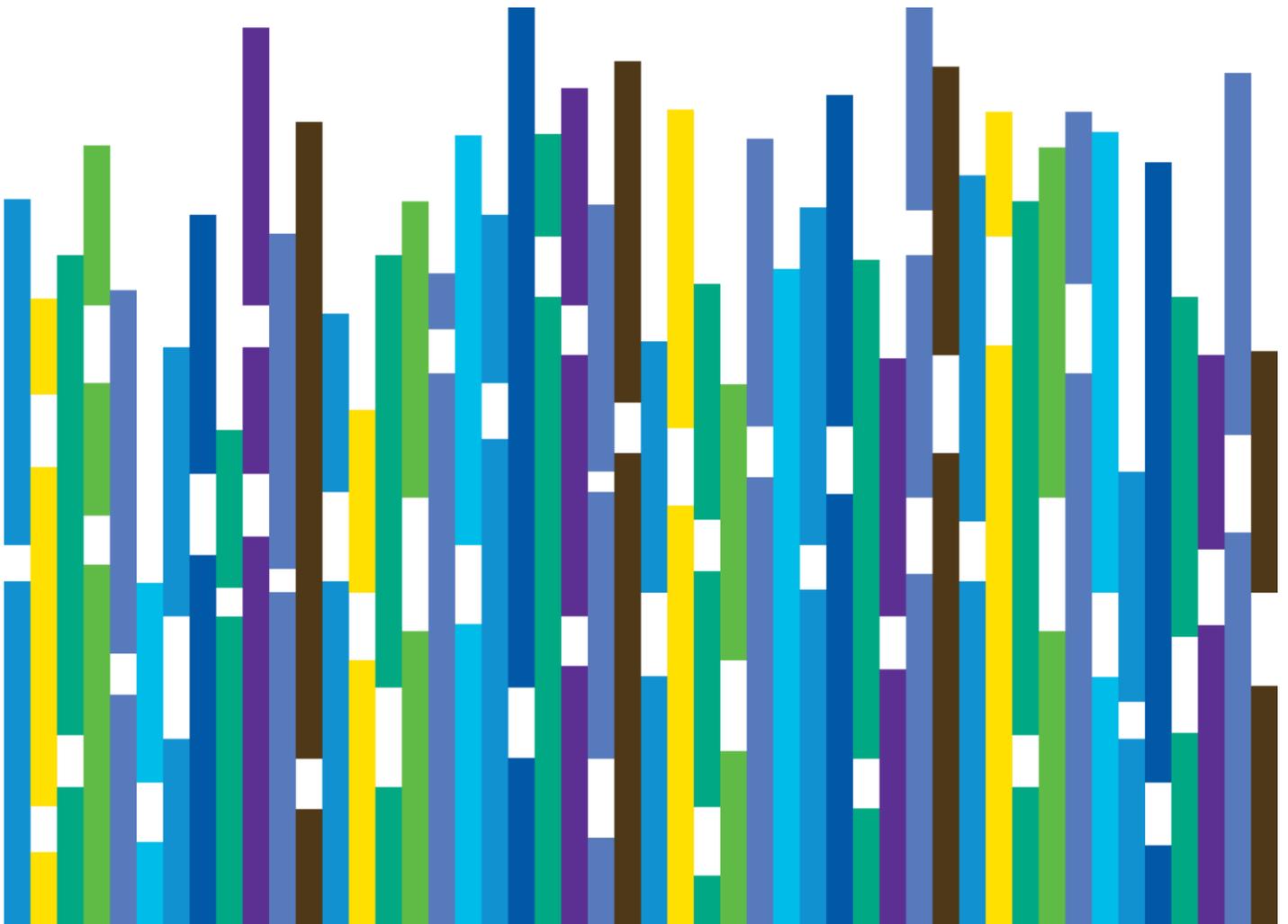


## **ASSISTANCE TO FIRMS CONSIDERING COMPLIANCE WITH THE GIPS® STANDARDS**



# Assistance to Firms Considering Compliance with the GIPS Standards

This document is a guide for firms considering compliance with the Global Investment Performance Standards (GIPS®). It is divided into three sections:

1. An introduction that provides a brief overview of why firms should comply with the GIPS standards and the benefits of claiming compliance.
2. A step-by-step approach to achieving compliance with the GIPS standards.
3. A case study of a mutual fund company in an emerging economy that recently claimed compliance with the GIPS standards.

Please note that the requirements and recommendations for certain alternative or nontraditional types of investments, such as private equity, real estate, and wrap fee accounts, differ from the requirements for more traditional investments. This document focuses on more traditional investment strategies and does not address any differences there might be for private equity, real estate, and wrap fee/separately managed account (SMA) portfolios.<sup>1</sup>

## Introduction

### Why Comply with the GIPS Standards?

In the past, the lack of an industry-wide performance standard made the comparison of the performance of investment managers difficult, both within a country and globally. As noted by Fred Muller, CFA, in his foreword to the 1991 report of the Performance Presentation Standards Implementation Committee: “[We] recognized the serious need to establish and maintain sound, ethical, and uniform performance reporting practices. The lack of standardization in performance reporting within the industry leaves a door wide open for practitioner misrepresentation and for confusion and mistrust among clients and potential clients.”

Without a standardized, ethical approach to the calculation and presentation of performance history, or when a performance standard exists but a firm chooses not to follow that standard, decisions can be made, intentionally or unintentionally, that cause the presentation and reporting of performance to deviate from a fair, ethical, and comparable framework. Examples of potential abuses include the following.

**Selective use of time periods and portfolios:** selecting nonstandard time periods; presenting incomplete time periods as the complete track record; linking across periods in which no investment in the strategy occurred; basing reported performance on only the best-performing portfolio(s).

**Improper aggregation of portfolios:** combining portfolios with different mandates; excluding portfolios with similar mandates.

**Nonstandardized calculation methodology:** using a calculation methodology inappropriately in order to overstate performance—for example, using the internal rate of return when a time-weighted rate of return is necessary to compare managers’ track records or annualizing performance for periods of less than 12 months.

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<sup>1</sup>Please refer to the [GIPS Handbook](#) available on the GIPS website for more information on private equity, real estate, and wrap fee/separately managed account (SMA) portfolios.

**Survivorship bias:** removing portfolios that have been terminated from the performance history to improve the track record.

**Improper valuations:** using a book value or cost that may not represent the fair value in the marketplace.

**Inappropriate benchmark:** using a benchmark that is not representative of the investment strategy—for example, using a price-only index when the portfolio earns and reinvests dividends; changing the benchmark historically to enhance active return.

**Misrepresenting model performance:** presenting model or back-tested performance as actual performance; combining model performance with actual performance.

The need for a practitioner-driven, standardized, industry-wide approach to calculating and reporting investment results, based on ethical principles, led the Association of Investment Management Research (AIMR®), now known as CFA Institute, to sponsor, develop, and publish performance standards by which firms could calculate and present their investment results. The GIPS standards are a voluntary set of standards based on the fundamental principles of full disclosure and fair representation of performance results. Investment management firms that comply with the GIPS standards allow clients, prospective clients, and consultants the best opportunity to fairly evaluate their past performance. Compliance also enables firms to fairly compete against other firms throughout the world.

## Support and Development of the GIPS Standards

The GIPS standards are owned and administered by CFA Institute, a global association of investment professionals with more than 123,000 members in 145 countries and territories. GIPS country sponsors,<sup>2</sup> which are local industry organizations in different jurisdictions around the globe, partner with CFA Institute to promote the GIPS standards in their local markets and represent their respective markets in providing input to the global development of the GIPS standards. They own and protect GIPS translated materials, interpret and support questions on local issues, deliver educational programs, and promote the GIPS standards across the local investment profession.

## Benefits of the GIPS Standards

Many stakeholders benefit when firms claim compliance with the GIPS standards.

### Enhanced prospective client confidence

- Consistent, informative presentations with meaningful disclosures
- Consistent input data and calculations that allow for comparisons among products and firms
- Availability of a firm's performance-related policies and procedures

### Assurance to regulators

- Evidence of commitment to self-regulation and best practices that complement legal and regulatory requirements
- Documented policies and procedures supporting the claim of compliance

### Improved investment manager internal controls

- Strong control framework with comprehensive policies and procedures
- Reduced risk of error and restatement
- Potential driver for a firm to continually assess its technology infrastructure
- Increased confidence that performance is fully disclosed and fairly presented

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<sup>2</sup>Please see the GIPS website for the most current list of [GIPS country sponsors](#).

