HIGHLIGHTS FROM THE 2020 GIPS STANDARDS FOR VERIFIERS

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AGENDA

• The 2020 GIPS standards update process and rationale
• Revised verification report language
• Required verification procedures
• Verification versus performance examination procedures
• The 2020 GIPS standards timeline
THE 2020 GIPS STANDARDS EXPOSURE DRAFT

• The 2020 GIPS standards include several significant changes, e.g.:
  - Differentiates the treatment and marketing of composites versus individual funds
  - Eliminates asset-class specific sections
  - Broadens the ability to use money-weighted returns (MWRs) versus time-weighted returns (TWRs)
  - Allows for the synthetic allocation of cash to carve-outs
  - Includes guidance specific to asset owners
• These and other changes to the GIPS standards required us to update the required verification procedures
• We also wanted to:
  - Improve the clarity of existing verifier guidance
  - Update required verifier procedures to reflect best practices
CONSOLIDATION OF VERIFICATION GUIDANCE

• Currently verification guidance is included in:
  - Chapter IV of the GIPS standards (2010 edition)
  - Guidance Statement on Verification
  - Guidance Statement on Performance Examination
  - Guidance Statement on Verifier Independence

• We wanted to consolidate the verifier guidance as much as possible
VERIFIER INDEPENDENCE GUIDANCE STATEMENT

• This updated Guidance Statement was issued for public comment, but had not been finalized prior to drafting the 2020 GIPS Standards Exposure Draft

• All public comments were reviewed and considered by the Verification Subcommittee

• Key requirement from this Guidance Statement is incorporated in the 2020 GIPS Standards Exposure Draft
  - If a firm (or asset owner) chooses to be verified, it must create policies and procedures for determining that the verifier is independent from the firm (or asset owner).

• This Guidance Statement is not open for public comment, and therefore is not included in the Exposure Draft
VERIFICATION REPORT LANGUAGE

• We reassessed the wording of the verification reports issued by the verifier
• Current wording does not fully describe the work required to be performed by the verifier
• Current wording also speaks only to maintaining and presenting composites
• In the 2020 GIPS standards we need to accommodate:
  - Composites and pooled funds for firms
  - Total funds and additional composites for asset owners
• We updated the verification report wording to more closely align it with the required testing procedures as well as to reflect the 2020 GIPS Standards Exposure Draft.
• We have proposed that the verifier's report address:
  - The design of certain policies and procedures in compliance with the GIPS standards, and
  - If certain policies and procedures have been implemented on a firm-wide or asset owner–wide basis.
VERIFICATION REPORT LANGUAGE

• The verification report must opine that:
  - The firm’s (or asset owner’s) policies and procedures for complying with the GIPS standards with respect to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards, and
  - These policies and procedures have been implemented on a firm-wide (or asset owner-wide) basis for the period(s) for which the verification has been performed.
SCOPE OF VERIFICATION

• Verification does not test every requirement contained in the GIPS standards
  - For example, firms must comply with all applicable laws and regulations regarding the calculation and presentation of performance, but verifiers are not required to test this
• For clarity, we explicitly state the verification does not provide assurance on the firm’s (or asset owner’s) claim of compliance with the GIPS standards in its entirety.
ASSET OWNERS

• The 2020 GIPS standards have provisions that are tailored to asset owners (sections 8-12)
• The verification and performance examination procedures are written from the perspective of a verifier that is conducting an engagement for a firm.
• When conducting an engagement for an asset owner, the testing procedures need to be adapted to the asset owner based on its specific facts and circumstances.
  - The specific procedures that need to be performed for one asset owner could significantly differ from those for another asset owner.
  - The procedures will also differ from those required for firms. For example, because asset owners do not have prospective clients or investors, they have different requirements for distributing GIPS reports.
• To acknowledge these differences, however, we have included language for both verification and performance examination to explain that verifiers must tailor procedures for asset owners to the extent possible, based on each asset owner’s unique facts and circumstances.
VERIFICATION VERSUS PERFORMANCE EXAMINATION PROCEDURES

• Verification guidance is separate from performance examination guidance
• While many of the procedures are the same for both verification and performance examination, the scope is different
  - Verification testing is conducted firm-wide
  - Performance examination is conducted on one or more composites and/or pooled funds
• Performance examinations are not commonly conducted in all markets, so we wanted to maintain separate guidance
  - But this separation results in some repetition
REQUIRED VERIFICATION PROCEDURES
PLANNING

