



Global Investment Performance Standards

Guidance Statement on Error Correction

Adoption Date: 28 September 2010

Effective Date: 1 January 2011

Retroactive Application: Not Required

www.gipsstandards.org

GIPS® Guidance Statement on Error Correction

Introduction

Firms claiming compliance with the Global Investment Performance Standards (GIPS®) are faced with situations in which errors are discovered that must be specifically addressed. Even with the tightest of controls, errors will occur. Errors can be quantitative and/or qualitative. This Guidance Statement only addresses errors related to compliant presentations. This Guidance Statement does not address errors discovered in advertisements prepared following the GIPS Advertising Guidelines.

Background

For a variety of reasons, an error might occur in a firm's processes that results in errors in, or directly related to, a composite's compliant presentation. An error is defined as any component of a compliant presentation that is missing or inaccurate.

Errors in compliant presentations can result from, but are not limited to, incorrect, incomplete, or missing:

- Composite returns,
- Benchmark returns,
- Composite assets,
- Firm assets,
- Number of portfolios in a composite,
- Measure of internal dispersion,
- Three-year ex-post standard deviation, and
- Disclosures.

Errors in compliant presentations can be caused by, but are not limited to:

- Input data errors,
- Prior period adjustments,
- System/spreadsheet calculation errors,
- Incorrect assignment of portfolios to composites,
- Incorrect timing of inclusion and/or exclusion of portfolios to composites,
- Missed trades,
- Mishandling of corporate actions,
- Software errors,
- Incorrect treatment of cash flows,
- Pricing or exchange rate problems,
- Incorrect benchmark returns supplied by the benchmark source,
- Incorrectly calculated customized benchmark returns,
- Inadequate creation or implementation of policies and procedures used in establishing and maintaining compliance with the GIPS standards, and
- Poor internal communication.

Guiding Principles

Firms must remember that the fundamental principles of the GIPS standards are fair representation and full disclosure. Firms therefore, must not present performance or performance-related information that is false or misleading. The objectives of the GIPS

standards include presenting investment performance in a fair, comparable format that provides full disclosure. The GIPS standards were created to ensure accurate and consistent performance data for reporting, recordkeeping, marketing, and presentations. The GIPS standards require firms to make every reasonable effort to provide a compliant presentation to all prospective clients.

In addition, the GIPS standards state that firms must document their policies and procedures used in establishing and maintaining compliance with the GIPS standards. In that spirit, firms must establish error correction policies and procedures.

Additionally, firms must comply with all applicable laws and regulations regarding the calculation and presentation of performance, including error correction.

To deal with errors appropriately, firms must adhere to the following requirements:

- Error correction policies and procedures must be established and then implemented consistently.
- Materiality must be defined in the error correction policies.
- The lack of a required disclosure is considered an error and the compliant presentation must be corrected.

With respect to a material error:

- The error must be corrected and disclosed in a corrected compliant presentation.
- Disclosure of the change in the corrected compliant presentation must be included for a minimum of 12 months following the correction of the compliant presentation. Firms are not required to disclose the material error in a compliant presentation that is provided to prospective clients that did not receive the erroneous presentation. However, for a minimum of 12 months following the correction of the compliant presentation, if the firm is not able to determine if a particular prospective client has received the materially erroneous compliant presentation, then the prospective client must receive the corrected compliant presentation containing disclosure of the material error. This may result in the preparation of two versions of the corrected compliant presentation to be used for a minimum of 12 months following the correction of the compliant presentation.
- The corrected compliant presentation must be given to all existing clients that received the erroneous presentation.
- Every reasonable effort must be made to provide the corrected compliant presentation to all prospective clients and other parties that received the erroneous compliant presentation. However, a firm is not required to provide a corrected compliant presentation to former prospective clients that did not hire the firm and are no longer considered a prospective client. If a firm wishes to differentiate between current prospective clients and former prospective clients that no longer qualify as current prospective clients, the firm must establish procedures to determine when a prospective client no longer has an interest in or no longer qualifies to invest in the composite strategy in question and therefore no longer is considered a prospective client for that composite strategy. If a firm is not able to differentiate between prospective clients and former prospective clients, the firm must send the corrected compliant presentation to both groups.

The following recommendations have been introduced:

- Error correction policies and procedures should be unambiguous and should include specific steps to discover and correct errors.
- Error correction policies and procedures should include how the corrected compliant presentation will be distributed to all applicable parties.
- Error correction policies and procedures should include procedures for documenting the error and actions taken.

When an error is made, it is important that the firm assess the impact and determine whether the corrective action will meet the guiding principles as described above.

Error Correction Policies and Procedures

A firm's control procedures are critical to mitigating errors and then identifying errors that do occur. It is important that the firm identify the parties within the organization that are integral to compliance with the GIPS standards and ensure that these parties are in communication with each other so that all areas affecting the firm's compliance with the GIPS standards are addressed in the firm's error correction policy. There should be a framework within the organization by which material errors in compliant presentations are escalated.