## Consistent investment manager reporting

- Transparent and consistent approach to reporting and presenting performance to prospective clients, which should also benefit existing clients and the performance information that they receive
- A single standard for presenting a firm’s historical investment returns around the globe

The following quotes are from asset owners and GIPS-compliant firms that recognize the benefits of the GIPS standards:

“Compliance with the GIPS standards is always to be encouraged. It produces reliable and comparable performance information and indicates those firms with rigorous internal controls.”

– *Principal of an investment consultant firm, United Kingdom*

“Being GIPS compliant is an important element for our firm’s inclusion in new business opportunities, as well as providing confidence from a due diligence perspective for our clients. The reputation of our firm and maintaining the highest ethical standards are paramount. GIPS compliance was a natural step in that same direction.”

– *Senior vice president of an investment management firm, United States*

“While English is the world’s unifying language of finance, the GIPS standards are the global language of investment performance presentation.”

– *Department head of the Hong Kong Monetary Authority, Hong Kong*

“The GIPS mantra of fair representation and full disclosure translates to ‘the numbers can be trusted’ and ‘full commitment to professional ethics.’ Overall, the implementation of the GIPS standards not only increases opportunities to sell products on a global stage but also enhances internal controls in the firm.”

– *Global head of GIPS standards for an investment management firm, United States*

“Not only do the GIPS standards establish a generally accepted, fair, and transparent platform of investment performance calculation, disclosure, and reporting, but also their composite construction concept provides asset managers with a sound and efficient business solution.”

– *Deputy general manager of an investment management firm, China*

## Getting Started

### Step-by-Step Process to Achieving Compliance with the GIPS Standards

This section builds on the five-step process—Learn, Analyze, Build, Implement, and Stay (up to date)—shown on the GIPS website ([www.gipsstandards.org](http://www.gipsstandards.org)) and highlights some of the major issues to be considered and resources available when achieving and maintaining compliance with the GIPS standards. It also includes links to the resources available on the GIPS website.



## Step 1: Learn about the GIPS standards

The place to start is with the most current edition of the GIPS standards, which is available electronically or in hard copy. The reader will become familiar with the provisions of the GIPS standards, which cover fundamentals of compliance, input data, calculation methodology, composite construction, and presentation and reporting, as well as the more specialized areas of real estate, private equity, and wrap fee/separately managed account (SMA) portfolios. Other sections included in the document are the GIPS Valuation Principles, GIPS Advertising Guidelines, and Verification.

The GIPS website contains a great deal of interpretive guidance, including the [GIPS Handbook](#), [Guidance Statements](#), and [Q&As](#). These are all important because in order to claim compliance, firms must comply with all requirements of the GIPS standards, including any updates to the GIPS standards themselves, Guidance Statements, interpretations, Questions and Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee.

The GIPS standards and related guidance include requirements and recommendations. Requirements are tasks or actions that must be followed or performed if they are applicable to a firm. Recommendations are suggested tasks or actions that firms should follow or perform because they are considered to be industry best practice.

There are a number of third-party resources that can help a firm learn about the GIPS standards, including GIPS verifiers and GIPS consulting firms (firms that typically do not offer verification services but help firms with precompliance assessment and with attaining and maintaining GIPS compliance). Some GIPS experts provide workshops and training programs that may be available as tailored, in-house programs for firms. Additional learning opportunities are available through conferences and workshops. Some of these are dedicated to the GIPS standards, whereas others have a broader performance measurement theme but include sessions focused on the GIPS standards.

## Step 2: Analyze your firm's ability to comply

### 2.1 Management Support

Management support is necessary if a firm wishes to comply with the GIPS standards for the following reasons.

1. When a firm claims compliance with the GIPS standards, it is committing to the ethical behavior represented by the GIPS standards. That commitment must have the support of senior management, who set the ethical tone of the firm.

**BUY-IN:** *Is there commitment from the firm's senior management?*

2. Many areas and functions within the firm will be affected by the decision to achieve compliance with the GIPS standards. The agreement that all affected areas will modify their policies and

procedures as needed to facilitate compliance with the GIPS standards has to be driven by senior management.

**FIRM-WIDE:** *Has senior management's commitment to compliance with the GIPS standards been communicated to all areas of the firm?*

3. There will most likely be a significant investment of time and resources for a firm to achieve and maintain compliance with the GIPS standards. Such an investment requires the support of senior management.

**FUNDING:** *Has the firm adequately budgeted both the financial and human resources required to attain and maintain compliance?*

4. There needs to be a top-level commitment to obtaining sufficient expertise to ensure that the claim of compliance can be attained and maintained.

**EXPERTISE:** *Is there a plan to build expertise with the GIPS standards within the firm?  
Will external consultants be hired to provide additional GIPS expertise as necessary for the implementation project?*

## GIPS Expertise

Prior to the “Implementation” step, if the budget allows, the firm may be able to employ a third party to provide the required knowledge of the GIPS standards. The possibility of using a GIPS verifier to help achieve GIPS compliance should be investigated at an early stage of the project. Although verifiers must be independent from the firm they are verifying and cannot test their own work or perform management functions, they can provide advice and assistance during the process of achieving compliance. However, the firm will eventually need to have its own in-house expert who understands the technical details of the GIPS standards. Even if the size of the firm does not demand a full-time GIPS expert, a staff resource who has “GIPS expert” as part of his or her job description is essential for efficient maintenance of GIPS compliance. A potential source of in-house expertise could be employees who are candidates for or have obtained the CIPM® or CFA® designations. They will have encountered readings relating to the GIPS standards as part of working toward gaining that designation.

## GIPS Project Team

Multiple areas within a firm will be affected by, and essential to, implementing the GIPS standards. Representatives of the following functions should be considered for membership on the GIPS project team:

- Portfolio accounting
- Portfolio administration
- Performance measurement
- Product management
- Information technology
- Risk management
- Sales and marketing
- Legal and compliance

## 2.2 Definition of the Firm

One of the first tasks is to define the firm that will seek to attain compliance with the GIPS standards. The definition of the firm is critical because this definition determines the asset base from which the historic performance information will be derived and maintained prospectively.

A firm must be defined as an investment firm, subsidiary, or division held out to clients or prospective clients as a distinct business entity. A distinct business entity is defined as a unit, division, department, or office that

1. is organizationally and functionally segregated from other units, divisions, departments, or offices;
2. retains discretion over the assets it manages; and
3. should have autonomy over the investment decision-making process.

Possible criteria that can be used to determine the firm definition include

- being a legal entity,
- having a distinct market or client type (e.g., institutional, retail, private client), and
- using a separate and distinct investment process.

The definition of the firm must be a fair and reasonable representation of the asset management business in which the firm is engaged. The firm should adopt the broadest, most meaningful definition of the firm and consider how the firm is held out to the public.

## 2.3 Period of Compliance

A firm that claims compliance with the GIPS standards must be able to initially present performance information that meets the requirements of the GIPS standards for at least a five-year period, or since inception of the firm if the firm has been in existence less than five years. The firm must determine whether it will initially claim compliance for a longer period of time than the required five years.

## 2.4 Changes in the Firm Definition

The firm definition may be applicable for the total period for which compliance will be claimed. However, if the firm made an acquisition or spun off part of the company during the period for which the firm claims compliance, such activity would typically be considered a significant event that needs to be disclosed to ensure that the firm definition is clear and unambiguous. Corporate events that need to be considered for disclosure include acquisitions, mergers, spinoffs, and creation or dissolution of a partnership.

An example that illustrates an acquisition:

- ABC Asset Management is defined as all assets managed by ABC Asset Management. From 1 January 2012, the firm includes the assets of Minnow Capital Management, which was acquired by ABC on that date.

Further guidance regarding the definition of the firm is available in the [Guidance Statement on Definition of the Firm](#).

## 2.5 Portfolios in the Defined Firm

All portfolios that have been managed within the defined firm during the period of time for which the firm intends to claim compliance need to be identified. This includes both active portfolios and those that have terminated.

