

Global Investment Performance Standards

Exposure Draft

INVITATION TO COMMENT:

Exposure Draft of the Guidance Statement on Verification

CFA Institute established the GIPS Executive Committee as the governing body for the Global Investment Performance Standards (GIPS[®]). The GIPS Executive Committee seeks comment on the proposal set forth below regarding proposed revisions to the Guidance Statement on Verification.

Comments must be submitted in writing and received no later than 25 November 2010. Responses will be accepted in hardcopy and via fax, but should also be submitted via e-mail. Please submit your comments as early as possible to facilitate the review process. Unless otherwise requested, all comments and replies will be made public on the GIPS standards website (www.gipsstandards.org). Comments may be submitted as follows:

E-mail: standards@cfainstitute.org

Fax: 1-434-951-5320

Post: CFA Institute
Global Investment Performance Standards
Re: Guidance Statement on Verification
P.O. Box 3668
Charlottesville, Virginia 22903

Executive Summary

The current version of the Guidance Statement on Verification became effective 1 January 2006. The GIPS Executive Committee, in collaboration with various technical subcommittees including the Verification/Practitioner Subcommittee, has revised the Guidance Statement on Verification to reflect the 2010 edition of the GIPS standards and to improve existing guidance on the verification requirements and recommendations. A red-line version of this document, highlighting each proposed change, is available for review on the GIPS standards website.

The questions & answers (Q&As) originally included in the Guidance Statement on Verification have been removed and will be reviewed and updated as deemed necessary by the GIPS Executive Committee and the Verification/Practitioner Subcommittee. Additional history and background on the GIPS standards can be found on the GIPS standards website.

Effective Date

The expected effective date of the revised Guidance Statement on Verification is 1 January 2011 to coincide with the effective date of the 2010 edition of the GIPS standards. Verifiers must conduct their verification engagements in accordance with this Guidance Statement for all verifications contracted on or after 1 January 2011. Prior versions of this Guidance Statement are available on the GIPS standards website.

Summary of Proposed Revisions to the Guidance Statement on Verification

The following is a brief summary of some of the more significant revisions to the Guidance Statement on Verification other than changes made to conform to the 2010 edition of the

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GIPS standards.

1. GIPS Verification Report-Previously this section included both required elements and a listing of items generally included in a verifier's opinion. The vast majority of the items that were formerly denoted as generally included in a verifier's opinion have been upgraded to items that are required to be included in the verifier's opinion. Two additional items have been added to this listing.
2. Knowledge of Firm Policies – This section of the proposed Guidance Statement was originally included in Section III of the 2005 edition of the Standards. This section was not included in the 2010 edition of the GIPS standards as the Guidance Statement on Verification was deemed to be a better location for this guidance. The text within this section has been revised as deemed necessary.

Comments Requested

The GIPS EC is seeking comments from the industry on the proposals set forth in the following revised Guidance Statement on Verification. In addition to commenting on specific items, please provide feedback on the rest of the document including items you support. The GIPS EC would also like feedback as to the appropriateness of the required items to be included in the verification report.

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Guidance Statement on Verification

Effective 1 January 2011

Introduction

This Guidance Statement supplements the verification procedures outlined in Chapter IV of the Global Investment Performance Standards (GIPS®) and provides additional guidance to verifiers and investment management firms. Verification is a process by which a verifier assesses whether the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The GIPS standards recommend that firms be verified.

Verifier Qualification Requirements

The verification must be performed by a “verifier” with appropriate professional abilities and experience, and a practical level of expertise regarding investment management practices, including performance calculation procedures and business processes. Verifiers must be knowledgeable about the GIPS standards and must understand all the requirements and recommendations of the GIPS standards, including any updates, Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee, which are available on the GIPS standards website (www.gipsstandards.org) as well as in the *GIPS Handbook*. Verifiers must also be knowledgeable of applicable laws and regulations regarding the calculation and presentation of performance.

The verification must be performed by a verifier who is independent of the investment management firm. Please see the Guidance Statement on Independence Considerations for Investment Management Firms and Verifiers for additional guidance.

Verifiers generally comprise auditing, consulting, and other firms that have a high degree of knowledge regarding the investment management industry. Verifiers must follow currently accepted standards of practice within their industry (if applicable) when performing a verification pursuant to the GIPS standards.

The GIPS standards do not include additional qualification requirements to conduct a verification.

