

CFA Institute
CFA Centre for Financial Market Integrity
Reference: Guidance Statement on Verifier Independence
PO Box 3668
Charlottesville, Virginia 22903
United States of America

Dear Sir/Madam,

February 15, 2005

Proposed Guidance Statement on Verifier Independence

PricewaterhouseCoopers wishes to thank the CFA Institute for this opportunity to comment on the Proposed Guidance Statement on Verifier Independence. We welcome the efforts of the CFA Institute to continuously develop the GIPS standards and its commitment to fair representation and full disclosure.

Our comments are provided in the appendix attached to this letter. If you wish to discuss these points further, please contact Kelvin Laing-Williams in London at +44 (20) 7804 1707 or Peter McNamara in New York at (646) 471 8743.

Yours faithfully,

PricewaterhouseCoopers LLP

APPENDIX: PWC COMMENTS ON THE PROPOSED GUIDANCE STATEMENT ON VERIFIER INDEPENDENCE (THE “GUIDANCE STATEMENT”)

1. Do you agree with the principles established in the Guidance Statement? See comments below.
2. Are there other elements involved in verifier independence that are not included? See comments below.
3. Do you agree with the proposed Effective Date? Yes

General Comments

We support the idea of a Guidance Statement on verifier independence as many verifiers presently performing verifications are not subject to independence rules or they might be subject to significantly different rules based on jurisdiction. This Guidance Statement will help to ensure that the verifiers, GIPS compliant firms and their clients understand that sound practices regarding independence need to be adhered to by all and that independence is an important topic for all interested parties.

Generally, we believe that the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) and related Securities and Exchange Commission (“SEC”) rules governing auditor independence for public company clients and the American Institute of Certified Public Accountants (“AICPA”) independence rules for non-public company clients define very clearly and thoroughly the independence requirements and responsibilities of independent auditors in the United States.

The SEC has identified three basic principles that should guide the assessment of services performed by audit firms

- i. The auditor should not function in the role of management
- ii. The auditor should not be in a position of auditing his or her own work.
- iii. The auditor should not serve in an advocacy role for the client.

That being said, we believe this Guidance Statement should be applied to all parties that act as independent verifiers. More importantly, given the strict regulations governing auditor independence in the United States, we believe it is critical that guidance be adopted for non certified public accountants (“CPAs”) and consultants acting as verifiers.

While we agree that Guidance Statements in general provide a useful means for the Investment Performance Council (“IPC”) to oversee changes to GIPS, it appears that this Guidance Statement on Verifier Independence adds no significantly new guidance to existing rules and regulations that CPAs must already follow in the United States and certainly adds a bit of confusion. Additionally, this Guidance Statement only addresses the negative implications of utilizing an independent verifier that also provides other services

to an investment management firm; however, it fails to mention the benefits of such relationships.

We believe the following points need to be taken into consideration when assessing the principles established in the Guidance Statement:

1. The Guidance Statement refers to Independence throughout as “conflicts of interest”. Independence generally is understood to refer to a mental state of objectivity and lack of bias. Conflict of interest has connotations that something is amiss, not right. The fact that the investment manager pays the fees of the independent verifier may be viewed inherently a “conflict” but the verification firm can still be “independent” in fact and appearance and can still perform the verification service. The use of the words “conflict of interest” provides a negative tone to the Guidance Statement.
2. The Guidance Statement as it is written appears to be biased against the large accounting firms since they are more likely to provide additional services to investment management clients.
3. The Guidance Statement states that most verification firms “provide additional products and services” to an investment manager. As a result of Sarbanes-Oxley and the SEC rules governing auditor independence, many audit firms which audit the financial statements of companies are also providing “audit and non-audit services” to clients. In most cases, these “audit related services” have been pre-approved by a Company’s Audit Committee and do not represent an independence issue. In many cases, the firm providing these additional services is the most independent qualified firm. They have no financial or non-financial relationships with the client. For example, because of an audit relationships with a client, a CPA Firm cannot have any mutual or conflicting interests with that client, including any financial relationships (for example, financing, investment advisory, insurance arrangements or personal investments).
4. Independent auditors cannot act in the capacity as management or as an advocate for management due to our professional guidelines. All GIPS verifiers should be governed by the same requirements on independence.
5. The Guiding Principles section should mention that Independence is the responsibility of both the Verifier and the investment management firm being verified.

Specific Comments

Introduction, Page 3, first paragraph

Penultimate sentence states “Although most verification firms provide additional products and services that an investment management firm may utilize, a verification firm must strive to create its own policies and procedures that maintain its independence within the

parent organization and, more importantly, manage the potential conflicts of interest and disclose them to all prospective verification clients.”

In the United States, this is already being done for most audit relationships.

If an investment management client hires a verification firm to perform an attestation of their claim of compliance with GIPS, typically, this service and fee are recognized as an “audit related service” which would require pre-approval by the client’s audit committee.