## 2.6 Defining Discretion

The GIPS standards require firms to include all actual (i.e., not model, hypothetical, or back-tested), discretionary, fee-paying (and, optionally, non-fee-paying) portfolios in at least one composite. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. Discretion is the ability of a firm to implement its intended strategy. If documented client-imposed restrictions interfere with the implementation of the intended strategy to the extent that the portfolio is not representative of the strategy, the portfolio would be considered nondiscretionary. A client-imposed restriction that no tobacco or alcohol stocks can be purchased may or may not cause the portfolio to be nondiscretionary, depending on the type of stocks typically purchased for the strategy. If a client must review all investment decisions prior to their execution, a manager may determine that, due to possible differences in the timing of trading, the portfolio is not representative of the strategy and should be considered nondiscretionary. For a discussion of discretion, see the [Guidance Statement on Composite Definition](#). The firm must include its definition of discretion in its GIPS policies and procedures.

The firm's definition of discretion should be determined during the "Analyze" step. By establishing the criteria that a portfolio must meet if it is to be considered "discretionary" or "nondiscretionary," the firm will determine which portfolios must be included in and which must be excluded from the firm's composites. If a portfolio is excluded from a composite, for example, because the client must preapprove trades and it is considered to be nondiscretionary, the reason for exclusion should be documented. Nondiscretionary portfolios may not be ignored. The value of nondiscretionary portfolios that are excluded from composites must be determined because they will be included in the firm's total assets as long as the firm has either conditional or unconditional authority to trade the assets in those portfolios.

There may be portfolios in which a portion of the holdings—such as inherited stocks, holdings with sentimental value, or art or other illiquid assets—is not managed but is included in the overall portfolio. These assets, which sometimes are called "unmanaged assets," can often be excluded from the discretionary portion of the portfolio. The performance of the total portfolio, both unmanaged and managed assets, is reported to the client, but only the managed portion is included in a composite.

## 2.7 Analysis of Historical Records

As previously discussed, when initially claiming compliance, at least five years of performance (or for the period since the firm's inception or the composite inception date if the firm or the composite has been in existence less than five years) must be presented. The firm needs to determine whether the necessary data are available in order to calculate the required performance. Input from the GIPS project team representatives from portfolio accounting, portfolio administration, and performance measurement will be critical for this step.

The firm must be able to support the following for the period for which compliance with the GIPS standards will be claimed:

- Valuations in accordance with the definition of fair value and the GIPS Valuation Principles (Chapter II of the GIPS standards) for periods beginning on or after 1 January 2011. For periods prior to 1 January 2011, valuations must be based on market values.
- Portfolio valuations at least monthly beginning 1 January 2001. For periods beginning on or after 1 January 2010, valuations monthly and on the date of all large cash flows, if portfolio returns are not calculated daily.
- Calendar month-end or last business day of the month valuation for periods beginning on or after 1 January 2010.
- Trade date accounting, for periods beginning on or after 1 January 2005.
- Accrual accounting for fixed-income securities.
- Time-weighted portfolio returns generated at least monthly and adjusted for daily-weighted external cash flows for the relevant period.

- Total returns that include cash and cash equivalents.
- Total returns calculated after the deduction of trading expenses.

Further details and discussion can be found on the [GIPS website](#), in the [GIPS Handbook](#), and specifically, in the [Guidance Statement on Calculation Methodology](#).

There may be obstacles to producing the required historical data, such as the following:

- the inability to extract adequate records from a system that was retired several years ago,
- the lack of supporting records for accounts that have closed,
- incomplete information for terminated strategies, or
- the lack of electronic records leading to significant manual work with archived paper records.

The ability to overcome these and other challenges may determine the length of the historical period that can be brought into compliance. If the required data for the minimum five-year historical period are not available initially, the firm can start to work toward the required five years of compliant performance. Even if the defined firm is not immediately able to claim compliance with the GIPS standards, there are many benefits that the asset manager can derive as soon as it begins to follow the policies and procedures that are required for compliance with the GIPS standards.

#### [An example of historical data analysis](#)

Assume an asset manager starts managing assets on 1 January 2010 and decides during 2016 that it wants to claim compliance with the GIPS standards. During 2016, the firm puts in place the policies and procedures that will enable it to collect the necessary data for all the portfolios that are included in the defined firm. The plan is for the firm to claim compliance with the GIPS standards in 2017. The GIPS project team works back through the firm's records to bring five years of historical data (2012 through 2016) in line with GIPS requirements. The team determines that the methodology the firm used from 1 January 2013 forward supports the requirements of the GIPS standards but the methodology used before then does not. There is no way the historical data from 2012 can be brought into compliance, so there are only four years of historical data that meet the requirements of the GIPS standards. Knowing that it must present a minimum of five years of compliant data, the GIPS project team determines that the firm can only begin to claim compliance with the GIPS standards after 31 December 2017, once it has complied for the period of 1 January 2013 through 31 December 2017.

## **2.8 Portability**

In some cases, the historical track record that a firm wishes to bring into compliance with the GIPS standards includes performance generated while the investment managers responsible for that track record were employed at a different firm. For the historical performance of a prior firm or affiliation to be linked to the ongoing performance of the current firm, the following conditions must be met for the specific composite:

- Substantially all of the investment decision makers must be employed by the new or acquiring firm;
- The decision-making process must remain substantially intact and independent within the new or acquiring firm; and
- The new or acquiring firm must have the records that document and support the performance.

If an acquiring firm cannot meet the portability requirements for a specific composite, the past performance record of the former firm or affiliation must not be linked to the ongoing performance record of the new or acquiring firm. However, the past performance record may be presented as supplemental information when relevant, provided the new or acquiring firm has all data and information necessary to support the performance.

For a more detailed description of the requirements that must be met in order for a track record to be portable, please see the [Guidance Statement on Performance Record Portability](#).

## 2.9 Analysis of System Capabilities

Sections 1, 2, and 3 of the GIPS standards (input data, calculation methodology, and composite construction) include the relevant requirements when considering the capabilities that the firm's portfolio accounting and performance measurement systems will need in order to support compliance with the GIPS standards. Some systems may also help the firm meet presentation and disclosure requirements.

### Build vs. Buy

If the firm's portfolio accounting and/or performance measurement systems are unable to support the processes necessary for compliance with the GIPS standards, it will be necessary to build additional capability in-house or buy it from one or more third parties. Third-party solutions supporting GIPS compliance include products from individual vendors that the firm can integrate into its existing systems, fully integrated solutions purchased from a single vendor, and outsourced providers that offer a full range of middle-office functions. For a small firm with a limited number of portfolios, it may be possible to use the firm's current systems for portfolio performance calculations while satisfying the composite requirements of the GIPS standards through the use of spreadsheets.

When evaluating the available options, the firm needs to consider a number of factors, including the extent of automation a system provides and the reports that can be generated to support compliance with the GIPS standards. It may be prudent to include both the build and buy options in the evaluation, so that all options can be evaluated quantitatively. Factors to consider include

- functionality,
- technology requirements,
- maintenance and availability of upgrades,
- commitments to making updates to reflect changes in the GIPS standards,
- implementation time,
- any key person dependencies for an in-house team, and
- a vendor's commitment and ability to support the product long term.

The firm is responsible for the integrity and accuracy of the data used to maintain its claim of compliance. The firm must be satisfied that the systems and processes chosen by the firm will produce data that are accurate and in keeping with the requirements of the GIPS standards.

Constructing a comprehensive set of criteria and a scorecard for the evaluation of each solution can help a firm determine which solution is the best fit for the firm. Whether the firm decides to implement an in-house or a third-party solution, it must stay up to date with changes to the GIPS standards. Any required changes to the system must be implemented by the effective date of the new GIPS requirement.

### Functionality of a System vs. Cost of Manual Maintenance

When analyzing system capabilities, it is important to consider both the functions required to support compliance with the GIPS standards and the costs and benefits of automating various functions compared with performing these functions manually.

This chart includes some of the potential questions that should be asked regarding system capabilities.

