

Achieving and Maintaining AIMR-PPS® (GIPS®) Compliance

In June 2001, Munder Capital Management made the decision to become compliant with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS). (AIMR has since changed its name to the CFA Institute.) This article highlights the important lessons learned during the process. Obviously, the issues involved in becoming and remaining compliant will differ from one firm to the next. Nonetheless, it is the author's conviction that the sharing of experiences among investment firms will help all of us achieve and maintain compliance with the standards in the most efficient way possible.

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BECOMING COMPLIANT

As of January 1, 2006, the Global Investment Performance Standards (GIPS) will replace all country versions of GIPS, including AIMR-PPS. The comments made in this article about achieving and maintaining compliance apply to both sets of standards.

The Challenge

The degree of difficulty involved in becoming compliant with the AIMR-PPS (GIPS) Standards depends on several factors:

- the number of portfolios, especially those that are not assigned to a composite
- the number of composites
- the number of years involved (AIMR-PPS requires 10 years of performance history or since inception if there is less than 10 years of history. GIPS, which replaces AIMR-PPS as of January 1, 2006, requires five years of performance history for firms first

coming into compliance.)

- the quality of performance records

Since we had been focused on composites for our key strategies only, most of our portfolios had never been assigned to a composite. As we mapped out the task, we found that we had to deal with:

- over 2,800 accounts
- over 220 composites
- the requirement to develop 10 years of compliant performance data for the firm, which meant going back to September 30, 1992.

It was a daunting task.

BEGINNING THE PROCESS

Firmwide Buy-in

The first important rule is a simple one: Be an advocate

for compliance, but do not be a lone crusader. Make sure that compliance is a firmwide goal.

Our first step was to get buy-in at all levels and from all areas of the firm. We started at the top, getting a strong commitment from the executive management team. We then worked on gaining support from everyone else who would be involved. Given the scope of the task, most areas of the firm – portfolio management, legal and compliance, marketing, systems, operations and wrap – would be impacted by our move to AIMR-PPS compliance. Going back through time, and assigning hundreds of accounts to composites, required a great deal of help from portfolio managers and the operations team. Because we had strong support for becoming compliant, people were willing to be part of the effort. Without cooperation across the firm, an already difficult task would have been close to impossible.

Education

If you want real buy-in, people need to understand exactly what they are supporting and why. We made a point of educating all of the relevant teams on the *benefits* of compliance as well as on the *requirements*. We had meetings for the marketing team, portfolio managers and administrators, operations, and legal and compliance, with information and handouts specifically tailored to each group.

The education sessions for portfolio managers, the legal and compliance team, and the marketing team should include a discussion of any required changes to your firm's marketing materials. The marketing folks may not like the idea of having to reveal what a small percentage of the firm's assets is represented by a particular composite. Be firm but flexible. We listened carefully to the issues raised and could usually find ways to address concerns while still meeting the requirements of the Standards, often through the use of supplemental information. The fact that we had educated the firm on the importance of being compliant made the acceptance of the new marketing template easier than it might otherwise have been.

Education pays off in other ways as well. During one finals presentation, our team was asked about the importance of AIMR-PPS, and those presenting for our firm were able to provide a strong response.

Responding to questions with a compelling case for the benefits of working with a firm that is AIMR-PPS (GIPS) compliant helped in our efforts to win a new relationship in another finals presentation.

Clarity on Roles

Be clear on the roles that will be played by the various teams. In discussions with our general counsel/chief compliance officer, we determined that, for our firm, it made the most sense for GIPS expertise to reside in the Data & Communication Services team, the group responsible for constructing and maintaining composites, and calculating composite performance.

A GIPS Champion

A final point: Make sure you have a champion who will drive the process. Teams are important, but, ultimately, one person has to be in charge and accountable. Set a realistic but firm deadline. We had established a deadline of September 30, 2002. As the deadline approached, a number of folks wanted more time to finish up their part of the task. We held firm. We believed our timetable was realistic, and in our view, the people who wanted "just a few more months" now would be asking for "just a few more months" no matter what deadline we set.

