

# GIPS Guidance Statement on Error Correction

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# Effective Date

- ▶ Public comment period: October 2004 - February 2005
- ▶ Adopted 18 June 2008
- ▶ Effective date: 1 January 2010
  - ▶ Firms must establish error correction policies and procedures by the effective date
  - ▶ Firms must follow their procedures for any error in a compliant presentation identified after 31 December 2009.
- ▶ Firms are strongly encouraged but not required to adopt this guidance prior to the effective date
- ▶ No retroactive application required

# Scope of this guidance

- ▶ An error is defined as any component of a compliant presentation that is missing or inaccurate.
- ▶ Adjustments to prior period returns or presentations.
- ▶ Errors can be quantitative and/or qualitative.
- ▶ The Guidance Statement on Error correction addresses errors related to GIPS compliant presentations, but not the errors discovered in advertisements prepared following the GIPS Advertising Guidelines.

# Possible sources of errors

Errors can result from incorrect, incomplete or missing

- ▶ Composite or benchmark returns
- ▶ Composite or firm assets
- ▶ Number of portfolios in a composite
- ▶ Measure of dispersion
- ▶ Disclosure
- ▶ Etc.

Errors can be caused by

- ▶ Input data errors
- ▶ Prior period adjustments
- ▶ Incorrect timing of inclusion and/or exclusion of portfolios to composites
- ▶ Inadequate creation or implementation of policies and procedures
- ▶ Etc.

# Basis for this guidance statement

The fundamental principle of the GIPS is fair representation and full disclosure. Firms must, therefore, avoid presenting misleading information.

0.A.11 requires firms to make **every reasonable** effort to provide a compliant presentation **to all prospective clients**.

0.A.6 states that firms must document, in writing, their policies and procedures.

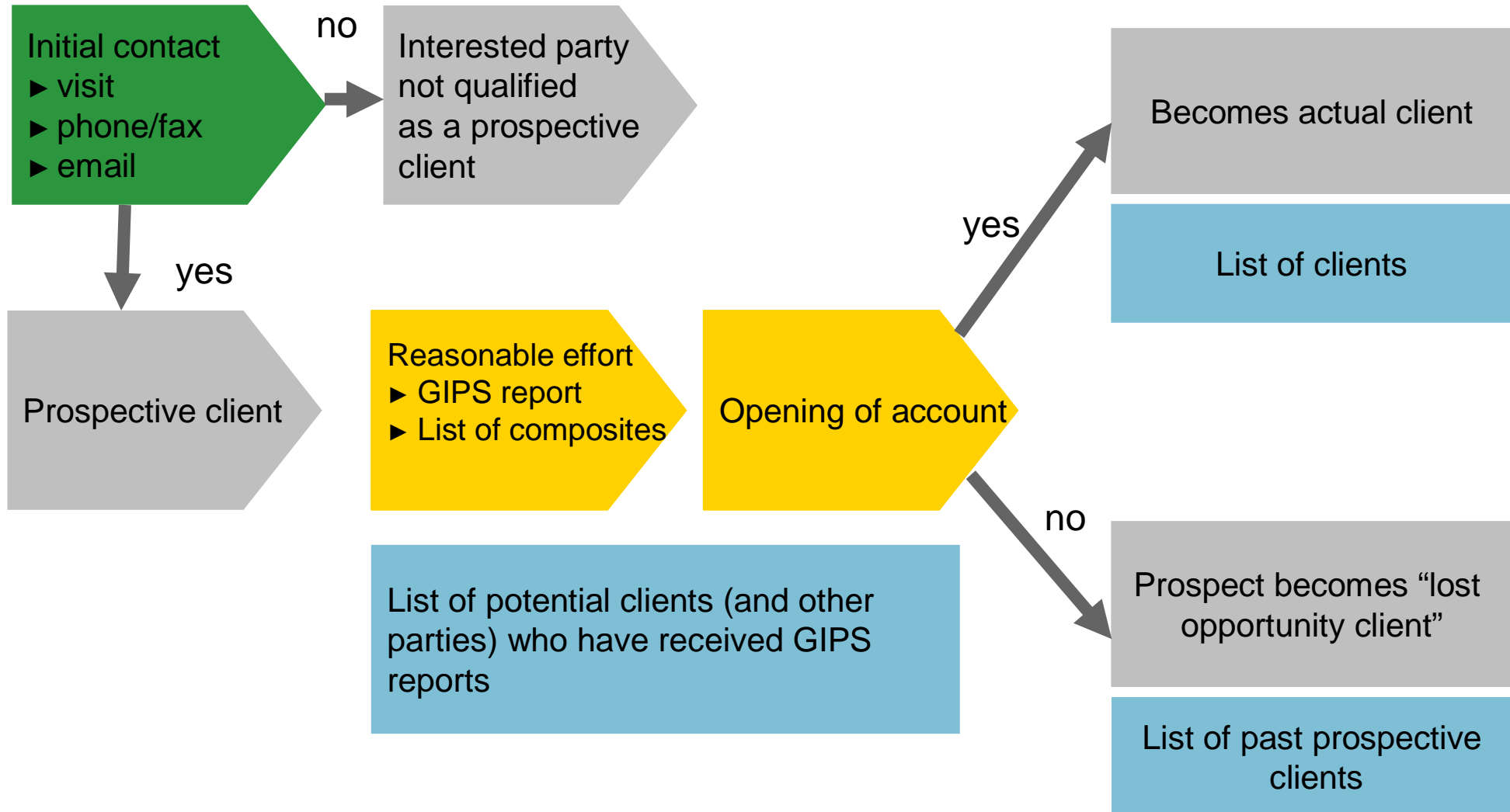
**A firm must establish error correction policies and procedures.**

