

## GIPS 2010 – Executive Update

On Friday, January 29, 2010, the GIPS Executive Committee (EC) approved the 2010 version of the GIPS standards. The EC, which serves as the decision-making authority for the GIPS standards, continually updates the standards through interpretations, guidance, and new provisions. In 2008, the EC (working with technical committees and GIPS country sponsors), began a comprehensive review of all of the GIPS standards in an effort to further refine the provisions, eliminate provisions that are no longer necessary, and add new requirements and recommendations that promote best practices. This comprehensive review, which incorporated feedback from the public, resulted in the 2010 version of the GIPS standards. The 2010 version of the GIPS standards becomes effective January 1, 2011.

We have summarized some of the key points of the GIPS 2010 standards below. Please feel free to contact us with any questions on the new standards and how they might impact your firm.

### Fair Value

The prior version of GIPS required firms to use market values. The 2010 version of GIPS requires firms to use fair values and provides an Appendix titled “GIPS Valuation Principles” to assist firms in understanding the concept of fair value. The GIPS Valuation Principles are very similar to recently issued international and U.S. accounting standards, such as FAS 157.

For many investment advisors, this will have little to no impact on performance reporting. However, for those managers investing in harder to value securities (such as real estate, private equity, or other alternate investments), this may impact performance reporting. Firms will be required to disclose the use of subjective unobservable inputs for valuing portfolio investments.

### Claim of Compliance

GIPS 2010 provides specific wording for firms to use when indicating that the firm has been verified and when a composite has been examined. This prescribed wording was added to the standards to make such disclosures uniform and to avoid potentially misleading readers of performance presentations. In the past, some firms added a disclosure to unexamined composite presentations that the firm was verified, without explaining what a verification entailed. This created the potential for readers of the presentation to mistakenly think that the composite presentation had been examined, thereby placing a higher degree of reliance upon the compliance performance presentation than was intended by the disclosure indicating that the firm was verified.

## **Benchmark Disclosures**

Firms must now include descriptions of benchmarks in performance presentations.

## **Refinement of Fee Disclosures**

Net of fee returns have historically been calculated using either actual or model fees. However, disclosure of whether actual or model fees were used was not a requirement of the old standards. GIPS 2010 requires that this be disclosed, as well as whether the net of fee returns are net of any performance-based fees.

## **Three Year Annualized Ex-Post Standard Deviation**

As a measure of risk, firms will be required to disclose the three year annualized ex-post standard deviation (using monthly returns) of both the composite and the benchmark. If the underlying data are not available or a firm determines that annualized ex-post standard deviation is not relevant or appropriate, explanatory disclosures to this effect must be added to the performance presentation as well as an additional three year ex-post risk measure that the firm deems relevant and appropriate.

## **Real Estate Provisions**

GIPS 2010 requires that external valuations be performed at least once every 36 months for periods prior to 1/1/2012, and at least once every 12 months from 1/1/2012 onward. There is relief from this more frequent external valuation timeframe if client agreements stipulate longer periods for external valuation.

The new standards require increased disclosures regarding valuation, changes to policies, and external valuation. The new standards also require disclosure of since inception IRRs as well as many other metrics that were previously included in private equity presentations (such as paid in capital, distributions, committed capital, and various related multiples).

## **Private Equity Provisions**

One of the biggest changes impacting private equity (PE) performance presentations will be the fair value requirements noted above.

In the past, PE composites were required to be defined by vintage year. For PE fund of fund structures, this posed a problem as there were often fund of funds with different vintage years that had similar investment objectives and underlying investment funds. GIPS 2010 fixes this problem by allowing composite groupings to be designed around investment mandate, objective, or strategy.

Fund of Fund composites must also disclose the percentage of composite assets invested in direct investments and the percentage invested in underlying funds.

## Advertising Guidelines

The GIPS Advertising Guidelines were modified to be consistent with the changes made to the corpus of the Standards. Additionally, guidance was added addressing the periods to be disclosed when a firm has fewer than 5 years of return history.

The guidelines also require that other information included in the advertisement be shown with equal or lesser prominence relative to the information required by the GIPS Advertising Guidelines and that such information must not conflict with the requirements of the GIPS standards or Advertising Guidelines.

## Verification

There were significant changes and additional procedures added to the verification section of the GIPS standards. These changes and additional procedures will have virtually no impact on the verifications performed by Kreischer Miller as our verifications already incorporate most of these requirements, as well as the additional AICPA attestation standards we are always required to follow.

One of the steps added requires verifiers to perform procedures designed to test the existence and ownership of a firm's client assets. This was likely added as a result of the alleged fraud cases involving Westridge Capital Management and Locke Capital Management, both of which were allegedly subject to verification by a well known verifier.

## Glossary

The Glossary has been significantly expanded and definitions more clearly defined. This should be helpful to all users of the GIPS standards.

If you have any questions on this or other matters, please feel free to contact us.

Sincerely,



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