• In 2020, verifiers will have to conduct client-specific planning, and must consider the following matters when designing test procedures:
  - The nature and materiality of the information to be tested;
  - The control environment (including the extent to which automated and manual processes are used);
  - The likelihood of misstatements;
  - Knowledge obtained during current and previous engagements;
  - The extent to which the information is affected by judgment; and
  - Inadequacies in the underlying data.
PLANNING

• The verifier must consider the type of information that would be obtained when designing testing procedures:
  - Information obtained from independent parties (especially if obtained directly) provides greater assurance than information obtained from the firm;
  - Information obtained from the verifier's direct personal knowledge (such as through tangible documentation, observation, computation, operating tests, or inspection) is more persuasive than information obtained indirectly; and
  - The more effective the controls over the subject matter, the more assurance the controls provide

• The verifier must accumulate sufficient evidence and perform sufficient procedures such that the risk of not detecting errors during the verification is mitigated to an acceptably low level.

• Testing by inquiry on its own is insufficient to satisfy the required verification procedures. Verifiers must review sufficient and appropriate supporting documentation when performing verification procedures.
SAMPLING

• Verifiers must subject the entire firm to testing when performing verification procedures.
• Verifiers may use a sampling methodology when performing such testing procedures.
• The verifier must determine not only the appropriate sample size but also if the sample selected is reasonable considering the firm’s specific circumstances.
• The verifier must select samples from the entire period(s) being verified.
SAMPLING CRITERIA

• Verifiers must consider the following criteria, at a minimum, when selecting and evaluating a sample:
  - Number of composites and pooled funds at the firm;
  - Number of portfolios in each composite;
  - Composite definitions and pooled fund strategies;
  - Legal structure of the pooled fund;
  - Composite assets and pooled fund assets relative to total firm assets;
  - Internal control environment at the firm;
  - Number of years being verified;
  - Systems used in the construction and maintenance of composites;
  - Methodology and systems used for calculating and reporting performance; and
  - The use of external service providers.

• Missing or incomplete documents, or the presence of errors, would warrant selecting a larger sample or applying additional verification procedures.
RECORDKEEPING

• While conducting the required testing procedures, verifiers must determine whether:
  - The firm has captured and maintained all data and information necessary to support all items included in GIPS reports and GIPS advertisements.
  - The data and information are readily available.
  - The data and information are sufficient to support the claim of compliance on a firm-wide basis.
POLICIES AND PROCEDURES

• Verifiers must obtain the firm's policies and procedures used in establishing and maintaining compliance with the GIPS standards.

• Verifiers must understand the firm’s policies and procedures for establishing and maintaining compliance with all the applicable requirements and adopted recommendations of the GIPS standards.

• Verifiers must perform sufficient procedures to determine that:
  - The firm's policies and procedures are consistent with the GIPS standards;
  - The firm's policies and procedures are complete, clear, unambiguous, and adequately documented; and
  - The firm's policies and procedures are suitably designed to enable the firm to comply with the GIPS standards.
FIRM DEFINITION

- Verifiers must gain an understanding of the firm, including the corporate structure of the firm and how it operates.
- Verifiers must perform sufficient procedures to determine that the firm is, and has been, appropriately defined.
LISTS OF COMPOSITES AND POOLED FUNDS

• Verifiers must obtain the firm's:
  - list of composite descriptions,
  - list of limited distribution pooled fund descriptions, and
  - list of broad distribution pooled funds
• And then perform sufficient procedures to determine that these lists are complete.
TOTAL FIRM ASSETS

• For each annual period end within the period(s) being verified, verifiers must obtain:
  - A list of all portfolios, with each portfolio’s value, that constitute total firm assets.
  - A list of all portfolios included in composites.
  - A list of all segregated accounts that are not included in any composite.
  - A list of all pooled funds that are not included in any composite.

• Verifiers must select portfolios from these lists and perform sufficient procedures to determine that:
  - The list of all portfolios that constitute total firm assets, with each portfolio’s value, is complete.
  - Portfolios included in composites and other portfolios not included in composites are properly included in total firm assets and have not been double-counted.
  - Portfolios included in total firm assets are properly included in or excluded from composites.
  - Total firm assets reflect only actual assets managed by the firm.
  - Total firm assets are calculated accurately and reflect all assets for which the firm has investment management responsibility.
PORTFOLIOS EXCLUDED FROM COMPOSITES

• Verifiers must obtain a list of all portfolios that are classified as non-discretionary and excluded from composites during the period(s) being verified.