THREE CRITICAL TASKS

Three tasks had to be accomplished at the very start of the process:

- defining the firm
- identifying the composites
- creating a Policies and Procedures Manual

The Firm

Defining the firm can be complicated for multinational firms or firms with numerous name brands or product lines. In our case, defining the firm was relatively straightforward. We had four lines of business: institutional accounts, retail (mutual funds), wrap, and passive/quantitative management. Although the passive/quantitative division of the firm held itself out as a

separate unit, we decided to adopt the broadest definition and include that division, resulting in the largest number of assets under management. According to the standards, we could have either included or excluded that division, so it was ultimately a business decision.

Composites: How Many?

As you set up composites, remember that each composite, whether it is marketed or not, is subject to examination by the regulators or by your verifier. The more composites you have, the more cumbersome your monthly and quarterly checks will be.

We were far too scrupulous in setting up composites, ending up with many more than we actually needed. We separated taxable and nontaxable accounts in cases where the style of management was not significantly different. We had significantly more asset allocation categories for balanced composites than we needed or the standards required.

A number of composites were created largely because of perceived marketing needs rather than AIMR-PPS requirements. We should have thought more carefully about how we would be using the composites rather than assuming there would be broad marketing needs in every case. For example, the asset allocation of the balanced accounts we manage is driven by a client's specific investment goals. As a result, instead of marketing balanced composites, we typically market the underlying equity and fixed income disciplines. While our balanced accounts had to be placed in meaningful composites, we could have constructed far fewer asset allocation categories and therefore had fewer balanced composites. When we switched verifiers in 2004, their first goal was to help us rationalize our list of composites. While we still have a large number of composites, given the breadth of our investment disciplines, it is less than half of our original number.

Hint: as you create your list of composites, think carefully about how many you truly need to satisfy both the standards and your marketing needs. The fewer the composites needed to capture your disciplines, the better off you will be. Make sure that your marketing staff understands that there is a cost, in terms of ongoing time and effort, for each composite created. They are

then likely to be helpful in determining which composites are truly necessary from a marketing perspective, while you focus on what is necessary based on the requirements of the standards. This is an area where the expertise of a third-party consultant or verifier can be a significant benefit to your firm.

Composites: Criteria

Once you have identified your firm's composites, you need to think carefully about composite criteria, including the definition of discretion, rules for the timing of adding new accounts to composites, minimum size (if any), and the handling of cash flows. Firms have a great deal of latitude in defining composite criteria. The important point here is that all criteria must be carefully documented and consistently applied.

Exclusion Codes

One of the first things that a verifier will look for is whether every account is assigned to a composite or has a valid reason for being excluded from a composite. In order to quickly identify all unassigned portfolios, we assigned a code to every account – either a composite code or an exclusion code. Our exclusion codes, approximately 34 in all, are specific enough to indicate exactly why an account is excluded from a composite. For example, XC indicates that a client retains some discretion, while XL is used for accounts where the portfolio manager is prevented from taking losses. When we run an unassigned asset report, we can easily see which accounts are in a composite, which have a restriction (and what it is), and which are still unassigned. The assignment of specific exclusion codes has greatly enhanced the efficiency of our process.

Hint: if a regulator or verifier asks why a particular account was excluded from a composite, you will likely have to give a more specific answer than, "It has some restriction." Make sure your process allows you to quickly identify why a particular account cannot be assigned to a composite.

Policies and Procedures Manual

This manual is a critical document. It covers the policies you have established and the procedures you have

put in place to ensure that these policies are being followed. It is also one of the first things that the SEC is likely to ask for when they are conducting a routine audit. Do not even think of claiming compliance until you have completed your Policies and Procedures Manual *and* can prove that it is being followed.

Hint: do not start from scratch. Find someone, perhaps one of your vendors or a contact at a compliant firm, who can share a template. We worked from a template supplied by our composite software vendor. Being provided with the basic framework for our manual saved us a significant amount of time. Additional issues will arise that require documentation, especially issues specific to your firm. Simply modify your manual as needed. It is a good idea to review your manual at least semiannually to make sure that it is still up-to-date and reflective of your current policies and procedures.

IDENTIFYING THE TROUBLE SPOTS

It is helpful to determine up-front where your trouble spots are likely to be so that you can develop a plan of attack and avoid unpleasant surprises. Our biggest challenges included:

- the coding of accounts, both open and closed, that had never been assigned to a composite
- historical data for accounts that had come over in a merger
- historical data for wrap accounts.

