

CFA Institute
Centre for Financial Market Integrity
Reference: Global Investment Performance
Standards
P.O. Box 3668
Charlottesville, Virginia 22903

London, 30 June 2009

Comments on the GIPS Exposure Draft 2010

Dear Sirs,

We refer to your invitation to comment on the Exposure Draft of the 2010 Global Investment Performance Standards of January 2009 and would like to thank you very much for the opportunity to present our views as well as all the hard work put into producing the draft.

The remarks below, regarding both content and form, follow the chronology of the Exposure Draft. Thereby, we also address the specific questions asked. This document represents the global response of Ernst & Young to the 2010 GIPS and has been approved by all relevant local practices delivering GIPS verification services to our clients on a global basis.

At an overall level, we are supportive of the draft and believe it achieves the objectives set out by the GIPS Executive Committee. That said, our response notes some areas of specific concern in relation to the detailed guidance and sets out an alternative approach in relation to the valuation guidance set forth. While the sentiment behind Appendix D is entirely noble, such an approach is not yet workable at a practical level and risks enticing more questions than it answers.

Please do not hesitate to contact us should you need additional information.

Yours sincerely,

Matt Price and Susanne Klemm

For and on behalf of Ernst & Young's global GIPS
practice

General remark regarding the exposure draft:

Please check the consistent use of “return” and “performance” throughout the whole document.

Effective Dates

The statements referring to the effective date in chapters 6 and 7 are not fully consistent with the statement here.

Summary of Proposed Revisions to the GIPS Standards:

Please explain in the glossary the term of “seed” money when referring to “proprietary assets”.

0. Fundamentals of Compliance

O.A.6: We note that the list of firm policies and procedures listed under Section III Verification, B. d. has been deleted. We believe it is useful to continue to maintain a suggested list of policies and procedures, at least as an interpretation or in an updated Guidance Statement.

O.A.7: We suggest to delete “applicable”, so the provision would become “once a firm has met the requirements of the GIPS standards”.

We agree to the inclusion of a disclosure of the firm’s verification status within the claim of compliance. However, the second option (“firms that have been verified, but are not currently verified”) is confusing and does not give any additional information if the verified period / the dates are disclosed. We therefore propose to delete the second option “not currently verified” (and as a consequence also propose to delete the definition of ‘a current verification’).

We would like a firm to have only two options: state the verified period or state that the FIRM has not been independently verified.

Since firms are required to disclose annual performance, our opinion is that a verification should be considered “current”, if the verification report covers a period ending not more than 12 months ago (e.g., if the verification report covers the period of Jan 2008 - Dec 2008, the verification should be considered “current” until Dec. 2009, not Dec. 2010). We think that considering “current” a period ending not more than 24 months ago could be misleading.

We believe that language should be added to the compliance statement indicating what verification was designed to accomplish. This could include using the wording in the current Section III A.1, which would facilitate a framework in which the name of the verifier could also be disclosed at the discretion of the firm and the verifier (something we believe is of value to the users of verification reports). In addition, we believe consideration should be given to requiring that a verification opinion be provided to potential clients as the opinion generally contains much detailed language around the purpose and use of verification.

Do you agree with including disclosure of the firm’s verification status in the claim of compliance? We agree.

Do you agree with the classification of a current verification being within the last 24 months? We do not agree (see above explanation).

O.A.8: We suggest to delete “all applicable” for consistency with O.A.6.

We suggest that further guidance and interpretation be added on the concept of materiality, which should be done in the form of practical application principles to example scenarios rather than specifying quantitative benchmarks. We suggest that the concept be defined in the glossary or guidance statement and be stated in upper case (e.g. 'MATERIAL').

O.A.9: Please include a definition in the glossary of what constitutes a “performance presentation”

O.A.12: To avoid confusing the intention behind this statement (about whether there should be a list of Composites **AND** of descriptions, we propose it be amended to say the following:

“FIRMS MUST provide a complete list including a DESCRIPTION of the FIRM'S COMPOSITES to any existing or PROSPECTIVE CLIENT that makes such a request.”

O.A.15: We suggest to delete the word “applicable” for consistency with O.A.6.

O.A. 17: The scope of this provision is not clear. Where should firm's not present performance or performance related information that is false or misleading: In a GIPS compliant composite report? In any performance related document? In their advertising?