• Verifiers must select portfolios from this list and perform sufficient procedures to determine that the firm's classification of the portfolios as non-discretionary is appropriate by referring to the portfolio's investment mandate, objective, or strategy, as indicated by the portfolio's investment management agreement, investment guidelines, and other appropriate documentation.
ASSIGNMENT OF PORTFOLIOS TO COMPOSITES

• Verifiers must obtain composite membership details, including which portfolios are included, with their returns and values, for all period(s) being verified.

• This information must include new, existing, and terminated portfolios.

• Verifiers must select portfolios from composites and perform sufficient procedures to determine that:
  - The firm has defined and maintained composites in compliance with the GIPS standards.
  - The firm's policies and procedures for creating and maintaining composites have been consistently applied.
  - Portfolios included in composites are properly classified as discretionary, as indicated by the portfolio's investment management agreement, investment guidelines, portfolio summary, and other appropriate documentation.
  - The investment mandate, objective, or strategy of portfolios included in composites, as indicated by the portfolio's investment management agreement, investment guidelines, portfolio summary, and other appropriate documentation, is consistent with the composite definition.
  - Portfolios included in the same composite share a similar investment mandate, objective, or strategy.
ASSIGNMENT OF PORTFOLIOS TO COMPOSITES

- The timing of inclusion of new portfolios in composites is in accordance with the firm's new portfolio policies and procedures.
- The timing of exclusion of terminated portfolios from composites is in accordance with the firm's terminated portfolio policies and procedures.
- Movements of portfolios from one composite to another are appropriate; consistent with documented changes to a portfolio's investment mandate, objective, or strategy or the redefinition of the composite; and in accordance with the firm's moved portfolio policies and procedures.
- For composites that have a composite minimum asset level, and only for those composites, portfolios included in and excluded from composites in accordance with the firm's minimum asset level policies and procedures.
- For composites that have a significant cash flow policy, and only for those composites, portfolios are included in and excluded from composites in accordance with the firm's significant cash flow policies and procedures.
- For composites that exclude non-fee-paying portfolios, and only for those composites, non-fee-paying portfolios are excluded from composites in accordance with the firm's non-fee-paying portfolio policies and procedures.
OUTLIER TESTING

• Verifiers must perform sufficient procedures to determine that outlier returns within composites do not indicate portfolio return or composite assignment errors.

• Verifiers must:
  - For a sample of composites, review portfolio returns within the composite, to identify portfolios with returns that significantly deviate from the returns of other portfolios within the composite.
  - Select a sample of portfolios with outlier returns and for each portfolio determine that:
    - There are no input data or portfolio return calculation errors relating to the outlier returns.
    - The portfolio is properly included in the composite.
INPUT DATA TESTING

• For selected portfolios, verifiers must perform sufficient procedures to determine that the treatment of the following items is consistent with the firm's policies and procedures:
  - Classification of portfolio flows (e.g., receipts, disbursements, dividends, interest, fees, expenses, and taxes);
  - Accounting treatment of dividend and interest income;
  - Accounting treatment of taxes, tax reclaims, and tax accruals;
  - Accounting treatment of transaction costs;
  - Accounting treatment of fees and expenses; and
  - Accounting treatment and valuation methodologies for investments.
PERFORMANCE BASED ON ACTUAL ASSETS

• For selected portfolios, verifiers must perform sufficient procedures to determine that portfolio holdings, income, and cash flows are supported by appropriate documents from independent external parties.

• Examples of these documents include custodian, fund accounting, and broker statements, as well as client subscription and redemption notifications.

• Verifiers should obtain appropriate documentation directly from independent external parties.
PERFORMANCE MEASUREMENT

• Verifiers must perform sufficient procedures to determine that the firm has calculated performance in accordance with;
  - The requirements of the GIPS standards, and
  - The firm's policies and procedures.

• Verifiers must, for a sample of portfolios and composites, recalculate returns to determine that:
  - An acceptable return formula as required by the GIPS standards is used.
  - The firm's calculations, including the treatment of any fees and expenses, are in accordance with the firm's policies and procedures.
GIPS REPORTS

• Verifiers must perform sufficient procedures on a sample of GIPS reports to determine that each presentation includes all the numerical information and disclosures required by the GIPS standards.

