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## Guidance Statement on **GIPS<sup>®</sup>**-Performance Examinations **Effective 1 January 2012**

### Introduction

The scope and purpose of verification is to assess whether~~confirm that an investment management~~ firm has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS)<sup>®</sup> on a firm-wide basis and the firm's performance measurement processes~~policies~~ and procedures are designed to calculate and present performance results~~in compliance with the GIPS standards (Standards) on a firm-wide basis.~~ Verification does not confirm~~ensure~~ the appropriateness~~accuracy~~ of any specific composite presentation.

~~Should an investment~~ A firm want~~may choose~~ to also have ~~confirmed the appropriateness of a performance examination on~~ a specific composite presentation, ~~the firm may choose to have a further, more extensive, specifically focused examination (or performance audit) of a specific composite and its presentation.~~ The detailed review of any of the firm's composites by an independent ~~third party~~ "verifier" is termed a performance examination. Please note that the GIPS standards make use of the terms "composite" and/or "composite presentation" when describing a performance examination. Both terms should be viewed interchangeably in this context as it is the composite, including its associated composite presentation, that is examined as part of a performance examination.

A ~~the~~ performance examination may only be performed either concurrently with, or ~~upon~~ 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 conducting a performance examination generally comprise auditing, consulting, and other firms that have a high degree of knowledge regarding the investment management industry. Verifiers must follow currently accepted standards of practice within their industry (if applicable) when performing a performance examination pursuant to the GIPS standards. Please see the Guidance Statement on Verification for additional guidance on verifier qualification requirements.

A ~~P~~ performance examinations ~~are currently~~ is not required for a firm to be verified and is neither recommended nor required under the GIPS ~~s~~ Standards. ~~Examinations of this type are also~~

~~Performance examinations are unlikely to become a requirement of the GIPS standards. However, a firm may be asked or become mandatory; however, certain parts of the investment management industry require composite-specific may choose to obtain a performance examinations to provide them with additional and specific assurance that a particular composite has been independently examined with respect to the GIPS standards. The following guidance has been developed in order to ensure consistency of the procedures that are to be followed when a firm chooses to have a performance examination conducted on one or more of its composites.~~

## Scope and Purpose of Performance Examination

1. —A performance examination is ~~the review a detailed examination~~ of a specific ~~composite composite's compliant presentation~~ by an independent ~~third party~~ verifier. 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 ~~presents 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 ~~presentation~~, the verifier should consider the following presumptions, bearing in mind that they are not mutually exclusive and may be subject to ~~important~~ exceptions:

- Information obtained from independent sources outside the ~~investment management firm~~ provides greater assurance than information secured solely from within the ~~investment management 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 ~~should~~ must at a minimum be based on the verifier's consideration of:

- ~~T~~he nature and materiality of the information to be tested;
- ~~T~~he effectiveness of the control environment (including the extent to which manual processes are employed);
- ~~T~~he likelihood of misstatements;
- ~~K~~nowledge obtained during current and previous engagements;
- ~~T~~he extent to which the information is affected by judgment; ~~and~~
- ~~I~~nadequacies 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 performing 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 from the composite 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 ~~C~~consider the following criteria when selecting ~~the sample portfolios for~~ examination:

- ~~N~~umber of portfolios in the composite;
- ~~C~~omposite definition ~~of the composite~~;
- ~~T~~otal assets of individual portfolios relative to total composite assets;
- ~~I~~nternal control structure at the firm;
- ~~N~~umber of years under examination; and
- ~~U~~se of ~~technology and external service providers~~ computer applications, software used in the construction and maintenance of composite, the use of external performance measurers and other external service providers, and the method of calculating performance.

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**

The verifier's objective ~~W~~hen conducting a performance examination, the verifier must ~~is to~~ accumulate sufficient evidence and perform ~~sufficient~~ appropriate procedures such that the ~~risk~~

of not detecting errors ~~in the composite presentation~~ during the performance examination is mitigated to an acceptably low level ~~of risk~~.

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 investment management firm.