Once the scope is defined, please add 'knowingly or deliberately' before 'present' and add 'materially' before 'false' in the wording of article O.A. 7. Otherwise if a firm detects an error in the presentation, the firm doesn't meet this REQUIREMENT as currently drafted and would therefore not be compliant with the GIPS standards.

O.B.2: This recommendation clearly reaches out of the current scope of the GIPS standards where composite reports are aimed at prospective clients. We question both the practicability and value of this recommendation.

We would further like to know if this recommendation is fulfilled if the Composite reports are published on the firm's homepage? We propose that there be a Q&A clarification on this.

O.B.3: Is it really necessary to have a recommendation to comply with recommendations? This should be set out in the preamble and not in the main body.

O.B.4: FIRMS SHOULD be verified: We would add “at least once annually”.

1. Input Data

Do you agree with the change from market value to fair value?

It is recognized that Fair Value is a fundamental principle applied in International Financial Reporting Standards (IFRS). ERNST & YOUNG accepts the use of “Fair Value” as a more recent and appropriate proxy for “Market Value” but in doing so we advance the following notes of caution:

- Despite being enshrined within IFRS, GIPS 2010 ought to recognize (and does not based on what is drafted in appendix D) that IFRS is not widely adopted in Asia, the US and nor is it comprehensively applied by investment funds in Europe, since the EU regulation to mandate the use of IFRS applied only to “listed companies” (which some funds there are many that are not). Globally, there will be substantial application of local Generally Accepted Accounting Principles ('GAAP') for the foreseeable future despite the presence of

many global convergence initiatives. While UK GAAP is well known to have very few material divergences with IFRS, this is not fully the case with the US and certainly not the case with Asia.

- The financial market crisis is forcing some not inconsiderable rethinking of both the validity and breadth of the application of fair value in accounting practice under such banners as “how fair is fair value?” While the Fair Value concept looks set to withstand this, GIPS 2010 needs to reflect that the long envisaged endgame of universal endorsement of Fair Value is, at this point in time, much less of a ‘fait accompli’

Accordingly, we propose that (in a similar fashion to the provisions on allocating benchmarks to composites), Firms should be required to apply fair value principles to their portfolio accounting but where they do not are required to disclose and justify such actions.

We expect there to be two primary ‘valid cases’ for non-application:

1. Where fair value principles are not required to be applied in the GAAP mandated by the legally binding constitution of a fund
2. Where fair value principles are applicable but not followed because the fair value cannot be reliably determined.

Ernst & Young believes it is important that the 2010 GIPS recognizes and allows for this practical reality.

1.A.3: The wording may cause the reader to think that he/she can choose which method to use. We suggest that (b) should read: “At least on the date of all LARGE CASH FLOWS”. We would combine a) and c) to say “no more frequently than required by the Composite specific valuation policy, but at least monthly”.

1.A.4: We propose to add a sentence or give further guidance that either closing or intraday prices are allowed (provided the data is considered to be reliable according to the firm’s valuation process) plus a further sentence that yesterday’s closing prices in the local markets are also allowed. The latter point is needed to satisfy the concept at a practical level, and the former suggestion allows firms to apply more consistent pricing points among constituents of their composites.

Frequency of updating valuations: In the planned alternative assets guidance statement, guidance should be given for certain types of alternative funds where valuations may be quite old, i.e., at the end of December, the valuation may be effectively the one of October or November. Do such portfolios need to be revalued once the final prices as of end of December are known? If this cannot be achieved in the guidance statement, we recommend clarifying these aspects in the form of Q&A.

1.B.1: It should not be a recommendation to obtain FAIR VALUES from a qualified independent external third party, since it is not always appropriate to do so. There is already a wealth of industry level and accounting standards on such matters and we believe GIPS should steer clear of prescribing on parts of the existential guidance.

1.B.3: We suggest amending this provision to include performance fees also.

2. Calculation Methodology

2.A.4. We would favor the inclusion of this text in the TOTAL RETURN Definition of the Glossary.

3. Composite construction

Do you agree with requiring the inclusion of non-fee paying discretionary portfolios in composites?

Yes, we agree provided the notion of non-fee paying portfolio is clearly defined.

Do you agree with changing 3.A.9 from a recommendation to a requirement?No, we don't agree.