Once we had identified the problem areas, we worked with the operations team and portfolio managers to determine the best way to deal with these challenges. Operations ran special reports for us. Portfolio managers helped us sort out the history of accounts. Be warned that, when you first approach a portfolio manager about the appropriate assignment for an account that closed years ago, the first response is likely to be: “That account’s closed. We don’t have to worry about that one!” We had to convince managers that all accounts that had been active at any point in the 10-year period, regardless of their current status, had to be coded. Eventually, the managers got caught up in the spirit of getting the assignments right. One retired man-

ager even came in to go over his former accounts!

Hint: a portfolio’s investment mandate may change over time. A portfolio manager’s memory might be that an account had always been an equity account. With a little digging, you might find that the account was actually a fixed income or balanced account during the first years that it was with your firm. It is critical to have data to back up a portfolio manager’s memory.

THIRD-PARTY HELP

Determine at the beginning of your process if third-party help, such as composite software or consulting services, makes sense for your firm. If it does, get the help as early in the process as possible.

Composite Software

We first discovered composite software at an AIMR-PPS annual conference. Given the large number of composites and accounts we had, we knew that the software would be helpful in *maintaining* compliance. We did not realize how important it would be in *achieving* compliance.

We had hundreds of accounts with long histories and no composite assignment. The portfolio manager might tell us that it was, and always had been, a balanced account. The only way to verify the portfolio manager’s recollection was to run lengthy reports on each account and then check the history, month by month, calculating asset allocation. Once we had uploaded historical accounting system data into our composite software, we could literally push a button and view the historical asset allocation of an account over time. We often discovered that the “balanced” account had at one time been an equity or fixed income account.

With the organized and detailed information produced by our composite software, composite assignments could be made with greater speed and accuracy. With a small number of accounts and disciplines, it may be easy to baby-sit each portfolio, digging up old records or examining raw data on asset allocation back through time. With close to 3,000 accounts, we derived an enormous benefit from a more systematic approach. If we had known how helpful the software would be for our

firm, we would have incorporated it into our process sooner and saved a significant amount of time.

Consultants and Verifiers

There are firms that can provide good advice on the best way to move into compliance. For some investment management firms, that might be the best route to take. In our case, while the workload was significant, most of the issues were fairly straightforward. We therefore decided that we could proceed on our own.

If you have determined that you will have your claim of compliance verified, it is generally a good idea to select your verifier early in the process. The verifier will then be an additional resource to turn to when you come to a difficult issue or gray area. A good verifier can provide valuable input while still remaining independent. Some tools for assistance in making this choice can be found at the CFA Institute Web site. They have suggested questions for a firm to ask prospective verification firms (http://www.cfainstitute.org/standards/pdf/questions_verification_firms.pdf).

Marketing Materials

While we were still in the process of coding accounts, we began to work with our graphics team on setting up compliant templates for our marketing materials. Months before we were compliant, our marketing materials not only met regulatory requirements, they contained the information and disclosures required by AIMR-PPS. When we were ready to assert our compliance with AIMR-PPS, we simply added the compliance claim to our marketing materials. There was no delay in telling the world that we were now an AIMR-PPS compliant firm.

MAINTAINING COMPLIANCE

What Can Go Wrong

We met our deadline, claiming compliance as of September 30, 2002. Composite criteria were clearly defined. We had a Policy and Procedures Manual. Every portfolio back though September 30, 1992 had a composite or exclusion code. Compliant marketing materials were waiting for the September 30, 2002

data. The effort had been intense, especially in the last several weeks of the process. Virtually everyone in the firm knew of the effort and, since so many had been involved in one way or another, there was a genuine feeling of excitement and accomplishment when we finally announced compliance.

For a short period of time, we felt that we had reached AIMR-PPS nirvana. Then reality set in. The world is not static, and neither are an investment firm's accounts. It became apparent that staying compliant was going to involve a great deal of effort.

