



Global Investment Performance Standards

GUIDANCE STATEMENT ON PERFORMANCE EXAMINATIONS

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CFA Institute

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GIPS GUIDANCE STATEMENT ON PERFORMANCE EXAMINATIONS

Scope and Purpose of Performance Examination

The scope and purpose of verification is to assess whether a firm has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS®) 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. Verification does not ensure the accuracy of any specific composite presentation.

A firm may choose to also have a performance examination of a specific composite presentation. The detailed testing of any of the firm's composites and their associated compliant presentations by an independent verifier is termed a performance examination.

A performance examination may only be performed either concurrently with, or subsequent to the completion of, a verification. The verification and the performance examination need not be performed by the same verification firm. The performance examination must be performed by a verifier who is independent of the investment management firm. Please see the Guidance Statement on Verifier Independence for additional guidance.

Verifiers must follow currently accepted standards of practice within their industry (if applicable) when undertaking a performance examination pursuant to the GIPS standards. Please see the Guidance Statement on Verification for additional guidance on verifier qualification requirements.

A performance examination is not required for a firm to be verified and is neither recommended nor required under the GIPS standards. Performance examinations are unlikely to become a requirement of the GIPS standards. However, a firm may be asked or may choose to obtain a performance examination of one or more of the firm's composites.

A performance examination is the detailed testing of a specific composite and its associated compliant presentation by an independent verifier for a specific period. A performance examination tests, for a specific composite:

- a. Whether the firm has constructed the composite and calculated the composite performance in compliance with the GIPS standards, and
- b. Whether the firm has prepared and presented the composite presentation in compliance with the GIPS standards.

Fundamental Considerations for Performance Examinations

When conducting a performance examination of a specific composite and its associated compliant presentation, the verifier must consider the following presumptions, bearing in mind that they are not mutually exclusive and may be subject to exceptions:

- Information obtained from independent sources outside the firm provides greater assurance than information secured solely from within 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 they provide about the subject matter or the assertion.

The extent to which the performance examination procedures will be performed must, at a minimum be based on the verifier's consideration of:

- The nature and materiality of the information to be tested;
- The effectiveness of the control environment (including the extent to which manual processes are employed);
- 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.

A principal verifier may accept the work of another verifier as part of the basis for satisfying that a firm has previously received a verification report and/or as part of the basis for the principal verifier's performance examination opinion. A principal verifier may also choose to rely on the audit and/or internal control work of a qualified and reputable independent third party with appropriate professional abilities and experience, and a practical level of expertise regarding investment management practices, including performance calculation procedures and business processes. In addition, a principal verifier may choose to rely on the other audit and/or internal control work performed by the verification firm. If reliance on another party's work is planned, the scope of work, including the time period(s) covered, results of procedures performed, qualifications, competency, objectivity, and reputation of the other party must be assessed by the principal verifier when making the determination as to whether to place any reliance on such work. Reliance considerations and conclusions must be documented by the principal verifier. The verifier must use professional skepticism when deciding whether to place reliance on work performed by another independent third party.

Sampling

Verifiers must subject the entire composite to testing when conducting performance examination procedures unless reliance is placed on work performed by a qualified and reputable independent third party or appropriate alternative control procedures have been performed by the verifier. Verifiers may use a sampling methodology when performing such procedures. The size of the sample will vary based on the verifier's judgment when considering the criteria listed below. Not only must the verifier determine the appropriate sample size, but the verifier must also determine if the sample selected is reasonable considering the firm's specific circumstances.

Verifiers must consider the following criteria when selecting samples:

- Number of portfolios in the composite;
- Composite definition;
- Total assets of individual portfolios relative to total composite assets;

- Internal control structure at the firm;
- Number of years being examined; and
- Use of computer applications, software used in the construction and maintenance of composites, the use of external performance measurers, and other external service providers; and
- Performance calculation methodology.

This list is not all-inclusive and contains only the minimum criteria that must be considered in the selection and evaluation of a sample. For example, one potentially useful approach would be to include in the sample a portfolio that has the largest impact on composite performance because of its size or because of extremely good or bad performance. Missing or incomplete documents, or the presence of errors, would normally be expected to warrant selecting a larger sample or applying additional performance examination procedures.

Required Performance Examination Procedures

When conducting a performance examination, the verifier must accumulate sufficient evidence and perform sufficient procedures such that the risk of not detecting errors during the performance examination is mitigated to an acceptably low level.

The following are the minimum procedures verifiers must follow when conducting a performance examination. Verifiers must complete the performance examination in accordance with these procedures prior to issuing a performance examination report to the firm.