• If the firm's policy is to include supplemental information, performance from a prior firm or affiliation, or custom benchmarks in GIPS reports, verifiers should include in this sample GIPS reports that include such information.
For each GIPS report selected for testing, verifiers must perform the following procedures:

- Test composite, pooled fund, and benchmark calculations to determine that all presented numerical information, including any recommended information, (e.g., annual returns, three-year annualized standard deviation, additional risk measures, composite internal dispersion, and other statistics):
  - Adheres to the requirements of the GIPS standards.
  - Is accurate.
  - Is consistent with the firm's records and policies and procedures.

- If model investment management fees are used to calculate net-of-fees returns, or model total pooled fund fees are used to calculate pooled fund net returns, perform testing to determine that returns calculated using model fees are equal to or lower than those that would have been calculated if actual fees had been used.
GIPS REPORTS

- For each GIPS report selected for testing, verifiers must perform the following procedures:
  - Determine that the composite or pooled fund benchmark reflects the investment mandate, objective, or strategy of the composite or pooled fund and, if the composite or pooled fund does not have a benchmark, that this is appropriate;
  - If a custom benchmark or combination of multiple benchmarks is used, test the benchmark data used by the firm to determine that the calculation methodology has been correctly applied and the data used are consistent with the benchmark disclosure in the GIPS report.
  - Test benchmark returns to determine that:
    - The benchmark returns are consistent with the returns published by the index provider; and
    - Only total return indices are used.
  - Determine that total firm assets presented in the GIPS report or used in the calculation of composite assets or pooled fund assets as a percentage of total firm assets are consistent with total firm assets (as previously tested).
  - Review disclosures to determine that all required disclosures are included and all disclosures are consistent with the firm's records, and policies and procedures.
GIPS REPORTS – SUPPLEMENTAL INFORMATION

• If the GIPS report includes supplemental information, verifiers must determine that the supplemental information:
  - Relates directly to the composite or pooled fund.
  - Is not misleading, is clearly not false, and is not otherwise prohibited to be presented.
  - Is clearly labeled as supplemental information.
  - Does not contradict or conflict with the required or recommended information in the GIPS report.
  - Is not shown with greater prominence than the required composite or pooled fund information.
GIPS REPORTS - PORTABILITY

- If the GIPS report includes performance from a prior firm or affiliation that is linked to performance of the firm, and the linkage occurs during the period(s) being verified, verifiers must determine that:
  - The requirements relating to investment decision makers, the decision-making process, and supporting records have been met.
  - There is no break in performance between the performance from the prior firm or affiliation and the performance of the firm.
  - Composite performance from a prior firm or affiliation includes all portfolios that met the composite definition at the prior firm or affiliation.
  - Pooled fund performance from a prior firm or affiliation represents the performance of the pooled fund from the prior firm or affiliation.
  - The GIPS report includes required disclosures about the linked ported performance.
GIPS REPORTS - DISTRIBUTION

• Verifiers must perform sufficient procedures to determine that:
  - The firm has provided the appropriate GIPS composite report(s) to each prospective client and the appropriate GIPS pooled fund report(s) to each limited distribution pooled fund prospective investor.
  - Where a prospective client or limited distribution pooled fund prospective investor remains a prospect for more than 12 months, an updated GIPS composite report or GIPS pooled fund report, respectively, has been provided to the prospect at least once every 12 months.

• Verifiers must select a sample of prospective clients and limited distribution pooled fund prospective investors. For each selection, verifiers must review the information that was provided, to determine that the prospect received the required GIPS report(s).
ERROR CORRECTION

• Verifiers must inquire about errors in GIPS reports that have occurred in, were identified in, or affect the period(s) being verified. If errors have occurred, verifiers must select errors for testing and perform sufficient procedures to determine that:
  
  - The firm's errors have been treated in accordance with the firm's error correction policies and procedures.
  