The following is just a partial list of events that can throw your carefully constructed composite universes out of compliance:

- new portfolios require a composite assignment or exclusion code
- portfolios start to liquidate before they are officially closed and are no longer appropriate for inclusion in a composite
- portfolios change disciplines or asset allocations
- a mutual fund is added to a separately managed account, requiring a change in composite assignment
- cash inflows and outflows require actions spelled out in your Policies and Procedures Manual
- a change to the performance of an account is posted on the firm's accounting system after the monthly upload of data into the composite software
- restrictions for an account change or are no longer relevant for a particular composite
- unique brokerage arrangements make a composite assignment inappropriate
- a change in an account's composite assignment is not adequately documented
- SEC regulations or AIMR-PPS (GIPS) standards change

- changes involving the firm or the investment discipline occur that require changes in the disclosures on marketing materials.
- accounts with GICs (guaranteed investment contracts)
- the assignment of conflicting composite codes.

PROCEDURES FOR REMAINING IN COMPLIANCE

The Importance of Checklists

One of our first steps was to create a detailed document that outlined our monthly process for staying in compliance. We found that was not enough. We followed up with a checklist for each of the steps in the process, with a place for date and sign-off by the person completing the task. That allowed us to show clearly where the responsibility and accountability for a particular step in the process lay. If your firm claims AIMR-PPS (GIPS) compliance and is going through a routine SEC exam, one of the first requests by the SEC is likely to be your Policies and Procedures Manual *and* proof that it is being followed. A dated and initialed checklist provides strong documentation that the procedures are actually being carried out.

Hint: I have included our monthly checklist as an Appendix to this article. While the checklist is specific to our firm, it will give you a general idea of the checks and balances that we perform on a monthly, quarterly, or semiannual basis.

Reports that Test Composite Populations

Given our large number of composites and portfolios, reports generated by our composite software and our accounting system are critically important in our efforts to remain compliant. We run reports that allow us to look for:

- unassigned accounts
- violations of minimum portfolio size for inclusion in a particular composite
- asset allocation breaches
- performance outliers (this helps to alert us to an undetected change in the portfolio's discipline)
- accounts with mutual funds

We also use reports to monitor portfolios that are on a watch list for eventual inclusion in a composite and to verify the dates of closed accounts.

Portfolio Managers' Input

No matter how many reports are run, it is all too easy for something to slip through the cracks. It is important that the portfolio managers and account administrators understand what information, including documentation, is needed by those responsible for maintaining GIPS compliance. This is one area where education is especially important. In some cases, we have worked with the portfolio administration area on changes in practices and procedures that result in greater efficiency for the administrators and help us in our efforts to maintain compliance. Given the emphasis on teamwork, we have good cooperation from all areas of the firm. We are now one of the first stops on the notification trail when portfolio managers make significant changes to a portfolio.

Twice a year, portfolio managers are asked to review the coding of all their accounts. Not only do we get valuable input but also it helps to keep the standards front and center.

Hint: if you have a large number of composites, it helps if you provide each manager with a list of only those composite and restriction codes that apply to his/her accounts. Rather than wading through a lengthy list, the managers can quickly scan the list of codes relevant to them. They appreciate the effort to make the process as painless for them as possible, and tend to be especially responsive.

Changes Made by Operations

It is important to be notified of changes to accounts. We receive copies of account open, close, and update forms, and are notified of any other changes made to the accounting system. In addition, when we import the current month's data into our composite software, we import the prior three months as well. This allows us to pick up retroactive changes to performance. If any per-

formance number changes by more than eight basis points, our composite software sends a warning. We can then research the change, accept or reject the new number and document any changes.

Discovering an Error

At some point, no matter how diligent you are, you are likely to discover an error that has to be corrected, resulting in a change to a composite's history. Keep records on the:

- composite impacted
- portfolio(s) involved
- time period affected
- reason for the change
- impact on performance.

This is important information for you and your verifier. It is also essential information to have if the SEC asks about any retroactive changes to marketing exhibits. If performance was originally overstated, it may be necessary to send corrected information to those who received materials with the inflated number.

A GIPS Guidance Statement on Error Correction was out for comment through February 2005 and should be released within the next few months. The proposed effective date is January 1, 2006.

Materials

Ensuring that marketing materials remain compliant can be difficult. New pieces are created. SEC and GIPS requirements change. Disclosures may have to be altered or added on some or all materials because of changes impacting the firm or the discipline. In addition, given the number of hands that marketing materials typically pass through, mistakes can creep in. Disclosures can mysteriously disappear. Changes meant for all pieces may make it into only a few.