Section of the GIPS Standards	Questions regarding Systems
<b>Input Data</b>	<ul style="list-style-type: none"> <li>• Is there an interface between the system that generates portfolio returns and the calculation of composite asset values and returns?</li> <li>• Does the accounting system retain sufficient data (through time and with sufficient detail) to support the composite data presented?</li> <li>• What reconciliations will be required between accounting, portfolio, and composite data to ensure data integrity?</li> <li>• Where will benchmark data be sourced from and stored? How will these data be quality controlled?</li> <li>• How are changes in data identified and flagged?</li> </ul>
<b>Calculation Methodology</b>	<ul style="list-style-type: none"> <li>• Are return methodologies consistent with GIPS requirements?</li> <li>• How are fees accounted for? Can returns be calculated on both a net-of-fees and gross-of-fees basis?</li> <li>• Can composite returns be calculated in multiple currencies?</li> </ul>
<b>Composite Construction</b>	<ul style="list-style-type: none"> <li>• How many portfolios and composites can be accommodated?</li> <li>• Must portfolios be manually assigned to composites, or can rules be set up within the system to assign portfolios to a specific composite or to classify them as nondiscretionary?</li> <li>• How are revisions to composite membership or returns achieved once composites have been run?</li> <li>• Can the system identify or exclude portfolios that fall below minimum size criteria for a specific composite? Is a tolerance allowed so that portfolios are not moving in and out of a composite when close to the minimum size?</li> <li>• Can the system store composite attributes, such as name, description, and benchmark assignment?</li> <li>• Can the system identify significant cash flows?</li> </ul>
<b>Disclosure</b>	<ul style="list-style-type: none"> <li>• Can the system store composite disclosures?</li> </ul>
<b>Presentation and Reporting</b>	<ul style="list-style-type: none"> <li>• Can compliant presentations be run from the system?</li> <li>• How flexible is the system in creating firm-specific reports (e.g., inclusion of corporate logos)</li> </ul>

This chart includes other considerations relating to the systems solution.

Issue	Other Considerations
<b>Technical Support</b>	<ul style="list-style-type: none"> <li>• If buying, does the vendor offer technical support and GIPS expertise that can be drawn upon?</li> <li>• How quickly does the vendor make necessary modifications in response to changes to the GIPS standards?</li> <li>• Will the vendor continue to support earlier versions of the product if the firm does not choose to implement the latest release?</li> <li>• If building, how will the firm ensure in-house systems will be revised to accommodate changes to the GIPS standards?</li> </ul>
<b>Verification</b>	<ul style="list-style-type: none"> <li>• Will the system provide verifiers, regulators, and/or internal auditors with the reports and data they require?</li> <li>• Can verifiers access the system remotely given the firm's firewall protocol?</li> </ul>
<b>Global Needs</b>	<ul style="list-style-type: none"> <li>• Will GIPS presentations need to be provided in multiple languages?</li> <li>• Are multiple character sets supported?</li> <li>• Are presentations needed in multiple base currencies?</li> <li>• How flexible is the system in meeting these needs?</li> </ul>

<b>Local Standards</b>	<ul style="list-style-type: none"> <li>• Are there other local reporting standards that need to be supported in addition to the GIPS standards? Can these requirements be incorporated into a single-system solution?</li> </ul>
<b>Workflow</b>	<ul style="list-style-type: none"> <li>• Does the system or process support the required workflows, such as assigning new portfolios to composites or ensuring that presentations are properly signed off by appropriate parties?</li> </ul>
<b>Auditing and Review</b>	<ul style="list-style-type: none"> <li>• Does the system provide an audit trail with time, date, and author of changes to any key items (e.g., benchmark changes, disclosures)?</li> <li>• Does the system provide outlier reports to help monitor composites' internal dispersion?</li> <li>• Are there administrative and control reports to assist in monitoring data quality and composite maintenance?</li> </ul>
<b>Firm Needs</b>	<ul style="list-style-type: none"> <li>• What kind of system is appropriate for the firm, given the firm's size, number of composites, and reporting currencies used?</li> <li>• Are there business functions in the firm that could benefit from the information provided, such as risk management, internal audit, business continuity/recovery, portfolio manager, product evaluation, and compliance?</li> </ul>

**Step 3: Build the Infrastructure to Comply**

The “Build” step involves taking the necessary actions identified in the “Analyze” step. At this stage, there should be a solid understanding of what inputs are required from all areas of the firm.

**3.1 Develop Policies and Procedures**

A firm must document the policies and procedures used in establishing and maintaining compliance with the GIPS standards. The GIPS policies and procedures must include the policies and procedures the firm follows for meeting all applicable requirements of the GIPS standards, as well as any recommendations the firm has chosen to adopt. Before documenting policies and procedures, it is important to understand the difference between a policy and a procedure.

- A policy can be thought of as a statement that describes how a firm has chosen to comply with a requirement or recommendation of the GIPS standards.
- In contrast, a procedure is the course of action that must be followed to implement a policy consistently.

**Structure of GIPS Policies and Procedures**

The GIPS policies and procedures should be structured in a way that makes them easy to track for those who will have responsibility for following and maintaining the policies and procedures. One approach is to follow the structure and numbering of the provisions as presented in the GIPS standards. Doing so will make relating the firm's policies and procedures to the GIPS standards straightforward, especially when changes in the GIPS provisions require changes in the firm's policies and procedures. But remember that there are many requirements that are not in the provisions themselves. These additional requirements, which may be included in Guidance Statements, Q&As, and *GIPS Handbook* interpretations, must also be addressed in the GIPS policies and procedures.

Policies and procedures must be tailored to the firm. Adopting an off-the-shelf version of GIPS policies and procedures will not suffice. Poorly constructed policies and procedures, or a total lack of policies and procedures, have historically been a significant failing of firms whose claim of compliance with the GIPS standards has been found to be invalid by a regulator.

The GIPS policies and procedures help to ensure that the institutional memory of how and why things are done is not lost. They are also an important guide to how things are currently done. Robust GIPS policies and procedures can be a useful training tool for staff, providing guidelines to support day-to-day operations and processes. They are a key document for local regulators and for verifiers. The GIPS policies and procedures can also be of significant benefit to clients or consultants undertaking a due diligence review of a manager. It should be noted that all of the firm's policies and procedures do not need to be documented within one document. The GIPS policies and procedures can refer to other documents, such as the policies for oversight of fund administrators, the pricing matrix, or the valuation hierarchy. However, references to other documents must remain current and must contain the information that is referenced in the firm's GIPS policies and procedures.

#### **GIPS Policies and Procedures Documentation Considerations**

- For each requirement and adopted recommendation, do the policies and procedures clearly explain
  - what is being done to meet the requirement or recommendation of the GIPS standards,
  - how it is done, and
  - who is responsible for doing it?
- Are checks and controls included in the procedures and also documented?
- Has the firm established its error correction policy?
- Do the policies and procedures include information for all parties that the firm uses in maintaining compliance with GIPS standards? (This could be internal departments, such as business units responsible for valuation procedures, and external parties, such as third-party providers of fund information.)
- Would the policies and procedures be understandable and clear to someone who is not part of the team that does the actual work described in the policies and procedures, such as internal auditors, regulators, and verifiers?
- Would someone who has the skill level and knowledge required for the job be able to follow each step in the policies and procedures to successfully complete the task described in the policies and procedures?
- Do the policies and procedures include a policy to periodically review the firm's policies and procedures?

Policies cannot simply be a restatement of a requirement. For example, stating that the firm includes new portfolios on a timely and consistent basis after each portfolio comes under management would not suffice. The firm must determine and document a timing policy for when new portfolios will be included in composites.

#### **Policies and Procedures: Changes**

Policies and procedures may change over time for a variety of reasons, such as a result of changes in the GIPS standards, a change in the systems used, or the determination that a change in a policy or procedure would lead to greater efficiency. Changes may be applied prospectively but not retrospectively. Changes to existing policies must be accompanied by clear effective dates. In some cases, it may be appropriate to document the reason for the policy change. A firm must maintain both current and any previous versions of its policies and procedures, so that there is an accurate history of policies and procedures that covers the entire period for which the firm claims compliance.

[“Best Practices for Creating and Maintaining Policies and Procedures for Complying with the Global Investment Performance Standards \(GIPS®\)”](#) is an in-depth white paper containing ideas for best practices for creating and maintaining policies and procedures.