**Pre-Performance Examination Procedures ~~(applicable if the performance examination is being conducted by a verifier that did not perform the firm-wide verification):~~:**

- ~~1) Knowledge of the Investment Management Firm: Verifiers conducting the performance examination must obtain the relevant verification report(s) and the composite presentation(s) to be examined, as well as any other available information regarding the firm to ensure appropriate knowledge of the firm.~~
- ~~2)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, ~~reports, guidance statements~~ Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and ~~must consider all such information (See the GIPS Provision 0.A.15)-Executive Committee, which are available on the GIPS standards website (www.gipsstandards.org) as well as in the GIPS Handbook.~~~~
- ~~2)2) Knowledge of Applicable ~~Country-Specific~~ Laws and Regulations: Verifiers conducting the performance examination must be knowledgeable of ~~country-specific applicable~~ laws and regulations ~~applicable to~~ regarding the firm calculation and presentation of performance and must ~~determine~~ consider any differences between ~~the GIPS standards and the country-specific~~ these laws and regulations and the GIPS standards.~~
- ~~3) Knowledge of ~~Investment Management Firm's Policies: the Firm~~: Verifiers conducting the performance examination must obtain the ~~investment management firm's written policies and procedures used for~~ relevant verification report(s) and the composite when 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 ~~during the period to be examined. 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(s) being examined. The verifier must also ensure that the policies and procedures are clear, unambiguous, and consistent 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 as relating the composite(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 strategy. The verifier must obtain the composite definition with criteria for assignment of portfolios in the composite;
- Timing of inclusion of new portfolios in the composite;
- Timing of exclusion of closed portfolios in the composite;
- Accrual of interest and dividend income;
- Treatment of fees;
- Valuation of portfolio investments, including policies for determination of fair value;
- Computing the rates of return for each portfolio;
- Handling of cash flows (assumptions on the timing of capital inflows/outflows and handling of large and, where applicable, significant cash flows);
- Computing composite returns;
- Error correction;
- Preparation of composite 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 presentation.

5) Knowledge of Valuation Basis and Performance Calculations: Verifiers must understand the policies, procedures and methodologies used to value portfolios and compute investment performance.

#### **Performance Examination Procedures:**

~~1) Sample~~ Portfolio Selection: Objective: to ~~ensure~~determine that the proper portfolios are included in the examined composite. ~~Verifiers conducting the performance examination may check compliance with the GIPS standards using a selected sample of the composite's portfolios.~~

1) ~~Obtain~~The verifier must obtain a list of all open (both new and existing) and closed portfolios for the ~~firm's~~composite for the period(s) under examination and ~~ensure~~determine for the examined composite that:

- ~~1) The timing of inclusion policies and procedures were appropriately implemented;~~
- ~~2) Ensure the composite includes all actual, fee-paying discretionary portfolios that meet the definition of the composite for the period under examination; and~~
- ~~3) —~~

of portfolios in the composite ;

- has been consistently applied in accordance with the firm's policies and procedures;
- The timing of exclusion of portfolios from the composite has been consistently applied 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, portfolio summary, 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, have been consistently applied 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) ~~the methods used to account for cash flows, contributions, and withdrawals are appropriate and~~ External Cash Flows: Objective: to determine ~~whether capital contributions and withdrawals that~~ external cash flows for the examined composite:

- Are recorded in the proper portfolios;
- Are recorded at the correct amounts and;
- Are properly identified as large (as defined by the firm's policies and procedures); and
- Are recorded on a timely and consistent basis; in accordance consistent with the firm's established policies and procedures.

~~Sufficient p~~Procedures ~~must should be considered and performed at a level such that the verifier is satisfied to determine~~ that:

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

3) Income and Expenses: Objective: to determine that income and expenses for the examined composite are:

- R#recorded in the proper portfolios;
- Recorded at the correct amounts; and
- Recorded on a timely basis.

~~Sufficient P~~Procedures ~~should must be considered and performed at a level such that the verifier is satisfied to determine~~ that:

- I#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 consistently applied and appropriate relative in accordance with the firm's policies and procedures;
- Expenses are appropriately treated with respect to the calculation of net- and/or gross-of-fees performance returns; and
- The calculation and use of accrued income is reasonable, and consistently applied in accordance with the firm's policies and procedures.

4) ~~4)~~ Portfolio Trade Processing: Objective: to determine that portfolio purchases and sales of securities investments for the examined composite have been:

- ~~properly~~ recorded in the proper portfolios;
- ~~at the correct amounts, and~~

on the appropriate dates.

~~Procedures should~~ Sufficient procedures must be ~~considered and~~ performed at a level such to determine that ~~the verifier is satisfied that~~:

- ~~P~~portfolio trading activity is supported by appropriate documentation such as custody statements ~~or, trade confirmations, reconciliations, and~~ internal records; and
- ~~beginning and end-of-performance measurement period portfolio positions are supported by documentation such as custody statements or internal records, and~~
- The methods used to account for portfolio trading activity are appropriate and consistently applied: in accordance with the firm's policies and procedures.

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

- ~~a) Valued~~ correctly; and
- ~~b) Valued~~ on the correct dates.