# Define prospective client

“Every reasonable effort must be made to provide the corrected presentation **to all prospective clients and other parties** that received the erroneous presentation, including consultants and verifiers.” (p.5, GS on Error Correction)

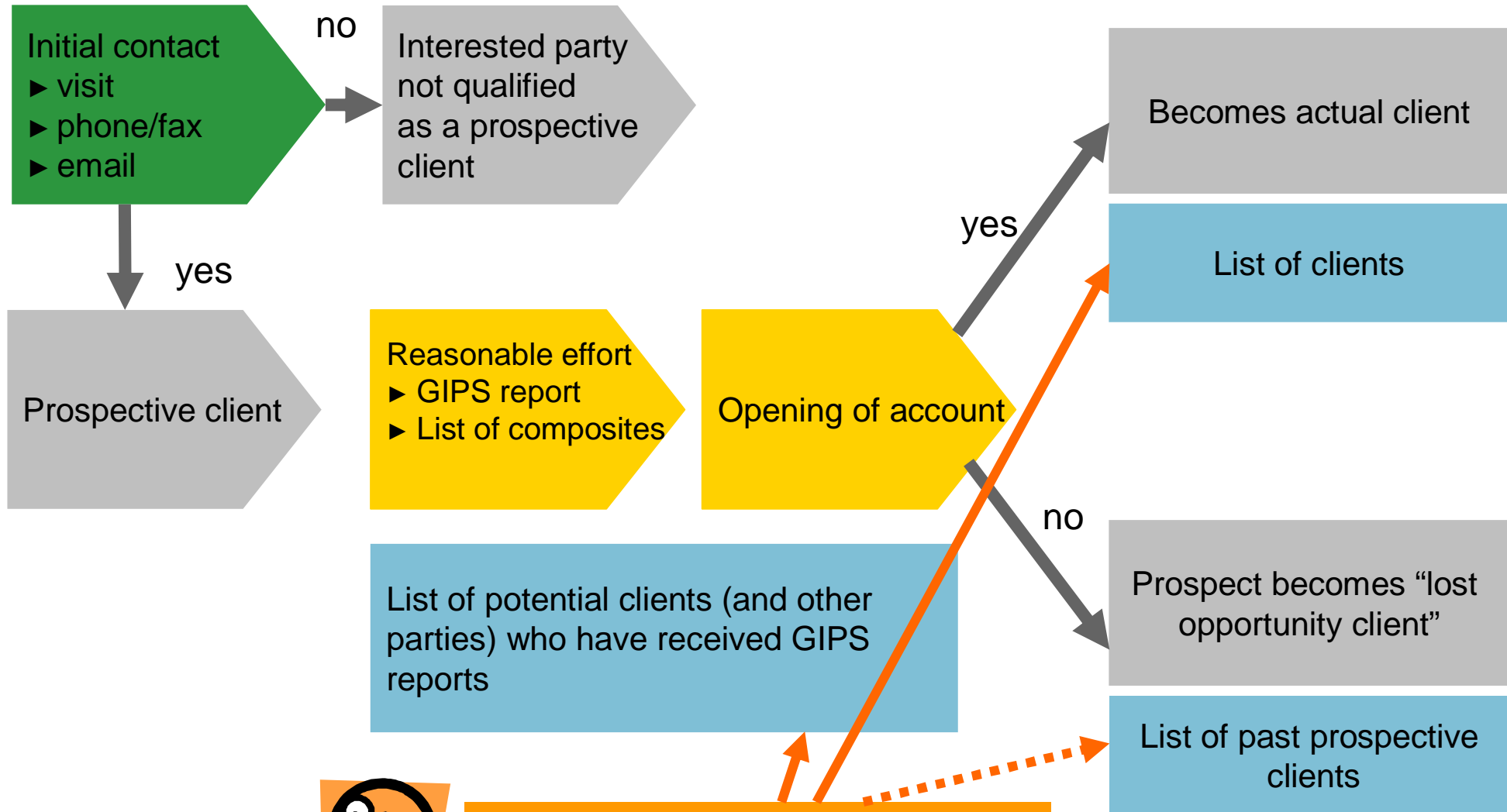
Prospective client: “It is up to the firm to determine how it defines a prospective client.” (p. 73 GIPS Handbook)