Investment Management Firm – Verifier Relationship

Verifiers must maintain fairness and independence at all times when performing procedures to evaluate a firm's claim of compliance as well as in expressing their opinion in the verification report. Prior to expressing an opinion, the verifier must obtain from the management of the firm a representation letter including affirmation that policies and procedures used in establishing and maintaining compliance with the GIPS standards are as described in the firm's policies and procedures documents and have been consistently applied throughout the period(s) being verified. The representation letter must also include affirmation that the firm complies with the GIPS standards for the period(s) being verified and any other relevant representations made to

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the verifier during verification. Typically, the representation letter will include the following representations:

- The firm's policies and procedures for establishing and maintaining compliance with the GIPS standards are properly described in the firm's GIPS policies and procedures documents;
- The firm's policies and procedures for establishing and maintaining compliance with the GIPS standards have been consistently applied throughout the period being verified;
- The firm is in compliance with the GIPS standards on a firm-wide basis;
- The firm's management bears all responsibility for maintaining compliance with the GIPS standards, including production and distribution of all compliant presentations;
- The compliant presentations are a fair and honest representation of the firm's investment performance;
- The firm has not knowingly presented performance or performance-related information that is false or misleading;
- The firm has provided the verifier with all necessary documents to be able to perform the verification and no relevant documents have been withheld;
- The time period the verifiers are reporting on;
- The firm complies with all applicable laws and regulations regarding the calculation and presentation of performance; and
- No significant events that would materially influence performance results or the outcome of the verification have occurred up to the date when the verifier expresses an opinion.

Knowledge of Firm Policies

Verifiers must understand the firm's policies and procedures for establishing and maintaining compliance with all applicable requirements and adopted recommendations of the GIPS standards. For example, verifiers must understand the firm's policies and procedures with regard to the following functions and objectives of the firm:

- Investment discretion. The verifier must obtain a copy of the firm's definition of investment discretion and the firm's guidelines for determining whether portfolios are discretionary;
- Definition of composite according to investment strategy. The verifier must obtain the firm's list of composite definitions with criteria for assignment of portfolios in each composite;
- Timing of inclusion of new portfolios in the composites;
- Timing of exclusion of closed portfolios in the composites;
- Accrual of interest and dividend income;
- Valuation of portfolio investments, including policies for determination of fair value;
- Computing the time-weighted rates of return for each portfolio;
- Assumptions on the timing of capital inflows/outflows;
- Computing composite returns;
- Presentation of composite returns;
- Use of leverage, derivatives and short positions;

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- Maintenance of books and records supporting the calculation of portfolio and composite returns, including the existence and ownership of client assets; and
- Any other policies and procedures relevant to performance presentation.

Using the Work of Other Verifiers and Independent Third Parties

The GIPS standards state that a principal verifier may accept the work of another verifier as part of the basis for the principal verifier's opinion. For example, when a firm engaged in global asset management services undertakes verification on a worldwide basis, including local offices/branches, the principal verifier may use the results of work performed for a local office/branch by another verifier. Similarly, when another verifier has already performed a verification, the current verifier may choose to accept the work of the previous verifier. A principal verifier may also choose to rely on the audit and/or internal control work of a qualified and reputable independent third party. In addition, a principal verifier may choose to rely on the other audit and/or internal control work performed by the verification firm.

GIPS Verification Report

The verification report must include the verifier's opinion which opines that:

1. The firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and
2. The firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards.

The verification report must also include a number of required elements.

The following information is required to be included in the verification report in addition to the verifier's opinion:

- The report title;
- The report date;
- The report addressee;
- The defined firm for which the verification has been performed;
- The period(s) for which the verification has been performed;
- The respective responsibilities of the firm's management and of the verifier, including a statement acknowledging the responsibility of the firm for the claim of compliance;
- A statement to the effect that verification has been performed in accordance with the required verification procedures of the GIPS standards;
- The signature or official seal of the verifier;
- A statement indicating that verification does not ensure the accuracy of any specific composite presentation; and
- A statement describing any other guidance frameworks that have been applied (e.g., ICAEW, JICPA, or AICPA guidance).

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In addition to the required content, the verifier's opinion may also include additional information, as appropriate, to make the context of the particular verification work clear.

Without such a report from the verifier, the firm must not state that it has been verified.

If the verifier concludes that the firm is not in compliance with the GIPS standards or that the records of the firm cannot support a verification, the verifier must issue a statement to the firm clarifying why a verification report could not be issued.

Performance Examinations of Compliant Presentations

A verification does not have the objective of examining specific performance results presented. To accomplish that objective, an investment management firm may choose to have a specifically focused performance examination of a particular composite's compliant presentation. A performance examination is not required for a firm to be verified.

Please see the Guidance Statement for Performance Examinations for additional guidance.

Effective Date

This Guidance Statement was originally effective 13 March 2002 and was initially revised to reflect the changes to the GIPS standards effective as of 1 January 2006. Subsequent revisions made to this guidance were made to coincide with the effective date of the 2010 edition of the GIPS standards, which is 1 January 2011. Verifiers must conduct their verification engagements in accordance with this Guidance Statement for all verifications contracted on or after 1 January 2011 or prior to 1 January 2011 if the investment management firm has adopted the 2010 edition of the GIPS standards. The contract date is typically evidenced by the date of the engagement letter signed by management of both the verification firm and the investment management firm. Verifiers may also voluntarily conduct their verification engagements in accordance with this Guidance Statement prior to 1 January 2011 and are encouraged to do so. Prior versions of this Guidance Statement are available on the GIPS standards website (www.gipsstandards.org).