3.A.9: We object to upgrading this recommendation to a requirement. The firm is not obliged to and seldom will have the knowledge of the prospective client's assets to invest, so it is also unworkable at a practical level. This should stay a recommendation as previously 3.B.3. "Firms should present the appropriate composite to a prospective client." Furthermore, if the minimum size is disclosed, the prospective client has all necessary information.

4. Disclosure

Should firms be allowed to remove certain disclosures after a defined period of time? Yes, but only those disclosures which will not impact the decision of (i.e. not considered material to) a prospective client. We believe that materiality or significance to the investor, rather than timeframe must remain the paramount factor.

If so, which disclosures would be eligible for removal and after what period of time?

- Removal after 5 years: 4.A.21, 4.A. 22. 4. A. 23. (name changes)
- Removal after 1 year: 4.A. 28 (errors corrected)

4.A.2: FIRMS MUST disclose the availability of a complete list and ~~description~~ DESCRIPTION of the FIRM'S COMPOSITES.

Please refer to our response to OA12.

Do you agree with the inclusion of short positions in provision 4.A.5? Yes, but additional defining guidance and sample disclosures are needed, either through the glossary or alternative investments guidance statement.

4.A.5: We agree with the inclusion of short positions in provision 4.A.5. Nevertheless additional guidance should be given perhaps through the glossary. As already mentioned, the concept of materiality should be explained.

4.A.8: See earlier comment on materiality. We question the feasibility of this provision for larger firms using many different valuation sources unless more guidance is given here.

4.A.16: When would it be allowed to use model investment management fees? Additional guidance is necessary for model fees. Is this intended to be for the inclusion of "non fee paying portfolios?"

Furthermore, we question the need of c). Performance fees are by definition (see Glossary) part of management fees so the statement is contradictory and should be removed.

4.A.17: We believe that firms should be required to disclose their performance calculation method.

Do you agree with requiring the disclosure of key characteristics and risks in the composite description? Yes, but we would combine or put closely together the articles 4.A.5 and 4.A.20. Both refer to a description of the strategy and risk and the provision should be more specific with the term 'risks'. A glossary definition would help here.

4.A.25: We would suggest "valuations of PORTFOLIO HOLDING...."

4.A.28: "MATERIAL" : needs to be defined elsewhere, e.g. in the Glossary

Do you agree with the inclusion of a standard deviation disclosure? NO, we do not support requiring firms to present the standard deviation of the composite and benchmark because this specific risk measure is not adequate for all types of investment products. Instead, the disclosure of an appropriate risk measure should be required.

We support the required inclusion of a measure of risk in all composite reporting, and suggest the provision be amended to allow them to "or present a more appropriate risk measure covering an equivalent period"

4.A.29: At a minimum, the calculation needs to be explained in an example and the formula to be given in the glossary or an interpretation. But we question the suitability for all investment products. The question of what risk measures, if any, need to be presented for a new composite, before it has a three year track record should also be addressed?

For consistency purposes this should be linked to 5.A.1

4.B.2: We cannot see the difference here with the required disclosure under 4.A.17 and the inconsistency should be addressed by removing this recommendation.

4.B.3: In our opinion, benchmark descriptions should be made mandatory (see also for consistency 7.A. 15 and Advertising Guidelines, point 7). Therefore, we suggest upgrading the first part of 4.B.3 into a requirement in section 4.A ("FIRMS MUST disclose the description of the BENCHMARK.") and leaving the rest of 4.B.3 as a recommendation ("FIRMS SHOULD disclose material differences between the BENCHMARK and COMPOSITE strategy.").

5. Presentation and Reporting

5.A.1.b: The wording should be changed to “FIRMS MUST present returns from the COMPOSITE inception through the initial period-end.” This is because not all composites are presented on a year-end basis.

Is it appropriate to discontinue disclosure 5.A.5 for periods after 1 January 2011? Yes.

5.A.6 c: We propose amending the wording as follows in order to be consistent with our comment regarding 4.b.3. It should be mandatory to give a description of benchmark / benchmark components.

“.....disclose the BENCHMARK components and the BENCHMARK creation and re-balancing process.”

5.A.7: The term “non-fee paying portfolio” should be defined in the Glossary including examples.

Do you agree with the requirement to present the percentage of the composite assets composed of proprietary assets? We do not think that this is absolutely necessary.

