress testing of private market strategies may require specific scenario analysis to be considered for different asset classes. For example, liquidity stress testing may not be a useful measure to assess in a closed ended investment structure. Private market managers may wish to consider scenarios which model changes in financing costs, margins and sales for leveraged buyout portfolio companies. Private credit managers may wish to understand how different scenarios may affect duration impact, debt recovery levels and impacts on the timings of debt repayments. Real estate managers may consider how changes in rental income could affect the value of the asset and its cap rate. These examples are not intended to be exhaustive, and private market managers should consider a full range of scenarios that could be applicable to their strategy. We believe that managers and investors should discuss which scenarios and stress tests may be appropriate for implementation.

Exhibit 6.2: Proposed new Standard and Guidance - Frequency of Valuation

Standard - Valuation - Frequency of Valuation
Managers should conduct regular valuation of fund assets, consummate with the redemption rights of the fund.
Guidance
Consideration should be given to the redemption rights of the fund; close-ended funds (whether valued internally or externally) should be valued at least annually. Evergreen structures (those which offer some degree of limited redemption rights) should be valued more frequently.
Managers should be mindful of the prevailing market and economic environment and may consider implementing ‘triggers’ or thresholds which would require an updated valuation to be conducted.
It is common for managers to produce valuation ‘estimates’ in the interim period between official valuations are conducted, this should be considered a good practice to follow.

Exhibit 6.3: Proposed new Standard and Guidance - Valuation Process and Procedure Evaluation

Standard - Backtesting - Valuation Review Upon Asset Disposal
Managers should be prepared to provide a comparison of prior valuation estimates to actual outcomes (e.g., subsequent sale prices) to evaluate the accuracy of valuation methodologies over time.

Exhibit 7: Proposed new Standard and Guidance - Liquidity Considerations

Standard - Ad hoc Considerations - Liquidity **Managers should be prepared to discuss how liquidity (or lack thereof) impacts the valuation of specific assets. Any special considerations or Discount for Lack of Marketability (DLOM).**