~~Sufficient P~~rocedures ~~should must~~ be ~~considered and~~ performed at a level such to determine that ~~the verifier is satisfied that~~:

- ~~B~~eginning- and end-of-performance measurement period security investment valuations are consistent with the firm's valuation policies, ~~and procedures, and the GIPS Valuation Principles in Chapter II of the GIPS standards~~;
- That portfolios are valued on the date of all large cash flows, as defined by the firm's policies and procedures;
- ~~F~~oreign currency exchange rates used are consistent 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 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 sufficient documentation such as custody statements and custody reconciliations. The verifier must make every reasonable effort to obtain these documents directly from independent external parties (e.g., custodian, broker); and
- The methods used to ensure the existence and ownership of assets are appropriate and have been consistently applied in accordance with the firm's policies and procedures.

6)7) Performance Measurement Calculation: Objective: to determine that ~~portfolio and composite~~ the methods used to calculate portfolio, composite, and benchmark returns for the examined composite are appropriate, have been consistently applied and the returns have been correctly calculated.

~~Procedures should be considered and performed at a level such that the verifier is satisfied that:~~

- ~~computations of portfolio returns are appropriate and consistently applied~~
- ~~computations of the composite's returns are appropriate and consistently applied~~
- The verifier must take a sample of all required 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 consistently in accordance with the firm's policies and procedures;
  - Only return methodologies as required by the GIPS standards are used;
  - Portfolio and composite returns are accurately calculated;
- If custom benchmarks or a combination of multiple benchmarks are used, determine that the calculation methodology has been correctly and consistently applied, and the data used are consistent with the benchmark description in the compliant presentation; and
- Computations of required risk measures are appropriate and have been consistently applied.

7)8) Compliant Composite Presentation Information and Disclosures: Objective: to determine whether 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 performancecompliant presentation; and
- Are appropriately supported by available 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 performancecompliant presentation.

Sufficient Procedures ~~should must~~ be ~~considered and~~ performed at a level such to determine that ~~the verifier is satisfied that:~~

- The composite benchmark reflects the investment mandate, objective, or strategy of the composite;

- The presentation includes all the information and disclosures required by the GIPS standards;
- ~~all of the required disclosure and presentation and reporting provisions have been adequately satisfied,~~
- ~~required calculations have been performed appropriately, and~~
  - the application and inclusion of the ~~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, the firm's documented policies and procedures, and the results of the verifier's procedures.~~

When supplemental information is presented in the examined composite's compliant presentation, at a minimum, the verifier must ensure that the supplemental information is not false or misleading, and the supplemental information is 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.

Maintenance of Records: The verifier must maintain sufficient ~~information documentation~~ to support ~~the performance examination report.~~

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- 9) Prior to issuing all procedures performed supporting the issuance of the performance examination report, including all significant judgments and conclusions made by the verifier.

### **Representation Letter**

Prior to expressing an opinion, the verifier conducting the performance examination must obtain from the management of the firm a representation letter from the investment management firm at a minimum confirming 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) confirming that the composite being examined has been constructed and calculated and its presentation in compliance with the GIPS standards;
- 3) The firm has been prepared and presented the composite presentation in compliance with the GIPS standards;
- 4) The management representation letter should also confirm any firm complies with the GIPS standards for the period(s) being examined; and
- 5) Any other specific 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;
- 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 ~~report is issued only performed~~ with respect to a ~~specific~~ single composite's compliant presentation examined by a verifier and does not ~~provide assurance attest on the compliant to the accuracy of a performance presentation for any other composite. If performance examinations are performed on multiple composites, the verifier may issue a single performance examination report covering the composites that have been examined. The performance examination report can either be prepared as part of a verification report or as a separate report attached to the verification report. The compliant presentation for the specified composite(s) that has been examined must be included in or attached to the performance examination report.~~

- a. ~~In order for a performance examination report to be issued the verifier must ensure that~~
- 1) ~~the investment~~ firm has a verification report(s) stating 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 processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards.

~~A principal verifier may accept the work of a local or previous verifier as part of the basis for satisfying that a firm has previously received a verification report. The verifier must use discretion when placing reliance on another verifier's verification report(s).~~

~~It is expected that the time periods covered by a verification report(s) include the performance examination time period. —~~

- 1)2) ~~A performance examination report must not cover periods beyond those periods covered by the verification report(s). Typically, the firm has a performance examination conducted concurrently with a verification and the time period covered by the performance examination is covered within this verification. In this instance, the A performance examination report must may not be issued prior to the verification report.~~

~~The verifier performs procedures to confirm that the specific composite has been constructed, calculated and presented in compliance with the GIPS standards.~~

- 3) The performance examination report must opine that:
- The composite was constructed and calculated in compliance with the GIPS standards;
  - and

- The firm has prepared and presented the composite presentation in compliance with the GIPS standards.