# Define prospective client - continued





# Define prospective client - continued



Make every reasonable effort to provide corrected presentations

# How to deal with errors: requirements

## Requirements

- ▶ Error correction policies and procedures must be established and then implemented consistently
- ▶ Materiality must be defined in the error correction policies
- ▶ When an error occurs, it is important that the firm assesses the impact and determines whether the corrective action will meet the guiding principles.

## Requirements if an error is **material**

- ▶ The error must be corrected and disclosed
- ▶ Disclosure of the change must be shown for a min. of 12 months
- ▶ **All existing clients** that received the erroneous presentation must receive a corrected version
- ▶ Every **reasonable effort** must be made to provide the corrected presentation to all **prospective clients** and other parties that received the erroneous presentation

# How to deal with errors: recommendations

Recommendations for error correction entail policies and procedures that should

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

# Error correction policies and procedures

The firm should identify the principal parties within the organization that are integral to GIPS compliance and ensure that these parties communicate with each other.

Errors must be identified, assessed, documented, communicated, escalated.

Within the firm a framework should be in place by which **material** errors in presentations can be detected and corrected.

Given the materiality and nature of the error, various error scenarios can be set up.

# Error correction policies and procedures continued

## Factors to consider

When determining error correction policies and procedures, a firm should regard

- ▶ the materiality of the error (in absolute or relative terms)
- ▶ whether the error is material relative to the benchmark
- ▶ whether returns were overstated or understated
- ▶ the significance of the missing or incorrect disclosures
- ▶ whether the error affects returns over time
- ▶ the period(s) affected by the error
- ▶ whether the policies will be applied on a firm-wide or on a composite-specific basis
- ▶ whether erroneous presentations have been provided to prospective clients, existing clients or other parties
- ▶ whether the firm is legally obligated to correct and/or disclose the corrections

# Definition of materiality

A key determinant of **materiality** is whether an error might affect a prospective client's investment decision and appropriate action is necessary to resolve the issue.