[Practical Recommendations for Developing Policies and Procedures](#) is a webcast that also contains helpful information on this topic.

### 3.2 Construct Composites

Having determined the definitions of the firm and discretion during the “Analyze” step (2.2 and 2.6), the firm can begin the construction of composites. Reviewing the [Guidance Statement on Composite Definition](#) will be helpful.

A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. The firm must include all actual, fee-paying, discretionary portfolios in at least one composite. Non-fee-paying portfolios may be included in composites. (If a composite includes non-fee-paying portfolios, the firm must present the percentage of composite assets represented by non-fee-paying portfolios as of each annual period-end.) The assignment of a portfolio to a composite should be supported by documentation, such as an investment management agreement and/or communications from clients regarding the management of their portfolios.

Firms should construct composites in a manner that provides a fair and meaningful representation of the firm’s investment strategies. The following list represents some key issues a firm should consider when constructing composites.

- A composite definition is the detailed criteria that determine the assignment of portfolios to composites. Criteria may include the investment mandate, style, or strategy; asset class; use of derivatives, leverage, and/or hedging; targeted risk metrics, investment constraints, or restrictions; and/or portfolio type. Composite definitions must be documented. All portfolios that meet a composite definition must be included in that composite.
- Changes to a composite definition can be applied only on an *ex ante* basis.
- If there are portfolios that are permanently or temporarily excluded from a composite, the reasons for the exclusion must be documented.
- If a firm sets a minimum asset level for inclusion in a composite, it must be implemented consistently. In addition, the firm should not present this composite to a prospective client known not to meet the composite’s minimum asset level.
- If a firm employs a sub-advisor and has discretion over the selection of the sub-advisor (i.e., can hire and fire the sub-advisor), the firm must include the sub-advisor’s performance as part of its performance history. Portfolios managed by the sub-advisor must be assigned to a composite, and the portfolios must be included in total firm assets.
- Portfolios must not be switched from one composite to another unless documented changes to a portfolio’s strategy or the redefinition of a composite make switching appropriate. The historical performance of the portfolio must remain with the original composite.
- A significant cash flow policy may be adopted on a composite-specific basis. A significant cash flow is the level at which the firm determined that a client-directed external cash flow may temporarily prevent the firm from implementing the composite strategy, and thus the portfolio is temporarily removed from the composite. Please see the [Guidance Statement on the Treatment of Significant Cash Flows](#) for more information.

Because a portfolio may be included in more than one composite, firms must be careful not to double count firm assets. More guidance and examples on this point are available in the [Guidance Statement for Alternative Investment Strategies and Structures](#). (This guidance statement is also applicable to strategies and structures that a firm may not typically consider to be an alternative investment strategy or structure.)

A composite description is general information about the investment mandate, objective, or strategy of the composite. The GIPS standards require that a firm make a list of the firm’s composite descriptions available to any prospective client upon request. Inactive or terminated composites must remain on the list for five years. Remember that this list must include all composites and not just the composites marketed by the firm.

### 3.3 Calculate Portfolio and Composite Returns and Additional Required Statistics

The [Guidance Statement on Calculation Methodology](#) provides detailed instructions on portfolio and composite calculations.

The firm must use accurate and consistent input data when calculating returns because correct performance output requires the processing of correct input data. Although there is some flexibility in the GIPS standards regarding portfolio return calculations, the return must be calculated using a methodology that incorporates the time-weighted rate of return concept for all portfolios except private equity. Provisions and guidance for private equity can be found in Section 7 of the GIPS standards and in the Guidance Statement on Private Equity (Section 4-9 of the *GIPS Handbook*).

In addition to portfolio and composite returns, additional statistics required for each annual period include

- total return of the composite's benchmark,
- number of portfolios in the composite at period-end,
- composite assets at period-end,
- total firm assets or composite assets as a percentage of the total firm assets at period-end,
- an internal dispersion measure of individual portfolio returns, and
- three-year annualized *ex post* standard deviation, using monthly returns, for both the composite and the benchmark, for periods ending on or after 1 January 2011.

None of these additional statistics should be difficult to produce or calculate if the required data have been collected.

### 3.4 Prepare Compliant Presentations

The compliant presentation contains the required composite information that must be presented to prospective clients. The following is an example of a compliant presentation.

Investment Firm									
Balanced Growth Composite									
1 January 2002 through 31 December 2011									
Year	Composite	Composite	Custom	Composite	Benchmark	Number of	Internal	Composite	Firm
	Gross Return	Net Return	Benchmark	3-Yr St Dev	3-Yr St Dev				
	(%)	(%)	(%)	(%)	(%)	Portfolios	(%)	(\$ M)	(\$ M)
2002	-10.5	-11.4	-11.8			31	4.5	165	236
2003	16.3	15.1	13.2			34	2.0	235	346
2004	7.5	6.4	8.9			38	5.7	344	529
2005	1.8	0.8	0.3			45	2.8	445	695
2006	11.2	10.1	12.2			48	3.1	520	839
2007	6.1	5.0	7.1			49	2.8	505	1,014
2008	-21.3	-22.1	-24.9			44	2.9	475	964
2009	16.5	15.3	14.7			47	3.1	493	983
2010	10.6	9.5	13.0			51	3.5	549	1,114
2011	2.7	1.7	0.4	7.1	7.4	54	2.5	575	1,236

Sample 1 Investment Firm claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sample 1 Investment Firm has been independently verified for the periods 1 January 2000 through 31 December 2010. The verification report is available upon request. Verification assesses whether (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. Verification does not ensure the accuracy of any specific composite presentation.

**Notes:**

- 1. Sample I Investment Firm is a balanced portfolio investment manager that invests solely in US-based securities. Sample I Investment Firm is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.**
- 2. The Balanced Growth Composite includes all institutional balanced portfolios that invest in large-cap US equities and investment-grade bonds with the goal of providing long-term capital growth and steady income from a well-diversified strategy. Although the strategy allows for equity exposure ranging between 50% and 70%, the typical allocation is between 55% and 65%. The account minimum for the composite is \$5 million.**
- 3. The custom benchmark is 60% YYY US Equity Index and 40% ZZZ US Aggregate Bond Index. The benchmark is rebalanced monthly.**
- 4. Valuations are computed and performance is reported in US dollars.**
- 5. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Composite and benchmark returns are presented net of nonreclaimable withholding taxes. Net-of-fees returns are calculated by deducting the highest fee of 0.083% from the monthly gross composite return. The management fee schedule is as follows: 1.00% on the first \$25 million; 0.60% thereafter.**
- 6. This composite was created in February 2000. A complete list of composite descriptions is available upon request.**
- 7. Internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year.**

The compliant presentation includes quantitative (data) and qualitative (disclosures) information to help prospective clients interpret the firm's performance record for the particular investment strategy being presented. The GIPS standards do not mandate the look and format for the content of the compliant presentation, and firms are free to brand their compliant presentations, provided all the required items are included. Remember that all data and information necessary to support all items in a compliant presentation must be captured and maintained.

Additional sample compliant presentations are included in Exhibit A in the GIPS standards.

Please see the [Disclosure Guide Matrix](#) for a comprehensive disclosure checklist that includes a list of all disclosures that are required and recommended to be included in compliant presentations.

#### **Step 4: Implement and Maintain Compliance with the GIPS Standards**

Some of the responsibilities involved in maintaining compliance with the GIPS standards include

- maintenance of the firm's GIPS policies and procedures;
- review and acceptance of changes to composite descriptions, definitions, and composite portfolios
- creation of an audit trail for portfolios that enter or exit a composite, including changes due to composite minimum policies and/or significant cash flow policies,
- provision of periodic training in the requirements of the GIPS standards, as well as GIPS policies and procedures, for departments that are involved in GIPS compliance, and
- review of revisions to previously released compliant presentations, determination of steps that must be taken based on the firm's error correction policy and materiality definition, and oversight of the necessary steps.

An implementation matrix that aligns the requirements of the GIPS standards with functional resources is an excellent way to identify key stakeholders that should be represented in the GIPS compliance process. An example of the departments that are typically stakeholders in the process, along with their roles and

responsibilities in achieving and maintaining compliance with the GIPS standards, is shown next. The actual alignment of responsibilities with departments will differ from firm to firm.

