

Professional Standards and Advocacy  
Association for Investment Management and Research  
PO Box 3668  
Charlottesville, Virginia 22903  
United States of America  
Re: GIPS Guidance Statement

October 30, 2002

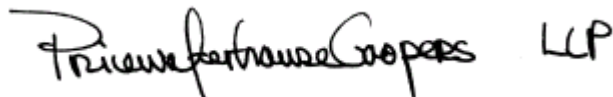
Dear Sir/Madam:

**Proposed Guidance Statement on Calculation Methodologies**

PricewaterhouseCoopers wishes to thank the Association for Investment Management and Research (AIMR) for this opportunity to comment on the Proposed Guidance Statement on Calculation Methodologies (Guidance) for GIPS®. We welcome the proposal by the Investment Performance Council (IPC) to clarify the various methodologies for calculating rates of return and asset weighting portfolio returns to calculate composite returns.

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,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP

## **Appendix: PwC Comments on the Proposed Guidance Statement on Calculation Methodologies**

We support the plans to provide clarification on the various methodologies for calculating rates of return and asset weighting portfolio returns to calculate composite returns. We have the following comments to make with respect to the draft guidance.

### **Principles in the guidance statement**

In general, we agree with the principles established in the Guidance Statement, which require the use of a time-weighted, total rate of return to calculate the performance of portfolios within a composite and the use of asset-weighted returns to calculate the performance of a composite.

However, given that the philosophy of the GIPS standards is to present performance returns that are as accurate as possible and that GIPS standards strive for uniformity in reporting so that results are directly comparable among investment advisors, we suggest that the Guidance Statement add comparability or uniformity in reporting as an objective.

Toward that end, we suggest that the Guidance Statement recommend firms to use a method that accounts for weighted cash flows, such as the beginning market value plus weighted cash flows method or the aggregate method, to calculate asset-weighted composite returns. We also suggest that the AIMR consider whether it is feasible to make this into a requirement in the future. Using a more uniform and accurate method to calculate asset-weighted composite returns will further the objectives of accuracy and comparability in performance return presentations.

In addition, to make the Guidance Statement more meaningful, AIMR may wish to consider if it should contain references to the adopted Guidance Statements on the treatment of significant cash flows, carve-outs, and proposed fees provision as it relates to rate of return calculation.

### **Rate of return and asset weighted composite calculation methodologies**

Page 3 – Standard 1.A.6 states that accrual accounting must be used for dividends beginning 1 January 2005.

Standard 1.A.6 requires the use of accrual accounting for dividends for periods beginning 1 January 2005. Due to potential differences in accounting conventions across jurisdictions, and the potential time lag in being informed about and therefore recording corporate actions, we recommend that firms also be required to disclose how dividend income is accrued beginning 1 January 2005.

## Appendix: PwC Comments on the Proposed Guidance Statement on Calculation Methodologies

Page 3 – A time weighted rate of return (TWRR), computed using a minimum of monthly valuations and adjusting for cash flows.

We recommend that the Guidance Statement clarify the monthly valuation period, i.e., whether the GIPS standards contemplate month-end valuation, or whether firms can use periods other than month-end (such as mid-month, last Friday of the month, etc.) to value their portfolios. In addition, we suggest that the Guidance Statement address whether firms are able to include portfolios with different valuation dates in the same composite, as well as the associated disclosure requirements. For example, a firm may manage both separate accounts and unitized funds, and may value the separate accounts on a month-end basis and the unitized funds on the last Friday of the month, which may not fall on month-end. As such, we propose that the Guidance Statement explicitly address whether these accounts may be included in the same composite, including any required disclosures.

Page 4 – Firms are permitted to include portfolios with different calculation methodologies in the same composite (provided the methodologies are permitted according the dates stated above). Firms must be consistent in the methodology used for each portfolio within the composite (e.g., firms cannot change the methodology from month-to-month depending on which methodology produces the highest return).

In general, we agree with the above two sentences, but we suggest that AIMR clarify the specific dates referred to in the first sentence. For example, the first sentence could be clarified to state that a firm can include in the same composite portfolios that are calculated using either the Original Dietz Method, time-weighted rates return that adjust for daily-weighted cash flows, or time-weighted rates of return with valuations at the time of any external cash flow prior to 1 January 2005, but cannot include portfolios that are calculated using the Original Dietz Method on or after 1 January 2005.