  - For material errors, the firm has provided the corrected GIPS report to all existing clients and existing investors that received the erroneous GIPS report, and the firm has made every reasonable effort to provide the corrected GIPS report to all prospective clients, prospective investors, and other parties that received the erroneous GIPS report.
MARKETING MATERIALS

• Verifiers must inquire about the firm's marketing practices, including whether the firm prepares GIPS advertisements. Verifiers must select a sample of marketing materials, including GIPS advertisements, if applicable, and must perform the following procedures:

- For each selection of marketing material that includes a GIPS report, verifiers must perform sufficient procedures to determine that:
  - The GIPS report includes all information required by the GIPS standards.
  - The numerical information in the GIPS report is accurate and consistent with the firm's records as well as its policies and procedures.
  - The disclosures in the GIPS report are consistent with the firm's records as well as its policies and procedures.
MARKETING MATERIALS

• For each GIPS advertisement, verifiers must perform sufficient procedures to determine that:
  - The GIPS advertisement includes all information required by the GIPS Advertising Guidelines.
  - The numerical information is accurate and consistent with the firm's records as well as its policies and procedures.
  - The disclosures are consistent with the firm's records as well as its policies and procedures.

• For each selection of marketing material that is not a GIPS advertisement and does not include a GIPS report, verifiers must perform sufficient procedures to determine that it does not include any improper references to the GIPS standards.
NOTIFICATION TO CFA INSTITUTE

• Verifiers must perform sufficient procedures to determine that the firm has notified CFA Institute of its claim of compliance with the GIPS standards by submitting the GIPS Compliance Notification Form.
MAINTENANCE OF VERIFIER DOCUMENTATION

• The verifier must maintain sufficient documentation of the following items for all verification procedures performed that are necessary to support the verification report:
  - The nature, timing, and extent of all procedures performed, including planning procedures, sample size rationale, sample selections, and testing procedures applied;
  - The results of all procedures performed and the evidence obtained;
  - Significant findings or issues arising during the verification, the conclusions reached thereon, and any significant professional judgments made in reaching those conclusions; and
  - Support that the verifier has conducted all required verification procedures.
REPRESENTATION LETTER

• At the conclusion of the verification engagement and prior to issuing the verification report, the verifier must obtain written representations signed by the firm’s management who the verifier believes are responsible for and knowledgeable about the matters covered in the representations

• The rep letter must include specific matters detailed in the GIPS standards for verifiers
GIPS VERIFICATION REPORT

• The verification report must opine that the firm's policies and procedures for complying with the GIPS standards with respect to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis for the period(s) for which the verification has been performed.

• The report must also include a number of other items detailed in the GIPS standards for verifiers

• If the verifier concludes that the firm is not in compliance with the GIPS standards, for any reason, the verifier must inform the firm why a verification report could not be issued
RECOMMENDATION LETTER

• After the verification is complete, the verifier should issue a recommendation letter to the firm describing specific findings, recommendations, and other areas for improvement arising from the verification
PERFORMANCE EXAMINATIONS

- Requirements are very similar to verification requirements
- Difference is that the performance examination procedures focus only on specific composites and/or pooled funds that are being examined
- Each examined composite or pooled fund must be subjected to all required testing, for all periods for which the examination is being conducted
EFFECTIVE DATE

• Verifiers must conduct their engagements in accordance with the 2020 GIPS Standards for Verifiers for all verifications and performance examinations for which the verifier is reporting on one or more periods for which the firm or asset owner claims compliance following the 2020 edition of the GIPS standards.
## THE 2020 GIPS STANDARDS TIMETABLE

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<td>Exposure Draft Issued</td>
<td>31 August 2018</td>
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<tr>
<td></td>
<td>31 October 2018 (Verification)</td>
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<tr>
<td>Comment Period End Date</td>
<td>31 December 2018</td>
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<tr>
<td>Final Version Issued</td>
<td>30 June 2019</td>
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<tr>
<td></td>
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<td>Effective Date</td>
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<tr>
<td>GIPS Reports Prepared per the 2020 GIPS standards Requirements</td>
<td>GIPS Reports that include performance results for periods ending on or after 31 December 2020</td>
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WHAT DO YOU THINK?

We Want To Hear From You!

Positive and negative feedback
RESOURCES

- The GIPS standards website: gipsstandards.org
  - The 2020 GIPS standards Exposure Draft
  - GIPS Reports for Asset Owners Comparison Table
  - GIPS Reports for Firms Comparison Table
  - Questions for Public Comment Summary
- Submit Your Comments (standards@cfainstitute.org)
- Helpdesk (gips@cfainstitute.org)
- GIPS newsletter
  - To subscribe, email info@cfainstitute.org
- Twitter: @MarketIntegrity
CONTACT INFORMATION

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