Size and impact of the error may vary for

- ▶ Asset classes (setting different thresholds)
- ▶ Reporting periods
- ▶ Time periods

# Definition of materiality and possible options

## Option 1

### No action

- ▶ Immaterial
- ▶ No change of data
- ▶ No disclosure of error

## Option 2

### Correction but no disclosure

- ▶ Not material
- ▶ Correction of presentation
- ▶ No disclosure of error
- ▶ No distribution

## Option 3

### Correction with disclosure

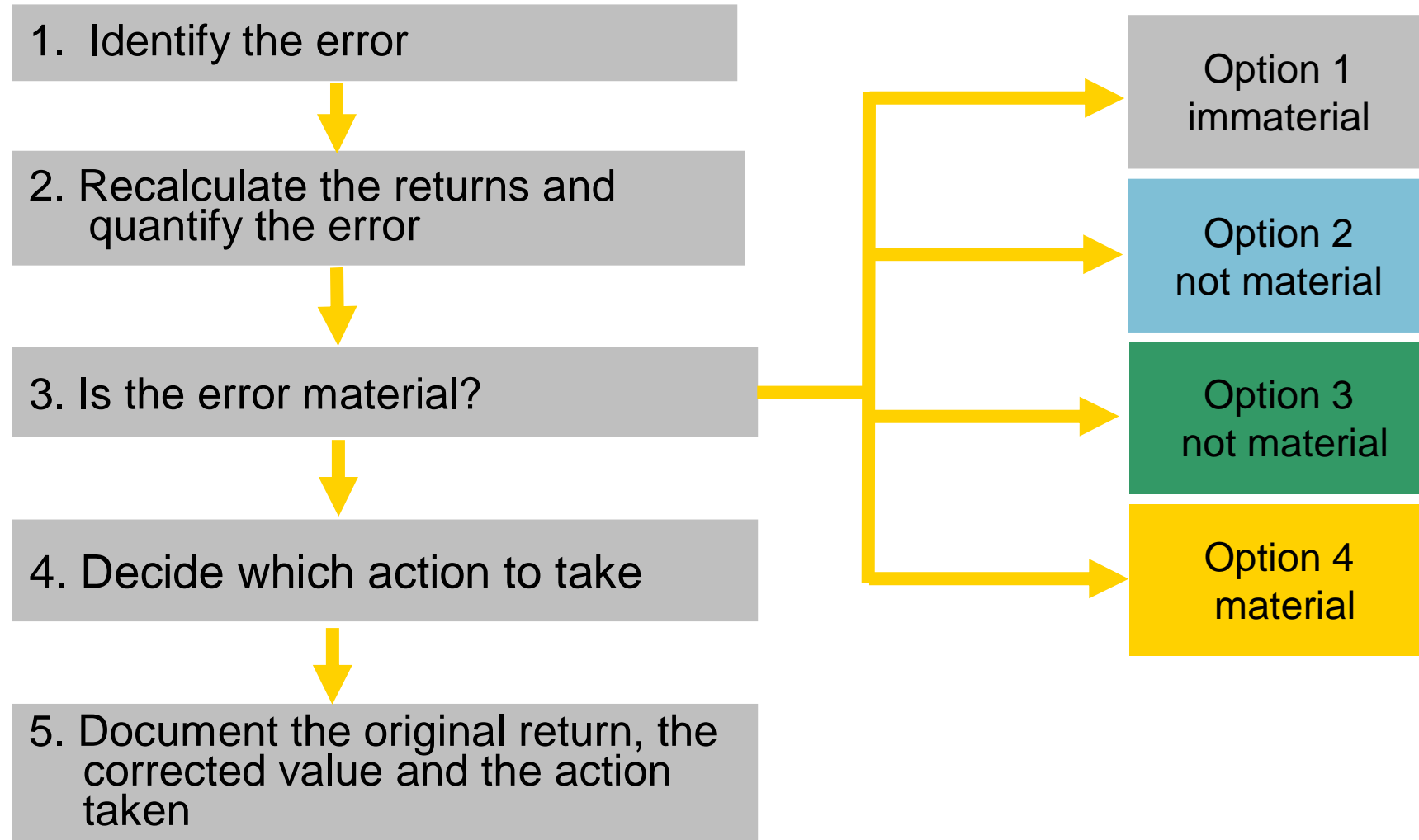
- ▶ Not material
- ▶ Correction of presentation
- ▶ Disclosure of error
- ▶ No distribution