If prospective client hires a verification firm with no existing relationship to the client, the verification firm is required to be “Independent” in fact and appearance with the client and would be required to follow their internal quality procedures on independence to ensure compliance with SEC and/or AICPA rules and regulations.

We believe that verification firms should share with their prospective verification clients a summary of the Quality Controls and Procedures in place to monitor Independence.

Introduction: Page 3, Second paragraph

“We suggest that both verification and investment management firms view independence as a continuum. At one extreme is a verifier who provides no other service to their verification client. At the other extreme is a verifier who provides a wide range of other services which might be perceived as creating a conflict of interest with regard to verification services.”

We believe that this view is extremely biased towards the larger accounting firms and is very self promoting for smaller firms who only perform verifications. The way this is written would suggest that the issue of independence is black and white which it is not. We suggest that this sentence be re-written.

Introduction, Page 3, second paragraph

“If a prospective client of an investment management firm places reliance on a verification report, would the prospective client’s perception of the value of the verification report be changed if they knew about other services that the verifier provides to the investment management firm?”

The issue is not whether there are other services provided but whether the verifier can maintain his/her independence and objectivity in performing the verification. The tone of the above is very negative. One could argue that the only firm that should be providing these additional services is a firm that is truly independent, not a firm that has no relationship with the client.

Introduction, Page 3, last sentence

If a verifier provides other services to the verification client, the verifier should discuss with the verification client whether the verification client should include a disclosure in GIPS-compliant presentations which describes the other services performed by the verifier,

and/or offers to provide additional information about those services to its clients or prospective clients, upon request.

There are a few concerns with this statement:

1. This statement is very unclear. Who will offer to provide additional information about those services to the clients? The concern here is that the verifier discloses their relationships to a prospective client of the investment management firm and the prospective client would like some clarification. Who is going to provide the clarification to the client?
2. Prospective clients and clients of the investment management firm will have different interpretations of Independence and what it means. What happens if a prospective client determines that a verification firm, in their view, is not independent? We can imagine a situation where a potentially large prospective client is ready to walk away from the table because they do not understand the independent auditors relationships and the investment management firm asks the verifier to meet with the client to discuss with them their independence. One could argue that you are now acting in a capacity of management by trying to move the sales process forward or as an advocate for the client. The verifier should not be put in this position. The verifier should not be involved in sales and marketing or meeting with clients. Client may indirectly view it as an endorsement by the verifier. The better solution would be to have management disclose in the presentation the conclusions reached by management and/or audit committee on the assessment of the auditor's independence.
3. The verification is typically provided on an annual basis and generally the verifiers are not involved in the periodic updates to the performance reporting by the investment management firm. To disclose to prospective clients other services that are provided to the investment management firm could require much more of the verifier's involvement both on an annual basis and throughout the year. Not only could this result in increased costs of the verification but would most likely lead to misinterpretation and misunderstanding.

Guiding Principles, Page 4

First two bullets: This is good guidance and should be required for all GIPS consultants and verifiers. We note that this is nothing new for verifiers in the United States that hold themselves out as CPAs.

Fourth bullet: Makes reference to "the client". This should say "verification client".

The Assessment of Verifier Independence, Page 4

The Guidance Statement sets forth 4 steps that the verifier should address. Again, we believe that these rules should be applicable for all verifiers. We note that in the United

States nothing in these steps is more restrictive or broader than the current independence rules set forth by the SEC or AICPA that CPA firms must adhere to.

2. Can a verifier provide other non-performance related services to a verification client?

Page 5: Second Paragraph

Again, this is biased towards the large accounting firms and should be removed. This sentence the way it is written makes no sense. How can a client decide whether an “unknown” service is an independence issue if they don’t know what the service is?

4. Are there other issues a verifier should consider when determining their status with regards to independence? Page 6

The SEC and AICPA have very detailed rules surrounding personal and financial relationships with clients so nothing in 4 is new for verifiers in the United States that hold themselves out as CPAs. However, for non-CPAs, this is an area where independence concerns need to be well defined. (i.e., ownership of client stock, loans from clients, investment in client 401-K plans, etc.) We believe more guidance is needed in this area to clearly set forth expectations rather than categorizing them as “personal and financial relationships”. Consideration should also be given to referencing existing United States regulatory related guidance so all interested parties around the globe can have the opportunity to review this existing material.

Page 7 – Question 4

Please clarify who “we” is and please clarify who “client” is? One could interpret this to be the verifier providing this to a potential client.

Question 4 on Page 7

This answer seems to contradict the last bullet point on Step 1, page 5 that states “Providing templates and systems for performance calculation” might be an independence conflict. Please clarify.

This answer seems to contradict the third to last point on Step 3, page 6 that states “Preparing compliant presentations” might create an independence conflict.

Applications: Page 6.

One question that was not included that would have been very helpful is the following:

If a verifier discloses all relationships and services provided to their investment management client in the compliant presentation and a potential client takes exception to the verifier independence, what should be done and by whom? We believe this is a very important question and some guidance should be included in the Guidance Statement.