Pre-Performance Examination Procedures:

- 1) Knowledge of the GIPS standards: Verifiers conducting the performance examination must understand all the requirements and recommendations of the GIPS standards, including any updates, Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee, which are available on the GIPS standards website (www.gipsstandards.org) as well as in the *GIPS Handbook*.
- 2) Knowledge of Applicable Laws and Regulations: Verifiers conducting the performance examination must be knowledgeable of applicable laws and regulations regarding the calculation and presentation of performance and must consider any differences between these laws and regulations and the GIPS standards.
- 3) Knowledge of the Firm: Verifiers conducting the performance examination must obtain the relevant verification report(s) and the compliant presentation(s) to be examined. Verifiers must gain an understanding of the firm, including the corporate structure of the firm and how it operates.
- 4) Knowledge of Firm's Policies and Procedures: Verifiers conducting the performance examination 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. The verifier must obtain a copy of the firm's

policies and procedures used in establishing and maintaining compliance with the GIPS standards and ensure that all applicable policies and procedures are properly included and adequately documented with respect to the composite and its associated compliant presentation(s) being examined. The verifier must also ensure that the policies and procedures are clear, unambiguous, in accordance with the GIPS standards, and meet any applicable requirements of the GIPS standards. For example, verifiers must understand the firm's policies and procedures with regard to, but not limited to, the following items with respect to the composite and its associated compliant presentation(s) to be examined:

- Investment discretion. The verifier must obtain a copy of the firm's definition of investment discretion and the firm's guidelines for determining whether portfolios are discretionary;
 - Definition of composite according to investment mandate, objective or strategy. The verifier must obtain the composite definition with criteria for assignment of portfolios to the composite;
 - Timing of inclusion of new portfolios in the composite;
 - Timing of exclusion of terminated portfolios from the composite;
 - Accrual of interest and dividend income;
 - Treatment of fees;
 - Valuation of portfolio investments, including policies and procedures for the determination of fair value;
 - Calculation of the rates of return for each portfolio;
 - Treatment of cash flows (assumptions on the timing of capital inflows/outflows and treatment of large and, where applicable, significant cash flows);
 - Calculation of composite returns;
 - Error correction;
 - Preparation of the composite's compliant presentation(s);
 - Use of leverage, derivatives and short positions;
 - Maintenance of books and records supporting the calculation of portfolio and composite returns, including the existence and ownership of client assets;
 - Selection, construction, and calculation of composite benchmarks; and
 - Any other policies and procedures relevant to the composite and its associated compliant presentation(s).
- 5) Knowledge of Valuation Basis and Performance Calculations: Verifiers must understand the policies, procedures, and methodologies used to value portfolios and calculate investment performance.

Performance Examination Procedures:

- 1) Portfolio Selection: Objective: to determine that the proper portfolios are included in the examined composite. The verifier must obtain a list of all open (both new and existing) and terminated portfolios for the firm for the period(s) under examination and sufficient procedures must be performed to determine for the examined composite that:

- The timing of inclusion of portfolios in the composite is in accordance with the firm's policies and procedures;
 - The timing of exclusion of portfolios from the composite is in accordance with the firm's policies and procedures;
 - The firm's classification of portfolios as 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/or other appropriate documentation;
 - Portfolios are completely and accurately included in the composite by tracing selected portfolios from:
 - a. The portfolio's investment management agreement and/or investment management guidelines to the composite; and
 - b. The composite to the portfolio's investment management agreement and/or investment guidelines.
 - Portfolios managed to a similar investment mandate, objective, or strategy are included in the same composite; and
 - Movements of portfolios into and out of the composite are appropriate, are in accordance with the firm's policies and procedures, and are consistent with documented changes to a portfolio's investment mandate, objective, or strategy or the redefinition of the composite.
- 2) External Cash Flows: Objective: to determine that external cash flows for portfolios in the examined composite are:
- Properly recorded in portfolios;
 - Recorded at the correct amounts;
 - Properly identified as large (as defined by the firm's policies and procedures); and
 - Recorded on a timely basis in accordance with the firm's policies and procedures.

Sufficient procedures must be performed to determine that:

- External cash flows reflect appropriate supporting documentation, such as custody statements or internal records;
- External cash flows reflect proper valuation and timely recording; and
- The recording of external cash flows is appropriate and in accordance with the firm's policies and procedures.

- 3) Income and Expenses: Objective: to determine that income and expenses for portfolios in the examined composite are:
- Recorded in the proper portfolios;
 - Recorded at the correct amounts; and
 - Recorded on a timely basis.

Sufficient procedures must be performed to determine that:

- Income and expenses reflect supporting documentation such as custody statements or internal records;

- The methods used to record income and expenses, including investment management fees, are appropriate and in accordance with the firm's policies and procedures;
- Expenses are appropriately treated when calculating net- and/or gross-of-fees performance returns; and
- The calculation and use of accrued income is reasonable, appropriate, and in accordance with the firm's policies and procedures.