We have set up a process that requires all AIMR-PPS (GIPS)-related marketing material to have a sign-off from a member of our compliance team for SEC com-

pliance and from a member of the Data & Communication Services team for AIMR-PPS (GIPS) compliance. Each piece is reviewed quarterly, and we go through an annual review process, during which each piece is thoroughly scrutinized.

Verification

Verification is currently recommended by the standards but not required. (Many expect that it will be required in the future.) In our experience, a *good* verifier is a valuable asset in both achieving and maintaining compliance. The benefits of a good verification process include:

- valuable input from someone with a thorough understanding of the current standards and where they are heading
- a third-party perspective on your compliance strategy and recommendations on how it can be improved
- access to knowledge of what other firms are doing – what works and what does not
- peace of mind from having confirmation of your claim of compliance.

Approximately three-quarters of the RFPs we respond to ask if our firm's claim of compliance has been verified. Assuming that a "yes" answer is preferred, there may also be some marketing advantage in going through the verification process.

These benefits, however, hinge on having a good verifier. We have found that there are some important questions that should be asked before hiring someone to do a GIPS verification.

1. How focused is the firm on GIPS compliance? What steps does the firm take to keep up with changes in GIPS recommendations and requirements?
2. How knowledgeable on the standards is the specific verifier (or verifiers) assigned to your account?
3. What is the background of the verifier assigned to

your account?

4. Does the verifier assigned to your account work on other GIPS-related assignments? Does he/she have a good feel for what is going on in the industry and how other firms are handling various GIPS-related issues?
5. Through working with clients on GIPS issues, has the verifier developed a sense of what the SEC is looking for when it examines a firm's AIMR-PPS (GIPS) claim of compliance?
6. Is the verifier responsive when you have a question?

These questions can be answered when you check references - a critical step!

I would caution that working with a verifier can smooth the process or make it more difficult. There have been cases in which a firm has to expend time and effort unwinding the advice of a verifier who provided incorrect guidance. Look for a verifier who combines strong auditing skills with a thorough and up-to-date knowledge of the GIPS standards.

Keeping Up with the Standards

You cannot maintain compliance if you do not keep up with changes in the standards. I strongly recommend that everyone involved in GIPS compliance sign up for the CFA Institute's email alerts. These alerts will provide prompt notification of important events, such as a change in the standards, the issuance of a guidance statement, or the release of a guidance statement for comment. Attending the CFA Institute's annual conference on the standards provides an important opportunity to listen to the latest thinking on the standards, ask questions about issues involved in their implementation, and network with other practitioners. Your verifier (and sometimes your composite software vendor) can also be good sources for information about the standards.

When you learn of changes to the standards, make sure that the appropriate areas of your firm are notified. When the new GIPS standards were released in February 2005, along with the notification that the

GIPS standards would replace AIMR-PPS as of January 1, 2006, we prepared handouts for our legal and compliance, marketing, client service, and portfolio management teams to alert them to the changes. It is important that those members of the firm who call on consultants or meet with clients are aware of and can speak knowledgeably about the standards and about anticipated changes.

SUMMARY

In our experience the following are the key elements involved in achieving and maintaining AIMR-PPS (GIPS) compliance:

- a firmwide culture of compliance
The most important requirement for both achieving and maintaining compliance is a firmwide culture of compliance. This implies an understanding, by everyone in the firm, of the importance of compliance in all aspects of the firm's operations and a willingness to do what it takes to maintain compliance.
- firmness and flexibility
If you want firmwide cooperation in your efforts to achieve and/or maintain GIPS compliance, avoid the reputation for being unhelpful, negative, and legalistic. You can be firm in demanding compliant procedures and presentations, while still being creative and flexible in your approach. Work hard to find ways in which compliance and marketing needs can be balanced. A solution that is satisfactory to everyone can often be found.
- clear accountability
A desire to be GIPS-compliant is not enough. There must be clear accountability. Someone or a team of people should be charged with understanding the GIPS standards and maintaining compliance. On-going firmwide education on GIPS should be part of the compliance process.
- documentation
All GIPS-related policies and procedures should be documented. A monthly checklist is helpful in showing when and by whom the procedures have been carried out and for demon-

strating to regulators and verifiers that documented policies and procedures are being followed.