~~3. The GIPS standards do not specify any particular format for the performance examination report issued by verifiers; however, a performance examination report generally includes the following information:~~

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 is for a performance examination.~~
- The report title;
- 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;
- ~~• The name of the composite that has beenwas examined;~~
- ~~• The time period covered by the report.~~
- The period(s) for which the performance examination has been performed;
- A statement indicating that the performance examination of the specified composite has been performed. The verifier conducted the performance examination of the specified composite in accordance with the Guidance Statement on GIPS Performance Examinations, required performance examination procedures of the GIPS standards;
- The verifier's opinion that the composite was constructed, calculated and presented in compliance with the GIPS standards. A statement indicating that the performance examination does not ensure the accuracy of any other specific composite 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.

~~Without the performance examination report from the verifier,~~

~~the firm must not state that a the composite has been examined with respect to the GIPS standards unless the performance examination report has been issued for the specific composite. The underlying composite presentation that is examined must be incorporated in the verifier's performance examination report (e.g., included in or attached to the report).~~

4) After completing the performance examination procedures, the verifier may conclude that the composite presentation does not comply with satisfy the GIPS standards (e.g., or the records of the firm cannot support the composite construction or calculation methodologies used) performance examination. In such situations, the verifier and the firm must issue a

~~statement to the investment management firm clarifying the reason(s) why it was not possible consider the impact of the verifier's inability to provide the a-performance examination report The verifier and the investment management firm must also 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. 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 or other areas of improvement arising from the performance examination.~~

### **Effective Date**

~~All investment management and verification firms that choose to engage in a performance examination of a specific composite that covers performance results for periods ended 31 December 2006 or thereafter must apply this guidance. Early adoption of this guidance is encouraged. This guidance should be considered industry global best practice. Firms are not required to have a composite presentation reexamined using this guidance if a performance examination was completed on a composite presentation that reported performance results prior to 31 December 2006, i.e., retroactive application of this guidance is not required.~~

~~This Guidance Statement was originally effective 31 December 2006. Subsequent revisions have been made to this guidance to coincide with the effective date of the 2010 edition of the GIPS standards which is 1 January 2011. Verifiers must conduct their performance examination engagements in accordance with this Guidance Statement for all performance examinations contracted on or after 1 January 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 verification engagements in accordance with this Guidance Statement prior to 1 January 2012 and are encouraged to do so. The prior version of this Guidance Statement is available on the GIPS standards website ([www.gipsstandards.org](http://www.gipsstandards.org)).~~

### **Applications:**

- ~~1. Our firm recently completed our annual verification process and then hired a different verification firm to conduct performance examinations on a few selected composites. During the verification, several issues were identified that might be important for the performance examination verifier to know. What is the investment management firm's responsibility to report such information?~~

~~It is the responsibility of the investment management firm to fully disclose any information that might impact the work of the verifier who is performing the performance examination(s). Although permitted by the GIPS standards, it is not required that the verifier conducting the performance examinations accept the work of another verifier as part of the basis of the opinion for the performance examinations. Investment management firms should consider the impact of having different verifiers perform the verification and the performance examination(s).~~

~~2. We are a verification firm and have been hired to conduct a verification for ABC Asset Management Firm. In addition to the verification, we have also been hired to conduct a performance examination on the ABC Large Cap Composite. What language must be included in our performance examination report?~~

~~The GIPS standards do not specify any particular format for the performance examination report issued by verifiers. There are several options for the language that can be included in a performance examination report. When the same verifier performs both the verification and performance examination, a commonly used template makes reference to both. The verification firm could consider using the language provided in the following sample report, and should also add references to any professional standards to which the verifier might be held.~~

~~ABC Asset Management Firm  
ABC Address~~

~~Re: Verification of ABC Asset Management Firm and Performance Examination of ABC's Large Cap Composite~~

~~This verification has been performed for the period from 1 January 2000 to 31 December 2006 for ABC Asset Management Firm Inc. (the investment management subsidiary of QRS Bank), and confirms that in our opinion:~~

- ~~• the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and~~
- ~~• the firm's processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards.~~

~~Also, in our opinion:~~

- ~~• for the period from 1 January 2000 through 31 December 2006, the firm has constructed and calculated its Large Cap Composite in compliance with the GIPS standards, and~~
- ~~• the accompanying presentation of the Large Cap Composite is in compliance with the GIPS standards.~~

~~We conducted this verification in accordance with the verification procedures set forth in the GIPS standards and performed this performance examination in accordance with the performance examination procedures set forth in the Guidance Statement on GIPS Performance Examinations.~~