5.A.8: Our impression is that this information may be interesting but should not be absolutely mandatory. Please include also “seed money” in the Glossary.

5.B.6: We believe this should be amended to say “.....AT LEAST quarterly”

5.B.7: Similarly to 4.A.29, we recommend to also permit the use of other adequate risk indicators in cases where the standard deviation is not appropriate.

6. Real Estate

“If a PORTFOLIO includes a mix of REAL ESTATE and other investments that are not REAL ESTATE, then these... must apply if the majority of...”

We agree to this limitation of the scope of this section. However, the wording ‘majority’ needs more clarification. Is it more than 50% direct real estate assets as of certain date or the during the period according to the applicable GIPS valuation principles?

We propose to include the requirement that real estate portfolios (i.e. where the majority of the assets are direct real estate) must not be included in composites with non-real estate portfolios. This would then define the current use of ‘REAL ESTATE COMPOSITE’ as for example used in 6.A.8.

Further, it should be clarified that for Investment types not considered as REAL ESTATE as mentioned, such as publicly listed real estate investment funds, whether the valuation requirements apply to these assets in addition to Chapter 1 of the GIPS.

Do you agree that real estate investments must be valued by an independent external appraiser every 12 months beginning 1 January 2012?Yes.

Do you agree with the additional requirements and recommendations for closed-end real estate funds as defined?
Yes.

6.A.7: We do not agree with the proposed requirement that composites for closed-end real estate funds must be defined by vintage year, unless it is necessary to provide a fair comparison of returns.

6.A.8: The definition of REAL ESTATE COMPOSITE must be given somewhere (see comment to the introduction of this section).

6.A.8 c: Why would there be a difference between the valuation used in performance reporting and the valuation used in financial reporting? We would think that these two should be the same, but if they are not in practice then there should be a REQUIREMENT to apply the external valuation (provided it represents the fair value of the Real Estate assets) in performance reporting from 1.1.12. Otherwise it begs the question why there is a requirement to have one?

6.A.8 d: Does this provision replace provision 5.A.1.d?

6.A.8 e: Does this refer to the fair value of composite assets at year end or for the annual period?

Do you agree that component returns must be disclosed, and that the method described in provision 6.A.9.b will no longer be acceptable for periods beginning after 1 January 2011?Yes.

6.B.5 : It should be a requirement to present a benchmark and, when available, the component returns should be also presented. In this case, the method of calculation of component returns should be disclosed.

7. Private Equity

The statement with respect to the effective date (“results for periods after 31.12.2010”) is different from the one in the top page of the Exposure Draft and should be changed for consistency.

We would like to suggest a statement limiting the scope of this section – in a similar way as for Real Estate since the same point of principle is in evidence:

If a PORTFOLIO includes a mix of Private Equity and other investments that are not Private Equity, then these REQUIREMENTS and RECOMMENDATIONS MUST apply if the majority of the FAIR VALUE of PORTFOLIO investments are in Private Equity.

7.A.5, 7.A. 7 and 7.A. 9 and 7.A. 21: There should be clarifying guidance on how to deal with these and other provisions in the context of fund-of-fund structures and how they should be compared to directly investing PE composites.

7.A.8: Direct investments may be made as co-investments with funds and be a part of the same investment product and composite. In our opinion, this requirement should be deleted.

Old Art. 7.A.14 on the firm’s documentation of valuation review procedures : has been deleted and should be reintroduced.

Old Art. 7.A.15: On the disclosure of the definition of the composite investment strategy should be reintroduced here.

8. Wrap Fees

Is it appropriate and/or necessary to include provision 8.A.6, which addresses presenting performance to existing clients, in the GIPS standards?

Should firms be allowed to present a “sponsor-specific composite” as opposed to a “style-specific composite”?

We do not think that firms should be allowed to do so. Sponsor specific composite can wash together different investment styles and it is not consistent with the composite current definition “Aggregation of individual PORTFOLIOS managed according to a similar investment mandate, objective, or strategy

III. Verification

In the paragraphs prior to section III A., we believe that language should be added to describe what verification is designed to do and what it is not designed to do. For example, it may be useful to explicitly state that verification is not designed to detect fraud. Such language will help to bridge the expectation gap between the verifier and the user of the verification report.