## Option 4

### Correction with disclosure and reasonable effort to distribute

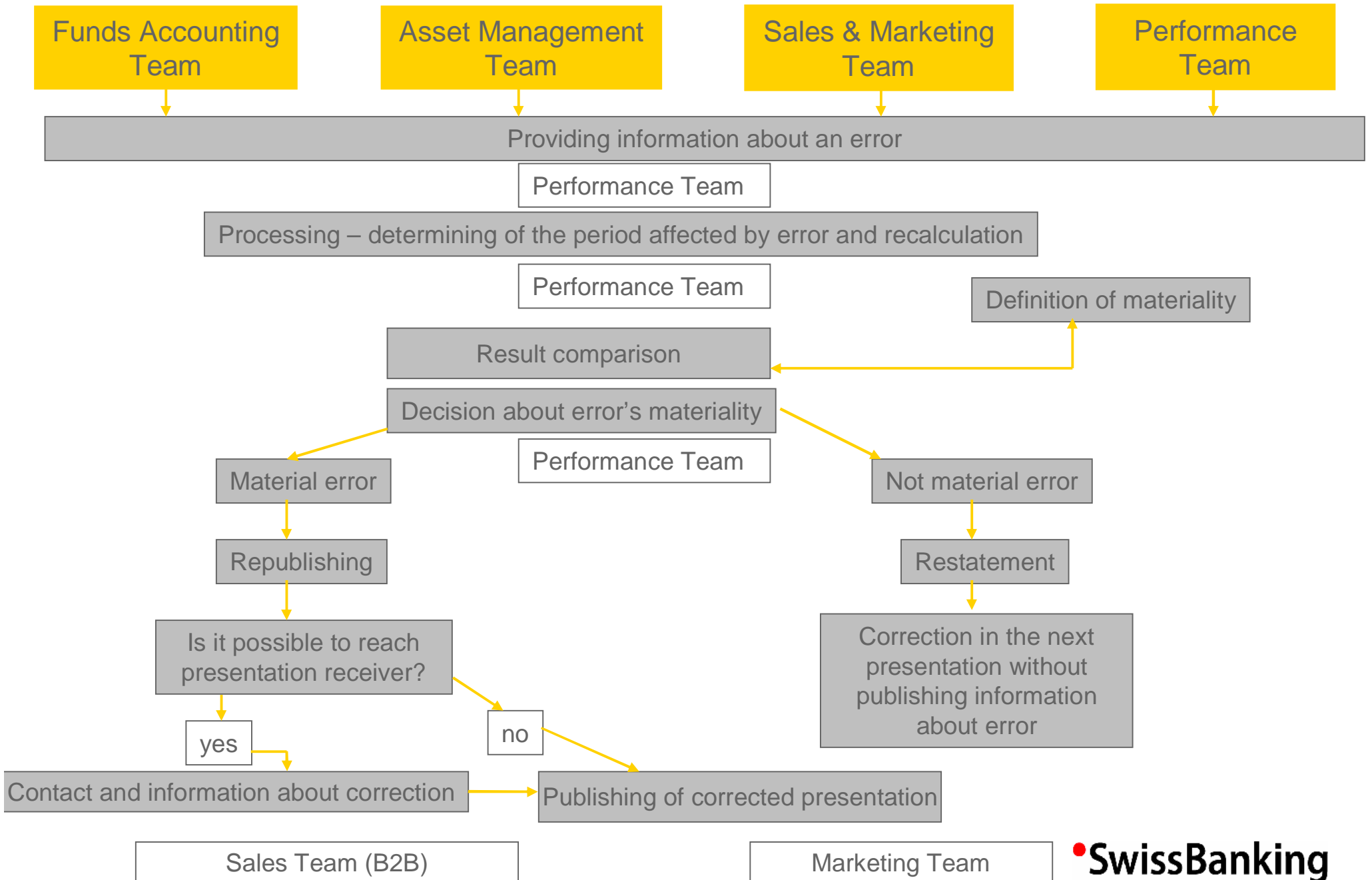
- ▶ Material
- ▶ Correction of presentation
- ▶ Disclosure of error
- ▶ Reasonable effort to provide corrected presentation to all prospective clients and other parties
- ▶ Min. 12 months