- a thorough review process for composite universes
Procedures should include a frequent review of composite populations to determine if the current portfolio assignments are still appropriate. Make sure there is appropriate documentation if an account moves from one composite to another.
- a thorough review process for materials
A robust review process for all materials, complete with a system of mandatory sign-offs, is essential in keeping materials, both for one-on-one presentations and broadly distributed advertising materials, in compliance with all regulations and standards.
- error prevention
When an error is discovered, focus on problems with the process, not the people. This focus creates an environment of prevention where mistakes are identified and dealt with, and the process is being constantly improved.
- appropriate third-party help
Get as much help as appropriate from outside sources. Composite software can be very cost-effective, increasing efficiency and improving accuracy. Third-party verification can give you peace of mind, good recommendations for tightening up your process, and confirmation of your interpretations of the standards.
- ongoing education
Educate yourself and make sure there is appropriate education throughout the firm. Have a process in place for keeping up with changes to GIPS.

While we knew there would be hard work involved in becoming AIMR-PPS (GIPS) compliant, our own journey to compliance was even more rigorous than we had originally anticipated. It required hard work, long hours, the overcoming of numerous challenges, and an

enormous amount of teamwork. The effort to remain compliant is also challenging, even with carefully thought-out processes and procedures, checks, and double-checks.

While achieving and maintaining AIMR-PPS (GIPS) compliance can require a great deal of work, we are convinced that the benefits of being compliant significantly outweigh the costs. We have found that there is a marketing advantage in being able to claim compliance with the standards. In fact, some RFPs make it clear that only compliant firms should respond. In our view, however, the most powerful argument for compliance is that the very process of achieving and maintaining compliance with the standards strengthens a firm's internal controls. The result is a robust business process focused on the integrity of the performance data being shown to the world. We therefore view AIMR-PPS (GIPS) compliance as an important part of our firm wide culture of compliance.

APPENDIX

Table 1. MONTHLY CHECKLIST AIMR-PPS (GIPS) COMPLIANCE

MONTH/YEAR				
Task	Completed By			Date Completed
	XX	YY	ZZ	
Data Download				
(Prior 3 months downloaded each month, with alert if performance changes by more than 8 basis points.)				
Manual Data Entry				
Mutual and collective fund market values and returns				
Benchmarks				
Muni carve-outs				
Combined accounts ex-pooled funds				
Process Pending Actions File				
(Make sure documentation for any change in composite assignment is in the appropriate account file)				
Run Composite Update Process				
Unassigned Assets Report				
Handle all unassigned portfolios for current month				
Watch List Accounts: Include/exclude for month				
Coding of New Accounts Using New Account Form				
Check for non-traditional brokerage arrangement (including wrap fee)				
Get documentation on why an account is not ready to be placed in a composite if it meets all objective tests and Portfolio Manager indicates that it is not ready				
Verification of Closed Accounts and Date of Closing				
(Use termination date, not date account closed on the accounting system)				
Process All Account Update Forms				
Check for Conflicting Composite Codes				
Check for Minimum Size Violations				
Check Accounting System Cash Flow Report				
Check Maintenance Report for Composite Criteria Violations				

Calculate Composites				
Check for Asset Allocation Breaches				
AFTER SECOND UPLOAD				
Check Dispersion Detail Report for Performance Outliers: Research Outliers				
WHEN FINAL				
Print Composite Structure Report for All Published Composites (as documentation of changes in composite populations)				
Run Watch List Clean-Up Report Periodically				

Table 2: QUARTERLY/SEMIANNUAL CHECKLIST AND SPECIAL REVIEWS AIMR-PPS (GIPS) COMPLIANCE

Task	Completed By			Date Completed
	XX	YY	ZZ	
QUARTERLY				
Quarterly check for accounts with mutual funds, GICS (guaranteed investment contracts), and third-party funds, and for accounts that are combined for performance reporting purposes				
Request reports from operations				
Check reports against current lists of accounts				
Revise lists of accounts as necessary				
Send revised lists to operations				
Check Master Account List for additions/deletions to the list of accounts with wrap-fee arrangements				
SEMIANNUAL				
Portfolio managers' review of composite and exclusion codes for their portfolios (May and Nov.)				
Review all marketing materials (Feb. and Aug.)				
Review all disclosures against requirements of standards				
Double-check data against composite software reports				