#### Operations

- Ensure that all investment transaction types are treated correctly and consistently through time; investment transaction types can include corporate actions, fees, securities lending, accruals, derivatives, and margin activities.
- Ensure consistent treatment of cash flows, including the application of large and significant cash flow policies.
- Value portfolios consistent with the GIPS valuation requirements.
- Calculate portfolio and composite returns.
- Document accounting changes, including any backdating or restatement that impacts portfolio returns included in composites.
- Calculate total firm assets and composite assets.

#### Client Service, Portfolio Management, and Product Management

- Maintain investment guidelines, restrictions, and other client documentation, including support for any changes in composite assignment over time.
- Maintain information on portfolios that are considered nondiscretionary.
- Identify any bundled fee and performance-based fee agreements.
- Monitor and alert the performance measurement and/or operations teams when significant cash flows occur or are expected to occur.
- Partner with the performance measurement team to develop and maintain clear, accurate, and up-to-date composite descriptions.

#### Legal and Compliance

- Review the processes in place to ensure that GIPS-compliant presentations are being provided to prospective clients.
- Monitor the use of error correction policies and procedures.
- Provide guidance on regulatory issues.
- Collaborate with the performance measurement team in the interpretation and application of the GIPS standards.
- Establish policies and procedures to ensure the firm complies with all applicable laws and regulations regarding the calculation and presentation of performance.

#### Sales and Marketing

- Ensure that all prospective clients receive the required GIPS-compliant presentations and that there is a mechanism in place to track the provision of the information.
- Inform other departments when new advertisements prepared in accordance with the GIPS Advertising Guidelines will be used.
- Collaborate with the performance measurement team to educate front-line professionals about the GIPS standards and ensure that marketing materials are consistent with GIPS-compliant composite information.

#### Information Technology

- Support the systems that provide input data, composite calculation, and/or compliant presentations and those that capture information for the recordkeeping requirements.
- Perform testing to ensure the functions or systems are providing accurate information.
- Support and liaise with external system or software vendor(s) to ensure seamless implementation and continuous support.

#### Performance Measurement

- Provide the technical expertise for the calculation of portfolio and benchmark risk and return data.
- Provide the GIPS expertise necessary to maintain compliance with the GIPS standards.

- Maintain the firm's composites.
- Ensure that input from third parties meets the requirement of the GIPS standards.

#### 4.1 Production Cycle

As of 1 January 2010, composite returns are required to be calculated at least monthly. Because compliant presentations must include annual returns, monthly composite returns must be linked to calculate annual composite returns. However, even if firms update compliant presentations annually, composite returns are usually calculated monthly throughout the year.

Discussions with the sales and marketing, product management, and client service teams will help determine the frequency of compliant presentation updates appropriate for the firm, what interim data need to be provided, and the number of business days after the completion of each period that the data need to be available for distribution. The frequency with which final composite data will be required to support internal uses must also be determined. These timelines will govern the firm's production cycle, along with the processing cycle that the accounting and performance teams and systems support. Typically, composite returns are calculated on a monthly basis, with compliant presentations updated on a quarterly or annual basis.

#### Input Data Validation

Once the month-end valuations for the portfolios have been generated, returns can be calculated and monthly returns can be validated. Because all the portfolios in a composite must be managed in a similar way, checking for outliers is a good way of identifying potential errors in portfolio returns or composite assignment. Typically, reasons for outliers include

- incorrect assignment of a portfolio to a composite;
- a transaction, such as an inflow of securities, that temporarily distorts the performance of the portfolio relative to other portfolios in the composite; or
- incorrect booking of one or more transactions.

Issues that affect all the portfolios assigned to a composite, such as a bad price for a security held by all portfolios or an incorrect treatment of a corporate action, will *not* be revealed in an examination of outliers. Such an issue may be detected, however, by comparing composite performance with that of its benchmark.

#### Composite Assignment

The incorrect assignment of a portfolio to a composite will affect at least two composites: the one it was in and the one it should have been in. Maintaining correct composite assignments requires identification of

- new portfolios under management;
- portfolios changing their investment mandate, objective, or strategy;
- portfolios that are in the process of being closed and are no longer discretionary;
- significant inflows and outflows of cash or securities, if significant cash flow policies have been adopted;
- portfolios whose size requires a change in composite inclusion, if composite minimum policies have been adopted; and
- portfolios that have a change in discretion status.

Good communication and monitoring of these events with client service, portfolio management, portfolio administration, and portfolio accounting teams are key to the composite assignment process running efficiently.

It is also a good idea to reconcile the number of portfolios under management to the number of portfolios specifically included in and excluded from a composite. This helps to ensure that all portfolios are accounted for.

## 4.2 Error Correction and Materiality

Given the amount of information being collected and processed, it is expected that errors will occasionally appear in compliant presentations. The [Guidance Statement on Error Correction](#) addresses the handling of both quantitative and qualitative errors related to compliant presentations. The error correction policy that a firm establishes and implements must distinguish material from nonmaterial errors and indicate the appropriate response for each type of error.

The GIPS standards require that

- error correction policies and procedures be established *ex ante* and implemented consistently,
- materiality be defined in the error correction policies, and
- the lack of a required disclosure be considered an error and the compliant presentation be corrected.

The firm generally has four options for how errors might be handled:

1. Take no action.
2. Correct the compliant presentation with no disclosure of the change.
3. Correct the compliant presentation with disclosure of the change and no distribution of the corrected compliant presentation.
4. Correct the compliant presentation with disclosure of the change, and make every reasonable effort to provide a corrected compliant presentation to all prospective clients and other parties that received the erroneous compliant presentation.

Option 4 is the only option that addresses a material error. All other options address the handling of nonmaterial errors. The criteria that determine how a nonmaterial error is assigned to one of the first three options should be a part of the firm's error correction policy.

Materiality is determined by the firm for all information included in the compliant presentation. One of the key considerations when deciding if an error is material is whether the error might have affected a prospective client's decision to invest in the strategy. If an error might have affected that decision, then the error is clearly material. Other factors to consider in determining materiality are

- the size of the error in absolute and relative terms,
- the impact on the composite's return relative to the benchmark,
- whether the error involves an overstatement (the composite actually performed worse than indicated) or an understatement (the composite actually performed better than was originally stated), and
- the time period affected by the error.

To minimize the number of errors, checks and balances need to be built into a firm's processes. When an error occurs, the firm's policies and procedures, including the controls in place and the checks and balances followed, should be reviewed to determine

- whether existing policies and procedures were followed;
- whether procedures, including controls and checks, are sufficient; and
- what additional controls or checks may be needed to eliminate a recurrence of this error.

Every error identified is an opportunity to strengthen a firm's policies and procedures and may point to the need for less manual processing and increased automation.

A GIPS Error Correction Survey was conducted in 2014 to inform the investment industry on how firms develop and administer their GIPS standards compliance programs with respect to such policies and

procedures. The [Executive Summary](#) of this survey—which analyzes the results of the survey, outlines what can be learned from it, and suggests best practices for firms to consider—is available on the GIPS website.

#### 4.3 Monitor Compliance on an Ongoing Basis

Once a firm is able to claim compliance with the GIPS standards, ongoing monitoring is necessary to maintain compliance. It should be standard practice to review the policies and procedures document regularly with at least two goals in mind:

- to ensure all policies and procedures are being followed by all the departments whose activities impact GIPS compliance and
- to ensure that the firm’s policies and procedures are still current.

It is important to recognize that, as the investment process evolves, so must policies and procedures. For example, if the pricing team is considering changing some of the policies affecting the valuation of securities, it needs to consider the requirements of the GIPS standards when assessing the proposed change. Or if the investment process begins to use leverage, this change may need to be reflected in the disclosures in one or more of the firm’s compliant presentations.

#### Staying Up to Date with Changes in the GIPS Standards

It is critical that a firm’s GIPS policies and procedures are updated in a timely fashion to reflect new guidance or changes to the GIPS standards, including new and updated Guidance Statements, Q&As, and any interpretations and clarifications published by CFA Institute and the GIPS Executive Committee or GIPS Technical Committee. All of this material is available on the [GIPS website](#).

Although changes to the GIPS standards and guidance statements are planned and communicated ahead of their effective date, new Q&As can be issued more frequently. A firm needs to ensure that all changes to and clarifications of the GIPS standards are well understood and incorporated into its policies and procedures in accordance with the appropriate effective dates.