Scope and Purpose:

1. “Verification must be performed by a qualified independent third-party. There should be a definition of “Qualified” or at the very least specification of aspects that would be considered relevant so that buyers of verification services can make informed judgments.

7. The distinction between “verifier” and the “VERIFICATION firm” should be clarified.

Should specific verification procedures be included for GIPS provisions 0.A.16 and 0.A.17: Yes. We believe there is inconsistency in the approaches taken by verifiers and that users as well as providers of verification services would welcome specificity in this area. Perhaps it should however be delivered as a separate guidance statement?

B. Required GIPS Verification Procedures

1.d. The list of policies and procedures should not be deleted or reference should be made to the Guidance Statement on Verification where the list of policies and procedures should be introduced.

2. b.i and vi: The meaning of these two provisions is very close (“defined and maintained composites” vs. “policies... consistently applied”). They could be combined or written more precisely to show the difference of the provisions, if that is intended.

2. c: We would propose “mandate” or “investment management agreement” instead of “account’s advisory agreement”, this might be difficult to understand since “advisory only” portfolios are not part of the firm.

2.d. iii Explain PORTFOLIO SUMMARY in the Glossary

2.d.v. On a sample basis - and for consistency with the other articles above and below - it is not possible to test if **all** portfolios sharing the same investment guidelines are included in the same COMPOSITE. This should read “portfolios sharing...”. Delete “all”.

2.e “Data review” should include “The market index data used by the FIRM for calculation of the BENCHMARK performance data to ensure that it is consistent with the BENCHMARK definition and applied correctly”.

2. f : ii. “all required numerical data” is too strong. Delete “all.”

B. 2 i: The representation letter should also confirm, that the firm complies with the GIPS standards and the local laws and regulations for the period verified”.

Advertising Guidelines

Last paragraph of the introduction “FIRMS may include other information”: We would reintroduce the reference to supplemental and/or additional information as worded previously.

We would propose to re-introduce in the Guidelines the actual version’s “examples” and “presentation tables” which are not shown here.

7. Here the Advertising Guidelines ask for the description of the Total Return for the Benchmark and a description of that benchmark to be provided. We favor this provision, but this is not consistent with recommendation 4.B.3, *recommending* to disclose the benchmark description. We advocate a mandatory description/disclosure in section 4 as well (see our comment there).

We would add a sentence that advertising is not subject to independent verification and it is the ultimate responsibility of the firm claiming compliance to ensure that it abides by the GIPS standards each time a compliance claim is made in an advertisement.

Appendix D: GIPS Valuation Guidelines

“Do you agree with the requirements and recommendations in the GIPS Valuation Principles below?”

No. The GIPS Valuation Principles in Appendix D in their current form will create far more problems than they are intending to solve and impinge on the general credibility of the GIPS Standards if released without amendment. The current climate only serves to raise the stakes involved in getting this area of the guidance right. The principal concerns of Ernst & Young are as follows:

- The guidance is too detailed and more complicated than necessary. This breaches our central claim, which must remain sacred, that GIPS is not a prescriptive standard. In addition to accounting standards, GIPS already contains (via the VC, RE and AI guidance statements) plenty of guidance on ‘hard to value assets’. The extensive prescription listed in Appendix D almost seems to imply that challenging valuations requiring hierarchies and “observable inputs” are the base case when it is patently not so for the vast majority of compliant (and aspiring to be compliant) Firms.
- This area of guidance raises the conceptual issue of how the GIPS Standards should interact with parallel standards of best practice, such as accounting standards or the International Private Equity Valuation Committee (IPEVC) guidance. Ernst & Young believes the approach of including certain provisions on a selective basis creates a number of practical problems and these should be avoided by interlocking rather than overlapping with the existing guidance from the expert bodies in those disciplines.
- As indicated above, the proposed provisions (and some of the guidance in the alternative investments guidance statement) draw from the patchwork quilt of global and national accounting standards on a selective basis without considering the extent to which they are applied and required on a global basis. While great strides have been achieved, a performance standard which assumes universal application of IFRS in portfolio accounting is being unrealistic.

The result will be considerable confusion, not only across the large parts of the world where such concepts remain in their infancy and are not well recognized by prospective clients but even within Europe where IFRS is not applied to many investment funds. The help desk would need to recruit considerable accounting and valuation expertise to handle this, and we believe this is best avoided from the start by cross referring the detailed guidance and leaving queries over its merits and application to the accounting standards boards that conceived them.