# Case example incorrect composite return





# Asset manager's examples



# Possible questions of the verifier

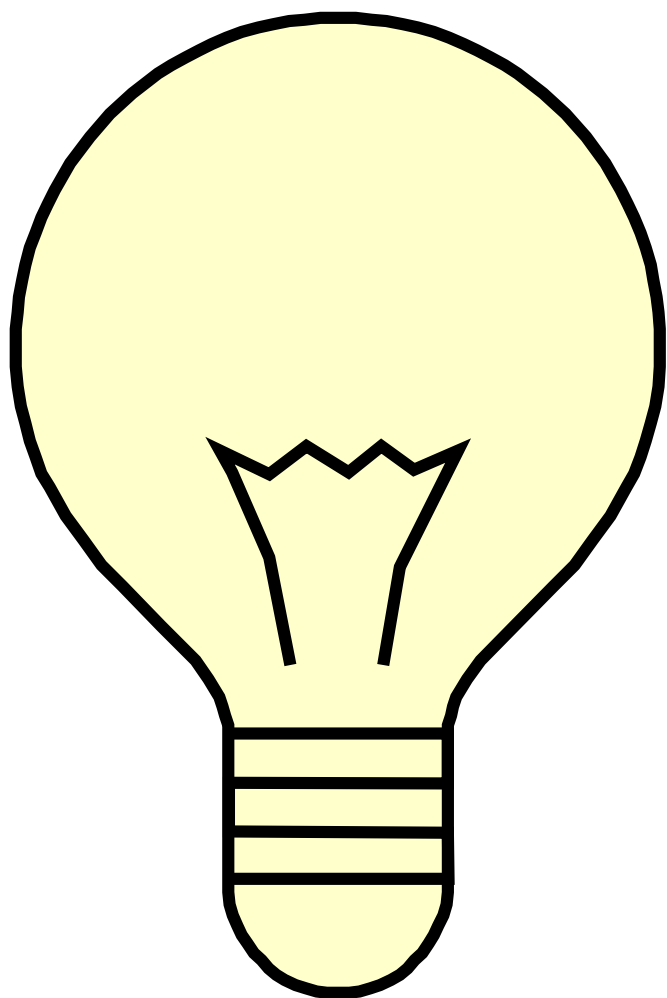
- ▶ Has the firm defined and recorded an error correction policy and procedures?
- ▶ Which procedures are in place to identify errors?
- ▶ What levels of materiality have been defined?
- ▶ Definition of prospective client
- ▶ The asset manager should provide a list of parties that have received GIPS compliant reports
- ▶ The asset manager should provide a list of parties that have received corrected reports

# Possible questions of the verifier continued

- ▶ Have there been any errors recorded in the period to be verified and if yes, what kind of errors have been identified?
- ▶ Are the errors detected during the verification considered material according to the asset manager's definition of materiality?
- ▶ What steps have been taken to correct the erroneous report, document the error and distribute the corrected presentation to the affected parties?
- ▶ Have material errors been disclosed for at least 12 months?

# Concluding remarks

- ▶ Fair representation and full disclosure
- ▶ Establish unambiguous policies and procedures for the correction of errors
- ▶ Define when an error is deemed material or not
- ▶ Do not forget policies to detect errors
- ▶ Establish communication processes between all involved parties
- ▶ Start to think about your policies, try out materiality levels suited to your products and services
- ▶ It is worth it!



Your questions?

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