##### Case Study: New Risk Requirement Causes Changes in Policies and Procedures

The 2010 edition of the GIPS standards introduced a new presentation requirement for all GIPS-compliant presentations: the three-year annualized *ex post* standard deviation of the composite and its benchmark for annual periods ended on or after 1 January 2011. The firm was thus required to develop procedures to perform the calculation and ensure the integrity of the numbers in its presentations. Because the firm’s composite system was not capable of calculating and storing the newly required measure, Phase 1 of the change in policies and procedures involved a manual process that used a spreadsheet program for the required calculations. A review of the manually calculated input for the firm’s compliant presentation was part of the process. In Phase 2, the firm implemented a routine whereby each time a compliant presentation was being created, the firm sourced the composite and the benchmark return database, calculated the standard deviation, and systematically added the measure to the compliant presentation. These procedural changes were documented in the firm’s policies and procedures.

#### 4.4 Consider Verification

It is not required that a firm claiming compliance with the GIPS standards undergo verification or have performance examinations conducted. However, verification is a recommendation of the GIPS standards, and firms should consider verification as best practice.

## What Is Verification?

Verification is a process by which an independent third party 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 verifier will issue a verification report to the firm upon the satisfactory conclusion of the verification.

Verification provides prospective and current clients with additional confidence concerning the firm's claim of compliance. It also provides the firm with additional confidence that it has the necessary policies and procedures in place to support its claim of compliance. In the [Guidance Statement on Verification](#), it is recommended that the verifier issue a recommendation letter to the firm describing specific findings, recommendations, or areas for improvement arising from the verification. Such a letter allows the firm to benefit from the experience and knowledge the verifier has gained from working with multiple firms claiming compliance. A firm that is compliant with the GIPS standards and has been verified references its verification in the claim of compliance that is included in its compliant presentations.

Some of the advantages and points to consider associated with verification are as follows.

Advantages	Points to Consider
<ul style="list-style-type: none"><li>• Independent evaluation of internal controls</li><li>• Recommended improvements provided by verifier</li><li>• Additional knowledge based on the GIPS standards</li><li>• Additional credibility of claim of GIPS compliance</li><li>• Mitigation of risk of a false claim of compliance</li><li>• Better preparation for a regulatory review</li><li>• Ability to respond "yes" when asked whether firm has been verified</li></ul>	<ul style="list-style-type: none"><li>• Cost of the verification</li><li>• Determination of whether the verification firm has the resources and experience to provide an effective engagement and deliver additional value and insight</li><li>• Cost of internal resources and time required to prepare for and support the verification</li><li>• Possibility of other professional services provided to the firm by the verifier compromising the verifier's independence</li></ul>

## Selection of Verifier

Specialist verification firms can be found in most countries, and many verifiers will travel to and work in countries/territories where the GIPS standards are not yet established. Many accounting and consulting firms have a division that provides GIPS verification.

The verification must be performed by a verifier with appropriate professional abilities and experience. A practical level of expertise regarding investment management practices, including performance calculation procedures and business processes, is required. Verifiers must be knowledgeable about the GIPS standards and applicable laws and regulations regarding the calculation and presentation of performance in the local market.

Factors to consider when choosing the verifier include the cost, qualifications, experience, and reputation of the verification firm, as well as its independence from the firm being verified. The verifier must be independent from the firm being verified, and the verifier must perform its service in an unbiased manner.

It is not uncommon for a firm to hire a consultant who can provide objective guidance during the firm's efforts to attain compliance but who also offers verification services. A verification firm can provide consulting services to a verification client for both GIPS-related and non-GIPS-related services. However, when the verification firm provides GIPS-related services, consulting members of the verification firm must *not* step into a management role or undertake any management function. Furthermore, the verification firm must not perform (or have performed in the past) any services that would result in its reporting on its own work product or decisions. Additional services and products provided by the verification firm, even if not related to the GIPS standards, may potentially result in independence issues. Please refer to the [Guidance Statement on Verifier Independence](#).

Firms can use the [Suggested Questions to Ask Prospective Verifications Firms](#) as a starting point in conducting due diligence on verification firms.

### Costs of Verification

Costs of verification are a function of many variables including, but not limited to the

- complexity of the firm,
- number and complexity of investment strategies used,
- type and quantity of portfolios,
- geographical boundaries of operation,
- number of periods to be verified,
- accounting and performance systems used,
- internal controls relating to GIPS compliance, and
- quality of policies and procedures documentation.

Costs also vary from country to country and from verifier to verifier. The best way to gauge the verification cost for your firm is to ask a number of prospective verifiers for their estimates while making sure you understand the work covered by the estimates, such as onsite visits, on-call advice, training, and so forth.

### Working with Verifiers

There are many specific procedures that verifiers must conduct, at a minimum, in order to issue a verification report. To carry out these procedures, the verifier is likely to request a great deal of data and information. The verifier will need to first gain an understanding of the firm, including

- how the firm is structured and operates,
- the firm's policies and procedures, and
- the firm's valuation and calculation methodologies.

The verification includes a series of tests, including but not limited to testing to determine whether

- the firm has been correctly defined,
- composites have been defined and maintained according to the firm's established policies and procedures,
- all actual, fee-paying, discretionary portfolios have been included in at least one composite, and
- compliant presentations include all the information and disclosures required by the GIPS standards.

For a more complete list of what verification must test, please see Section IV: Verification in the GIPS standards. Procedures may differ among verifiers, but the required verification procedures outlined under Required Verification Procedures in Section IV must be performed by all verifiers.

A verification report will not be issued if the verifier knows that the firm is not in compliance with the GIPS standards. In these cases, the verifier will issue a statement to the firm clarifying why a verification report cannot be issued and either give the firm the opportunity to correct those issues or agree to terminate the verification. The firm must not state that it has been verified unless a verification report has been issued.

A verification report has no particular format although it has a number of required elements. These required elements are included in the [Guidance Statement on Verification](#).

### **Performance Examination**

A verification report is issued with respect to the whole firm. Verification does not ensure the accuracy of any specific GIPS-compliant presentation. However, if a firm has been verified, it may choose to have a verifier conduct a performance examination, which involves the detailed testing of a specific composite and its associated compliant presentation. A performance examination may only be performed either concurrently with or subsequent to the completion of a verification. The [Guidance Statement on Performance Examinations](#) provides further information on the additional items that will be tested during a performance examination.

### **4.5 Claim of Compliance**

Once the firm has met all the requirements of the GIPS standards, it must include a claim of compliance in its compliant presentations. The claim of compliance to be used will depend on whether the firm has been verified and whether there has been a performance examination for a specific composite. The format of the claim of compliance that must be used is specified in provision 4.A.1 of the GIPS standards. A fourth claim of compliance for a verified firm that has had a performance examination more than 24 months ago for a specific composite is included in the *GIPS Handbook* on pages 149–150.

### **Validity of Claims of Compliance with the GIPS Standards**

Adoption of the GIPS standards is voluntary, and the GIPS standards do not contain enforcement procedures to deal with firms that falsely claim compliance with the GIPS standards. Verification, however, provides both the firm and its clients with additional confidence that the firm's claim of compliance is valid. In addition, in some countries/territories, regulatory authorities will investigate a firm's claim of compliance during their examination of the firm. Firms whose claim of compliance is found to be invalid have faced regulatory charges.

### **Step 5: Stay Up To Date with Current Development**

The final step in achieving and maintaining compliance with the GIPS standards is to have an ongoing process for staying current with developments in the GIPS standards, as well as with local laws and regulations. The [GIPS website](#) provides a significant number of resources, as do the websites of the [local sponsoring organizations](#).

#### **5.1 Sign Up for the GIPS Newsletter**

The GIPS standards are not static and continue to evolve with industry changes, with the GIPS Executive Committee and/or the GIPS Technical Committee issuing additional interpretation and guidance as needed. One of the best ways to stay informed of the latest news on the GIPS standards is to subscribe to the quarterly GIPS newsletter by emailing [standards@cfainstitute.org](mailto:standards@cfainstitute.org).