Error correction policies and procedures must be established and then implemented consistently. A firm should strive to create an unambiguous process that includes specific steps to discover and correct errors.

A firm must define materiality within the scope of its error correction policies and procedures. Once materiality is defined, the firm can decide how to treat errors of varying degrees. The policy should indicate the appropriate course of action given the materiality and nature of the error, yet be broad enough to capture various scenarios. Error correction policies and procedures should also include how the corrected compliant presentation will be distributed to all applicable parties as well as procedures for documenting the error and the actions taken. When determining error correction policies and procedures, a firm should consider the following factors:

- Materiality of the error, in absolute and relative terms,
- Whether the error is material relative to the benchmark,
- Whether returns are overstated or understated,
- Significance of the missing or incorrect disclosures,
- Whether the error affects returns over time and/or is a timing issue,
- Period(s) affected by the error,
- If these policies will be applied firmwide or on a composite-specific basis,
- Whether erroneous compliant presentations have been provided to prospective clients,
- Whether erroneous compliant presentations were provided to former prospective clients that are no longer considered prospective clients,
- Whether clients have received erroneous compliant presentations,
- Whether other parties have received erroneous compliant presentations, and
- Whether the firm has any legal or regulatory obligations related to error correction.

Definition of Materiality

The size and impact of the error may vary for different asset types (e.g., equities, fixed income, emerging market equities), reporting periods (e.g., monthly, quarterly, or annual returns), and time periods (e.g., prior to a specific date, more than five years ago). Whether an error might affect a prospective client's decision to invest is a key determinant of materiality and the appropriate action necessary to resolve the issue.

Error Correction

Once the investment management firm becomes aware of an error that affects the compliant presentation, the firm must determine how to proceed based on its previously established error correction policies and procedures. The firm generally has four options for how errors might be handled:

1. Take no action.
2. Correct the compliant presentation with no disclosure of the change.
3. Correct the compliant presentation with disclosure of the change and no distribution of the corrected presentation.
4. Correct the compliant presentation with disclosure of the change and make every reasonable effort to provide a corrected compliant presentation to all prospective clients and other parties that received the erroneous compliant presentation.

1. Take no action:

According to the firm's pre-established error correction policies and procedures, the error is deemed to be immaterial and does not require a change to any data or disclosures in the compliant presentation.

2. Correct the compliant presentation with no disclosure of the change:

The correction of the error results in a change to one or more items in the compliant presentation, but according to the firm's pre-established error correction policies and procedures, these changes are not material and, therefore, do not require disclosure of the change or distribution of the corrected compliant presentation to parties that received the erroneous compliant presentation.

3. Correct the compliant presentation with disclosure of the change and no distribution of the corrected compliant presentation:

The correction of the error results in a change to one or more items in the compliant presentation, but according to the firm's pre-established error correction policies and procedures, it is not deemed to be a material error. Therefore, the firm does not distribute the corrected compliant presentation. The error does, however, require disclosure in a revised compliant presentation.

4. Correct the compliant presentation with disclosure of the change and make every reasonable effort to provide a corrected compliant presentation to all prospective clients and other parties that received the erroneous compliant presentation:

According to the firm's pre-established error correction policies and procedures, the error is material and, therefore, requires correction and disclosure in a revised compliant presentation. The firm must provide the corrected compliant presentation to all existing clients that received the erroneous compliant presentation. In addition, the firm must make every reasonable effort to provide the corrected compliant presentation to all

prospective clients and other parties that received the erroneous compliant presentation, including consultants and verifiers. A firm is not required to provide a corrected compliant presentation to former prospective clients that did not hire the firm and are no longer considered a prospective client. Disclosure of the change must be included in the respective compliant presentation for a minimum of 12 months following the correction of the compliant presentation.

Firms are not required to disclose the material error in a compliant presentation that is provided to prospective clients that did not receive the erroneous presentation. However, for a minimum of 12 months following the correction of the presentation, if the firm is not able to determine if a particular prospective client has received the materially erroneous presentation, then the prospective client must receive the corrected presentation containing disclosure of the material error. This may result in the preparation of two versions of the corrected compliant presentation to be used for a minimum of 12 months following the correction of the presentation.

Examples

A basic error correction process involving an incorrect composite return within a compliant presentation may include the following steps:

1. Recalculate the returns and quantify the error.
2. Determine if the error is material based on previously established error correction policies and procedures.
3. Decide which action is the most appropriate based on previously established error correction policies and procedures.
4. Document the original return, the corrected return, and the action taken.

A basic error correction process involving an *incorrect or missing disclosure* may include the following steps:

1. Compare the composite's existing disclosures with those required in the GIPS standards.
2. Determine if an error has been made, including whether any disclosures are missing from the compliant presentation.
3. Determine if the error is material based on previously established error correction policies and procedures.
4. Decide which action is the most appropriate based on previously established error correction policies and procedures.
5. Document the original information, the corrected information, and the action taken.

Effective Date

The effective date for this Guidance Statement is 1 January 2011. The prior version of this Guidance Statement is available on the GIPS standards website (www.gipsstandards.org).