Leaving aside the points about prescription and interaction, there should be enough clarity by 2015 to conclude whether the concepts will be recognizable to the vast majority of the GIPS compliance constituency and for this reason it might be a useful input to that draft, or preferably to a full guidance statement on the topic. Currently, this fundamental 'recognition' test is not satisfied and makes the guidance unworkable.

Assuming (quite correctly in our view) that the degree of prescription and interaction with parallel guidance matters, we propose that Appendix D of 2010 GIPS be redrafted along the lines of the enclosed Appendix One to this letter. This proposal reduces the level of detail and complexity, transfers responsibility for the principles required back to the accounting standards boards who have written them already and presents a realistic framework to take account of the 'work in progress' that is the global convergence of accounting standards.

Finally, in creating the proposed redraft of Appendix D (below) we point the way to a possible removal of this section in its entirety, bringing the relevant principles (which are not many) into the main body of the Standards. In doing so, we do not reject the notion that there is considerable clamor for additional clarifying guidance on valuation, which has increased considerably as a result of the financial crisis. However, we believe the production of an "Accounting and Valuation" guidance statement between the 2010 and 2015 versions of GIPS (at a time when global accounting standards convergence will be substantially completed) represents a far better solution as opposed to over burdening the 2010 draft with a form and content of prescriptions that in some cases run contrary to the founding principles which have made GIPS such a successful global standard.

Requirements specific to Real Estate

1. Among the institutions listed, the International Valuation Standards (IVS) should be listed first, before the other bodies

9. Recommendation on rotation to be deleted. Or we propose the following wording: It is recommended that external appraisal firms are to be reviewed and rotated on a regular basis.

Glossary

BENCHMARK: "Total return" benchmark needs to be specified to be consistent with 5.A.6, otherwise price indices may be presented. This wording would also be consistent with Advertising Guidance, point 7.

COMPLIANT PRESENTATION: A presentation for a COMPOSITE that contains all information and *disclosures* required by the GIPS standards... (we suggest to add wording in italics).

COMPOSITE DESCRIPTION: Guidance and examples are needed to supplement this revised definition.

DISPERSION: We propose to include that only portfolios that have been managed for the full annual period are to be included in the dispersion calculation.

LARGE CASH FLOW: The level at which the FIRM determines that a client directed EXTERNAL CASH FLOW may distort performance *if an approximate calculation method is used.*

PROSPECTIVE CLIENT: We would like to stress that it is up to the firm to define the term of prospective client.

For the purpose of this definition we propose to define prospective client as:

Any person or entity that, based on the best available information at the time, qualifies to invest in a COMPOSITE strategy (e.g. is known to have assets above the COMPOSITE minimum asset level) and has expressed interest in one of the FIRM's strategies.

We would like to raise the question of a "past prospective client": If a firm identifies a person or entity as a PROSPECTIVE CLIENT and presents a COMPLIANT PRESENTATION to him/her, but then, the prospect walks away and never becomes an actual client, does the firm then still have to regard the prospect as a PROSPECTIVE CLIENT? We think he/she is not a PROSPECTIVE CLIENT because he/she did not buy the firm's product. This person may be a PROSPECTIVE CLIENT again when he/she comes back to the firm expressing an interest to the firm's strategy.

STANDARD DEVIATION: Is it appropriate to define the term only to mean dispersion of returns?

TOTAL RETURN: We would favor the inclusion of the definition of a total return benchmark.

VERIFICATION: Not "a verifier," but "an independent verifier."

The Guidance Statements on GIPS Verification and Verifier Independence should be referred to for more information and guidance.

WRAP FEE: Here, WRAP FEE is defined as a type of BUNDLED FEE, but throughout the Section II.8, the same term represents a particular investment product. This could be perceived to be confusing.

Appendix One – Specific comments and proposed amendments to GIPS valuation guidance and relevant provisions

Main body of GIPS

1A2

To be technically correct, this should say “.....PORTFOLIOS MUST be based on FAIR VALUE accounting principles [in accordance with the GIPS valuation principles in appendix D”]

1B1

This recommendation is a moot point. According to accounting standards which have adopted the principles of FAIR VALUE, obtaining them from a “qualified independent external third party” is often not possible for perfectly normal reasons. In fact, it is only in Real Estate that this is considered to be the standard approach. This provision should therefore be a requirement of the main Real Estate guidance only and not part of section 1 of the main GIPS.