4) Portfolio Trade Processing: Objective: to determine that purchases and sales of investments for portfolios in the examined composite have been properly recorded on the appropriate dates.

Sufficient procedures must be performed to determine that:

- Portfolio trading activity is supported by appropriate documentation such as custody statements, trade confirmations, and reconciliations; and
- The methods used to account for portfolio trading activity are appropriate and in accordance with the firm's policies and procedures.

It is preferable that verifiers obtain appropriate documentation directly from independent external parties (e.g., custodian, broker).

5) Portfolio Valuation: Objective: to determine that the beginning- and end-of-performance measurement period valuations of investments, including derivatives, for portfolios in the examined composite are:

- Valued correctly; and
- Valued on the correct dates.

Sufficient procedures must be performed to determine that:

- Beginning- and end-of-performance measurement period investment valuations are in accordance with the firm's valuation policies and procedures, and the GIPS Valuation Principles in Chapter II of the GIPS standards;
- Portfolios are valued on the date of all large cash flows in accordance with the firm's policies and procedures;
- Foreign currency exchange rates are used in accordance with the firm's valuation policies; and
- The methods used for portfolio valuation are appropriate and consistently applied.

6) Existence and Ownership of Client Assets: Objective: to determine that the firm's policies and procedures for ensuring the existence and ownership of client assets for the portfolios in the examined composite are appropriate and have been consistently applied.

Sufficient procedures must be performed to determine that:

- Beginning- and end-of-performance measurement period portfolio positions are supported by appropriate documentation such as custody statements and custody reconciliations; and

- The methods used to ensure the existence and ownership of assets are appropriate and in accordance with the firm's policies and procedures.

It is preferable that verifiers obtain appropriate documentation directly from independent external parties (e.g., custodian, broker).

- 7) Performance Calculation: Objective: to determine that the methods used to calculate portfolio, composite, and benchmark returns, and other required and recommended numerical data for the examined compliant presentation are appropriate, have been consistently applied and the returns, and other required and recommended numerical data have been correctly calculated.

The verifier must take a sample of all required and recommended numerical data (e.g., composite and benchmark calculations, risk measures, internal dispersion) to determine its accuracy and sufficient procedures must be performed to determine that:

- Portfolio and composite performance is calculated in accordance with the firm's policies and procedures;
- Calculation methodologies that meet the requirements of the GIPS standards are used;
- Portfolio and composite returns are accurately calculated;
- If custom benchmarks or a combination of multiple benchmarks are used, the calculation methodology is correct and consistently applied, and the method and data used are in accordance with the benchmark description in the composite's compliant presentation; and
- Calculations of required risk measures are accurate and consistently applied.

- 8) Composite Compliant Presentation Information and Disclosures: Objective: to determine that the compliant presentation for the examined composite includes all the information and disclosures required by the GIPS standards, such that the information and disclosures:
- Have been accurately and properly presented in the examined composite's compliant presentation; and
 - Are supported by appropriate documentation.

This objective is also applicable to additional information (i.e., recommended disclosure and presentation and reporting items) if it is included in the examined composite's compliant presentation.

Sufficient procedures must be performed to determine that:

- The composite benchmark reflects the investment mandate, objective, or strategy of the composite;
- The compliant presentation includes all the information and disclosures required by the GIPS standards;
- The inclusion of such items as required by the disclosure and presentation and reporting provisions are appropriate and reasonable; and

- The information and disclosures are consistent with the firm's records and in accordance with the firm's policies and procedures.

When supplemental information is presented in the examined composite's compliant presentation, at a minimum, the verifier must determine that the supplemental information is not misleading, clearly not false, or not otherwise allowed to be presented, and is correctly and clearly labeled and identified as supplemental information to a particular compliant presentation. Please see the Guidance Statement on the Use of Supplemental Information for additional guidance. The firm and the verifier must decide if any supplemental information will be subject to the performance examination.

- 9) **Maintenance of Records:** The verifier must maintain sufficient documentation to support all procedures performed supporting the issuance of the performance examination report, including all significant judgments and conclusions made by the verifier.

Representation Letter

At the conclusion of the performance examination engagement and prior to expressing an opinion, the verifier conducting the performance examination must obtain from the management of the firm a representation letter, confirming at a minimum, the following items:

- 1) The firm's policies and procedures used in establishing and maintaining compliance with the GIPS standards are as described in the firm's policies and procedures documents and have been consistently applied throughout the period(s) being examined;
- 2) The firm has constructed the composite and calculated the composite performance in compliance with the GIPS standards;
- 3) The firm has prepared and presented the composite presentation in compliance with the GIPS standards;
- 4) The firm complies with the GIPS standards for the period(s) being examined; and
- 5) Any other relevant representations made to the verifier during the performance examination.