~~ABC Asset Management Firm's management is responsible for compliance with the GIPS standards, the design of its processes and procedures, and for ABC's Large Cap~~

~~Composite presentation. Our responsibility is to express an opinion based on our verification and performance examination.~~

~~This report does not attest to the accuracy of any composite presentation of ABC Asset Management Firm other than the firm's Large Cap Composite.~~

~~\_\_\_\_\_ (signature)~~

~~XYZ Verification Company  
15 March 2007~~

~~3. How does a performance examination differ from a verification?~~

~~The purpose and scope of verification is to confirm that the firm has complied with all the composite construction requirements of the Standards on a firm-wide basis and the firm's performance measurement processes and procedures are designed to calculate and present performance results in compliance with the Standards on a firm-wide basis. Verification is not to be seen as an attempt to confirm the appropriateness of a specific composite presentation. Verification ensures the policies and procedures used to establish and maintain compliance with all the applicable requirements of the GIPS standards are in place and, on a sample basis, tests whether or not the processes and procedures used to implement those policies are in place.~~

~~A performance examination tests whether a specific composite has been constructed, calculated, and presented in compliance with the Standards. A performance examination includes testing on a specific composite to ensure the firm has implemented its processes and procedures to comply with the composite construction, calculation and presentation requirements of the GIPS standards for a specific composite.~~

~~For example, when conducting a verification, the verifier must determine the firm's policy with regard to the accrual of interest income. The verifier should perform testing for a selected sample of portfolios on a firm-wide basis to determine whether the firm's policies and assumptions with respect to the accrual of interest income is reflected in the calculation of returns. The selected sample of portfolios may or may not include portfolios from all of the firm's composites.~~

~~When a performance examination is conducted for a specific composite, a sample of portfolios in the specified composite is selected and the verifier must determine whether the firm has properly implemented the firm's policy, i.e., income is recorded in the proper portfolio, at the right amount and on a timely basis.~~

~~4. The performance examination procedures state that compliance with the Standards may be checked using a selected sample of the composite's portfolios. Is there any guidance on what the size of the sample must be to ensure the accuracy of the performance examination?~~

The size of the sample of portfolios selected from the composite will vary based on the verifier's judgment when considering the criteria listed in Procedure 1.c of the Guidance Statement on GIPS Performance Examinations. It should be noted that the process of using a selected sample of portfolios is similar to that used in the verification procedures when selecting a sample of the investment firm's portfolios to check compliance with the GIPS standards.

It is not possible to give a specific number of portfolios or a percentage of portfolios that must be checked per composite. As provided in the Guidance Statement on GIPS Performance Examinations, the verifier's objective is to accumulate sufficient evidence and perform appropriate procedures such that the risk of not detecting errors in the composite presentation during the examination is mitigated to an acceptably low level of risk.

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. For example, when testing security prices the verifier may determine that testing market values for securities listed on exchanges is relatively straightforward and minimal testing is needed; however, for thinly traded securities, the verifier may determine that additional testing is needed. The verifier must determine what procedures will be performed to determine that the portfolio valuation methodologies are reasonable.

*5. Our most recent firm wide verification report and performance examination for the Large Cap Composite covered the period from 1 January 2000 through 31 December 2005. We received a Request For Proposal (RFP) asking for our Large Cap Composite performance results from 1 January 2000 through 30 June 2006. The RFP asked whether the Large Cap composite had been independently examined with respect to the GIPS standards. Because we want to be able to say that the composite presentation has been examined for all periods being requested (through 30 June 2006), we would like to have a performance examination completed through 30 June 2006. Must the firm wide verification report be updated through 30 June 2006 before a performance examination can be completed for the Large Cap Composite for the same time period?*

It would be expected that the periods covered by a verification report would be consistent with the period(s) covered by the performance examination. The firm's best option would be to have both the verification and performance examination updated to cover the requested period, in this instance through 30 June 2006. However, recognizing that there may be limitations to the immediate availability of a verification firm to perform a full verification for the six month period, there may be unusual and infrequent situations where a performance examination could cover longer periods than the verification. Both the investment management firm and the verifier performing the performance examination would need to consider the firm's policies and procedures, including the controls surrounding the application of those policies and procedures to the longer period.

If the verifier concludes that they can issue a performance examination report for the period beyond the verification, it should not exceed twelve (12) months beyond the date of the most recent verification report. In the interest of fair representation and full disclosure, both the

~~performance examination report and the composite presentation accompanying the RFP should clearly disclose: (a) the lack of a verification for the specified time period and (b) that the document can only be provided to the prospective client making the request.~~