Overall, we believe that the question of the most relevant valuation source for a given asset class is not matter GIPS can easily prescribe on, and perhaps nor should we attempt to do so. There is considerable coverage of this topic by both accounting and trade body best practice standards (HFWG, IPEVC, RICS etc) which should be cross referred to rather than partially replicated.

1A5, 1A6, 1B2 and 1B3

All of these provisions could be covered by a single requirement stipulating that “Portfolio accounting for assets (including investments), liabilities, income and expenses must follow the accruals basis”. This principle is already well entrenched in accounting standards throughout the world and to a far greater extent than the concept of using FAIR VALUE”

Section 4A – Additional provisions

I. Given the comments we have made about the non universal application of FAIR VALUE, and to a lesser extent, ACCRUAL ACCOUNTING, we propose the inclusion of the following requirement:

“Where the accounting policies of PORTFOLIOS are contrary to or in conflict with the accounting principles of FAIR VALUE and the ACCRUALS BASIS, the composite report should disclose the nature, extent and justification for such departures.”

II The 4B2 recommendation is an important provision that we believe should be given greater prominence in light of both the financial market turmoil and the general trend towards greater complexity in investment products. It also needs to be linked to the specific guidance already given in GIPS covering most types of investment that are “hard to value”. Suggest that section 4A include the following as a draft provision:

“Where investment valuations are not based on quoted or published prices and do not fall within the scope of sections 6 or 7 of the GIPS Standards, Firms should disclose how they determine the FAIR VALUE of such investments in accordance with applicable accounting standards”.

III Linking to Appendix D4 (as per the Exposure Draft):

“Where changes in the policies, procedures and methodologies used to value portfolio investments have occurred that are material to the composite performance record, the nature and extent of such changes MUST be disclosed in the composite report as well as the date such changes became effective”

GIPS 2010 Appendix D

Paragraph 2 of the introduction is a concern. Large parts of the world will not be applying IFRS for the first time before 2011 and this will not necessarily apply to investment funds, even in Europe where IFRS is perhaps most well entrenched. We suggest this paragraph be removed because the following proposal for the provisions of Appendix D is an alternative to ‘cutting and pasting’ selected provisions from IFRS and US GAAP on the grounds that GIPS should not proscribe detailed accounting guidance.

The definition of FAIR VALUE is appropriate.

Below is a suggestion of how the provisions could be simplified, condensed and linked into the relevant underlying accounting guidance.

1. For periods beginning on or after 1 January 2011, PORTFOLIOS MUST be based on FAIR VALUE accounting principles (Provision 1A2). For the majority of portfolios, FAIR VALUE will be determined with reference to observable quoted market prices. If such inputs do not exist for the purposes of valuing PORTFOLIO investments, the Firm should follow the guidance on how FAIR VALUE should be determined contained within the accounting standards (commonly known as Generally Accepted Accounting Principles (‘GAAP’)) applicable to the portfolio.
2. In accordance with provisions OA16 and 4A9, Firms must comply with all applicable laws and regulations concerning portfolio accounting and investment valuation. Where such rules differ from the requirements of the GIPS Standards, Firms must disclose the nature and extent of the departure.

(Designed to cover 2 and 3)

3. In accordance with OA6, FIRMS MUST document their valuation policies, procedures and methodologies. Material changes to how investments are valued MUST also be documented.
4. Provision D5 should be kept in its current form

Provisions 6 and 7 are covered by the cross reference to “applicable accounting standards” which for a very large number of investment funds might not be IFRS or US GAAP. It also sits better with the ‘compliance of with local law and regulations’ disclosure requirement. For example in large parts of Asia or even ‘Anglo Saxon model’ countries like Canada, portfolios are not legally allowed to follow the above standards and must follow local GAAP. To keep the current prescription could prevent Firms in these countries from becoming GIPS compliant.

Provisions 8 and 9 are picked up above in additional provisions II and III respectively suggested for section 4A. Provisions 10 and 11 are needlessly replicating guidance already spelled out in the main body. Comments on these are provided above.