Typically, the representation letter will also include the following representations:

- The firm's management bears all responsibility for maintaining compliance with the GIPS standards, including production and distribution of the compliant presentation;
- The compliant presentation for the composite is a fair and accurate representation of the firm's investment performance;
- The firm has not knowingly presented performance or performance-related information for the composite that is false or misleading;
- To the best of the firm's knowledge and belief there has been no:
 - a. fraud or alleged fraud involving management or employees who have significant roles in the firm's processes and procedures relating to compliance with the GIPS standards, or
 - b. fraud or alleged fraud involving others that could have a material effect on the firm's compliance with the GIPS standards;

- The firm has provided the verifier with all necessary documents to be able to perform the performance examination and no relevant documents have been withheld;
- The time period the verifier is reporting on;
- The firm complies with all applicable laws and regulations regarding the calculation and presentation of performance for the composite; and
- No events that would materially influence performance results or the outcome of the performance examination have occurred up to the date of the representation letter.

Performance Examination Report

A performance examination is performed with respect to a specific composite and its associated compliant presentation, and does not provide assurance on the compliant presentation for any other composite. If performance examinations are performed on multiple composites and their associated compliant presentations, the verifier may issue a single performance examination report covering the composites and their associated compliant presentations that have been examined. The performance examination report can be prepared as part of a verification report (combined report) or as a separate report attached to the verification report. The compliant presentation for any composite that has been examined must be included in or attached to the performance examination report.

- 1) In order for a performance examination report to be issued the verifier must ensure that the firm has a verification report(s) which opines that a) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and b) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards.
- 2) A performance examination report must not cover periods beyond those periods covered by the verification report(s). A performance examination report must not be issued prior to the verification report.
- 3) The performance examination report must opine that:
 - The firm has constructed the composite and calculated the composite performance in compliance with the GIPS standards; and
 - The firm has prepared and presented the composite presentation in compliance with the GIPS standards.

The following information is also required to be included in the performance examination report. Please refer to additional guidance regarding the verification report in the Guidance Statement on Verification.

- The report title which must include the words "performance examination";
- The report date;
- The report addressee;
- The defined firm for which the verification has been performed;
- The period(s) for which the verification has been performed;
- The respective responsibilities of the firm's management and of the verifier, including a statement acknowledging the responsibility of the firm for the claim of compliance and for the preparation of the compliant presentation;
- The name of the composite that has been examined;

- The period(s) for which the performance examination has been performed;
- A statement indicating that the performance examination of the specified composite and its associated compliant presentation has been performed in accordance with the required performance examination procedures of the GIPS standards;
- A statement indicating that the performance examination does not ensure the accuracy of any other specific composite presentation;
- A statement indicating whether or not the performance examination covers supplemental information included in or attached to the compliant presentation;
- A statement describing any other professional guidance that has been applied (e.g. AICPA, IAASB, ICAEW, JICPA guidance); and
- The signature or official seal of the verifier.

The firm must not state that a composite presentation has been examined unless the performance examination report has been issued for the specific composite presentation.

- 4) After completing the performance examination procedures, the verifier may conclude that the composite presentation does not comply with the GIPS standards or the records of the firm cannot support the performance examination. In such situations, the verifier and the firm must consider the impact of the verifier's inability to provide the performance examination report on the investment management firm's claim of compliance with the GIPS standards. A performance examination report must not be issued when the verifier knows that the firm is not in compliance with the GIPS standards, the composite presentation does not comply with the GIPS standards, or the records of the firm cannot support the examination of the specific composite and its associated presentation. When a performance examination report cannot be issued, the verifier must issue a statement to the firm clarifying why a performance examination report cannot be issued.

Recommendation Letter

After the performance examination is complete, it is recommended that the verifier issue a recommendation letter to the firm describing specific findings, recommendations, and other areas needing improvement arising from the performance examination.

Effective Date

This Guidance Statement was originally effective 31 December 2006. Subsequent revisions have been made to this guidance to coincide with the 2010 edition of the GIPS standards. Verifiers must conduct their performance examination engagements in accordance with this Guidance Statement for all performance examinations contracted on or after 1 July 2012. The contract date is typically evidenced by the date of the engagement letter signed by management of both the verification firm and the investment management firm. Verifiers may also voluntarily conduct their performance examination engagements in accordance with this Guidance Statement for engagements contracted prior to 1 July 2012 and are encouraged to do so. The prior version of this Guidance Statement is available on the GIPS standards website (www.gipsstandards.org).