#### **5.2 Attend GIPS Workshops, Conferences, and Webinars**

GIPS workshops provide focused and hands-on learning about the GIPS standards. The interactive practical workshops offered by CFA Institute provide an in-depth review of the GIPS standards and help participants master the requirements of the GIPS standards. Some verification and consulting firms also offer workshops on the GIPS standards, including customized trainings designed for and delivered at a particular firm.

GIPS conferences offer continuing education on investment performance topics, as well as on the GIPS standards themselves, with subject experts sharing best practices and speaking to key challenges.

[Webcasts and podcasts](#) from some of the sessions of the GIPS Annual Conference, held in the United States, are available online and are free of charge. CFA Institute also offers periodic webinars on a variety of GIPS topics. Information about upcoming webinars is included in the GIPS newsletter.

## A Case Study: New GIPS-Compliant Investment Company (NGCIC), EmergingLand

### Background and Rationale for GIPS Compliance

NGCIC, one of the largest asset management companies in EmergingLand, aims to be the country's premier investment solution provider.

Local practices in the asset management industry in EmergingLand varied across asset managers, and these variations made it difficult for the investment community to obtain accurate investment performance data that allowed for meaningful comparisons of performance. This hindered the ability of EmergingLand firms to enter global markets.

NGCIC had plans to distribute its products in the Middle East and United Kingdom, and compliance with an international performance presentation standard was deemed critical to this goal. NGCIC thus decided to go beyond its local legal reporting requirements and demonstrate its commitment to open, honest, and ethical practices by implementing and claiming compliance with the GIPS standards. NGCIC hoped that being the first firm in EmergingLand to adopt the ethics, transparency, and full disclosure that go hand-in-hand with the GIPS standards would provide it with an advantage in the local asset management industry. NGCIC also believed that, if it were able to claim compliance with a recognized global investment performance standard, both its prospective and existing clients would have a greater degree of confidence in the performance returns presented by the firm.

### Implementation of the GIPS Standards

NGCIC followed the five-step process displayed on the GIPS website.

#### Step 1: Learn about the GIPS Standards

To learn about the GIPS standards, the firm reviewed all of the available resources on the [GIPS website](#), including the [GIPS standards](#), the [GIPS Handbook](#), and the [GIPS Standards Question & Answer \(Q&A\) database](#). After educating themselves about the GIPS standards, awareness sessions were conducted within the firm. The involved departments, including investment management, compliance, risk management, information technology, sales and marketing, and customer care were briefed on the concepts of the GIPS standards and the benefits of compliance.

#### Step 2: Analyze the Firm's Ability to Comply

Because NGCIC was the first firm to implement GIPS compliance in EmergingLand, accessing third-party resources trained in GIPS compliance was a significant challenge. This challenge was overcome by developing internal expertise in the GIPS standards. Two in-house teams were established—a GIPS Implementation Team and a GIPS Technical Team. Both teams included senior staff resources, as well as staff members who were CFA charterholders or CIPM certificants or were candidates in the CFA or CIPM Programs. Terms of Reference for the teams were prepared, showing how to go about the implementation of the GIPS standards. Brief highlights of the Terms of Reference are as follows:

- i. The GIPS Implementation Team is responsible for the successful implementation of the GIPS standards. The following departments are represented on the Implementation Team:
  - a) Investment management
  - b) Compliance
  - c) Risk management
  - d) Information technology
  - e) Sales and marketing
  - f) Customer care

The chief compliance officer is the project leader.

- ii. The GIPS Technical Team is responsible for providing oversight and support for ongoing GIPS compliance. This includes review of new guidance statements and updates to the GIPS standards and determining their impact on NGCIC's policies and procedures. The GIPS Technical Team is to be approached internally for interpretation and guidance on any GIPS developments.

The NGCIC GIPS Implementation Team examined what was needed to comply with the GIPS standards. A gap analysis was carried out to identify the differences between the firm's current policies and processes and those required or recommended by the GIPS standards. Comprehensive questionnaires were prepared by the GIPS Implementation Team for the firm's departments that would be involved in achieving and maintaining compliance with the GIPS standards. These questionnaires focused on compliance with some of the key fundamental concepts and issues of the GIPS standards, such as the following:

- a) Time-weighted rate of return
- b) Treatment of external cash flows
- c) Fair valuation and frequency of valuation
- d) Trade date accounting and use of accrual accounting
- e) Treatment of fees and expenses
- f) Treatment of hedge fund share classes

The assessment of the results of the gap analysis focused on the following:

- a) Are returns being calculated in accordance with the requirements of the GIPS standards?
- b) Are all significant and large external cash flows accounted for?
- c) Are actual trading expenses used in the calculations of returns?
- d) Should performance be presented net of fees and/or gross of fees, and should actual management fees be used to calculate net-of-fees returns?

### Step 3: Build the Infrastructure to Comply

The definitions of important terms, such as the firm, discretion, and composites, were first put in place.

The policies and procedures required to establish and maintain compliance with the GIPS standards were then formulated. These were documented in the firm's "GIPS Policy Framework and Guidelines" document. This policies and procedures document, which generally followed the structure of the GIPS standards, was divided into the following sections:

- a) Fundamentals of compliance
- b) Compilation of data
- c) Calculation methodology
- d) Construction and maintenance of composites based on defined criteria
- e) Disclosures in GIPS-compliant presentations
- f) Presentation and reporting, including the creation of GIPS-compliant presentations
- g) Steps taken to ensure continued compliance with the GIPS standards, including external verification

Policies and procedures also referenced the functions of the relevant departments that would be required to assist with implementation.

Finally, composites were created. The NGCIC firm included funds, separately managed portfolios, and investment plans. It was necessary to ensure that the mandate for all vehicle types were fully understood so that portfolios could be assigned to the correct composite. It was decided that the vehicle type had no impact on the management of the portfolios. For example, the Liquidity Composite included two portfolios with the same liquidity investment mandate: one money market mutual fund and one separately managed portfolio.

## Step 4: Implement the Requirements

NGCIC then began implementing the requirements by taking the following actions.

- i. Preparation and Availability of Compliant Presentations  
A compliant presentation for each composite was prepared in line with the requirements of the GIPS standards. A mechanism was put in place to ensure the availability of compliant presentations, both in physical and electronic form.
- ii. Training/Awareness Sessions  
Training/awareness sessions were carried out.
  - a) As a first step toward implementation of the GIPS standards, introductory sessions were carried out with heads of relevant departments to get their buy in. Their feedback was obtained and incorporated into the GIPS policies and procedures, as appropriate.
  - b) The next step was the preparation of frequently asked questions (FAQs) so the customer care unit (CCU) could educate clients and deal with their questions related to the GIPS standards. This was very important because of low awareness of the GIPS standards among the investing public.
  - c) Training/awareness sessions were carried out for each department, including sales and marketing and CCU. This was done separately for each department so the presentation could be focused on the specific needs and concerns of each department.
- iii. Promoting GIPS Compliance  
All one-on-one marketing materials were updated to include GIPS compliant presentations. NGCIC decided to claim compliance with the GIPS standards in all of its advertisements. Advertising materials—those meant for broad distribution rather than one-on-one delivery—and the company's website were brought into compliance with the GIPS Advertising Guidelines. (These guidelines are available in the [GIPS standards](#) and the [GIPS Handbook](#).) Clients were informed about GIPS compliance through an introductory letter and email.
- iv. Verification through Third Party  
Because NGCIC was the first firm in EmergingLand to claim compliance with the GIPS standards, NGCIC decided to obtain verification from a reputable verification firm. One of the major accounting firms expressed interest in doing the verification work. Because there was no local expertise, the accounting firm's regional office agreed to bring in the necessary expertise. NGCIC worked closely with the verifier in providing all necessary documents. Announcements were made in business newspapers once the verification report was issued.

## Step 5: Stay Up To Date with Current Development

The GIPS Technical Team, which has the task of staying up to date with the GIPS standards, performs the following tasks on a regular basis.

- a) Checks the GIPS website for updates to the GIPS standards.
- b) Subscribes to the GIPS newsletter and disseminates relevant information to the appropriate areas of the firm.
- c) Attends GIPS workshops and webinars and/or reviews presentations on the GIPS website.
- d) Works closely with the GIPS country sponsor and provides comments on proposed guidance and provisions.

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