Given the number of valid methods that satisfy the calculation requirements of the GIPS standards, we also suggest that disclosure of the calculation method used by the firm, which is currently a recommendation under the GIPS standards, be changed into a requirement. Such disclosure is considered beneficial because firms may use different valid calculation methodologies for different types of portfolios in the same composite; for example, Modified Dietz method for separate accounts, and the NAV method for unitized funds. Such disclosure will also assist users of performance presentations to evaluate differences in reported performance returns among different investment firms, and thus enhance the comparability of performance presentations among investment firms. In addition, we suggest that firms be required to disclose changes in their calculation methodology as differences in calculation methodology may significantly affect reported performance returns.

## Appendix: PwC Comments on the Proposed Guidance Statement on Calculation Methodologies

Page 7 – The proposed Guidance Statement states that the Daily Valuation Method calculates a true time-weighted rate of return rather than an estimate in two places.

We believe that a true time weighted rate of return occurs only when portfolios are valued on a continuous or contemporaneous basis. The Daily Valuation Method will not generate a true time weighted rate of return since portfolio valuations are only done each time an external flow occurs. As such, we suggest that the proposed guidance be clarified to state that the Daily Valuation Method calculates “a more accurate” TWRR instead of a “true” TWRR.

Page 8 – Geometric Linking

We note that geometrical linking of sub-period returns can also be obtained by addition of continuously compounded (logarithmic) returns and subsequent transformation of the sum through the exponent function back to the normal return, as described below:

$$R_{QT} = ((1 + R_{MO1}) \times (1 + R_{MO2}) \times (1 + R_{MO3})) - 1 = e^{\ln(1+R_{MO1}) + \ln(1+R_{MO2}) + \ln(1+R_{MO3})} - 1$$

We suggest that AIMR consider including the above formula in the proposed Guidance Statement.

Page 11 – Standard 2.A.4: “Composites must be asset weighted using beginning-of-period weightings or another method that reflects both beginning market value and cash flows.”

The proposed Guidance Statement states that the beginning market value plus cash flow-weighted method represents a refinement to the asset weighted approach, giving the example of a case in which one of two portfolios in a composite doubles in market value due to a contribution on the third day of a performance period. We agree that using the beginning market value plus cash flow-weighted method will result in a more accurate rate of return in instances where there are significant cash flows in the beginning of a performance period. As such, we suggest that the Guidance Statement recommend that firms use either the aggregate method or the beginning market value plus cash flow-weighted method to calculate asset-weighted composite returns, and consider making it into a requirement in the future. We believe this is consistent with the intent of the GIPS standards to move towards increasingly more accurate calculation methodology over time.

## **Appendix: PwC Comments on the Proposed Guidance Statement on Calculation Methodologies**

In addition, we also suggest that AIMR should recommend that firms use the beginning market value plus cash flow-weighted method when there are significant cash flows in the beginning of the performance period. In this instance, firms should define what constitutes a significant cash flow as well as the beginning of the performance period, and apply that definition consistently across composites.

### **Other areas of calculation methodology to be considered**

We suggest that the proposed guidance explicitly address the area of performance calculation for unitized funds. For instance, many unitized funds calculate period (daily) returns on the basis of the fund's net asset value (NAV) per share/unit. This calculation method would generate the same returns as in the case of return calculation on the basis of the fund's total portfolio value if there were no external cash flows. However, if there were external cash flows into the fund (e.g. issue of new fund units against cash contributions), this methodology would only generate same returns if new units have been issued at the price equal to the fund's NAV as of the beginning of the sub-period.

We also note that it is common for firms to add back the expense ratio of a unitized fund to the change in NAV to calculate a gross of fees rate of return. Such expense ratio includes not only the effect of investment management fees, but other expenses as well. As such, we suggest that the proposed Guidance Statement provide guidance for calculating both net of fees and gross of fees rates of return for unitized funds, and include examples for the valid methods.

We also suggest that the Guidance Statement be enhanced to discuss the treatment of fees in calculating net of fees rates of return. For example, if daily valuations are required, the Guidance Statement should indicate whether or not fees should be accrued to calculate the net of fees performance.

### **Proposed effective date of application**

We agree that the provisions of this Guidance Statement should be adopted on a prospective basis from the proposed effective date of 1 April 2003.