FSC Guidance Note No. 1.00

Australian Investment Performance Standards[1]

July 1999

Main features of this Guidance Note are:

- **The Australian Investment Performance Standards *(AIPS)* are voluntary standards for adoption by investment management firms for *presentation to wholesale clients*.**

- **The AIPS promote the fair and consistent representation of investment performance to investors. AIPS provide a framework for measurement and presentation including valuation and calculation guidelines.**

- **The goal is to achieve comparability of returns as well as demonstrating the industry's commitment to self-regulation and professionalism through the voluntary adoption of best practice in measurement and presentation.**

- **The AIPS are supported by FSC as guidance for members.**

- **Only firms that actually manage the assets can claim compliance. Other entities (including superannuation funds, consultants, custodians or regulators) can *endorse, encourage* or *require* the use of the standards, but cannot claim compliance.**

- **The standards comprise both requirements and recommendations and in order to claim compliance, a firm must meet all the composite construction, calculation, presentation and disclosure requirements of the AIPS.**

- **Verification by an independent third party is recommended but not compulsory.**

---

[1] The Australian Investment Performance Standards (AIPS) were formerly titled the Australian Investment Performance Measurement and Presentation Standards (AIPMPS). These standards were first released on 1 January 1998. This version of the Standards contains no material differences to the 1 January 1998 version.

FSC Guidance Note No. 1.00

Table of Contents

FSC Guidance Note No. 1.00

1 Title

1.1 This Guidance Note may be cited as FSC Guidance Note No. 1.00 'Australian Investment Performance Standard' ("AIPS").

2 Guidance Note and Commentary

2.1 The guidelines set out in this Guidance Note are shown in bold print. Commentary is shown in normal print immediately after the guideline to which it relates, as an aid to the interpretation of the guideline.

3 Date of Issue

3.1 19 July 1999

4 Effective Date

4.1 Effective dates for compliance

4.1.1 For an investment firm to claim compliance with the AIPS, the firm must meet *all* of the requirements of the AIPS from 1 January 1998.

4.2 Retroactive compliance

4.2.1 The AIPS require firms to report a minimum of 5 years of investment performance (or since inception of the firm or composite) that is in compliance with the requirements of the AIPS.

4.2.2 Firms with historic records for periods before 1 January 1998 that are not in compliance with the AIPS can still claim compliance if certain conditions are met. To claim compliance, such a firm has three options:

- **Re-calculate its performance record in accordance with the requirements of the Standards;**
- **Calculate returns going forward that are in accordance with the requirements of the Standards, and claim compliance with the Standards in five years' time (when the firm would have the required five year performance record); or**
- **Use its non-conforming historical record and disclose specifically when and how the performance is not in compliance.**

4.2.3 For the third option, if a firm claims compliance with the AIPS and historical records are not in compliance for the full period, then the firm must

- **disclose that the full record is not in compliance;**
- **identify the non-compliant periods; and**

- **explain how the non-compliant periods are out of compliance.**

4.2.4 The third option is only available for historic performance records for periods before 1 January 1998.

5 Application

5.1 This Guidance Note should be applied by the operator of a scheme (whether offered for public subscription or otherwise) in relation to that scheme.

5.2 The AIPS are voluntary standards for the investment industry. Firms are not required to comply with the Standards but it is expected that compliance will become widespread and a factor that trustees and consultants will use in evaluating investment managers.

5.3 The primary beneficiaries of the AIPS are prospective and current clients of investment management firms who are attempting to compare the investment performance of these firms.

5.4 The Guidance Note should be interpreted as minimum standards for presenting investment performance.

5.5 Where there is a conflict between the requirements of this Guidance Note, applicable legislation, and the constituent documents of a scheme, the requirements of this Guidance Note should, having regard to the purpose of the Guidance Note, be modified appropriately so that, as far as practicable, the scheme operator complies with the requirements of this Guidance Note.

6 Statement of Purpose

6.1 The purpose of this Guidance Note is:

- **to achieve greater uniformity and comparability among performance presentations;**
- **to improve the service offered to investment management clients;**
- **to enhance the professionalism of the industry; and**
- **to bolster the notion of self-regulation.**

6.1.1 The Australian investment community's need for a commonly accepted set of guidelines to promote fair representation and full disclosure in every firm's presentation of its investment performance results to clients and prospective clients has guided the development of this Guidance Note.

6.1.2 The Australian Investment Performance Standards ("AIPS") have in large part drawn on the AIMR Performance Presentation Standards (second edition) and the Global Investment Performance Standards (currently in draft format).

6.1.3 Readers are encouraged to refer to the discussion paper published separately to these Standards. The discussion paper outlines some of the reasoning behind the requirements and recommendations contained in the AIPS, provides a fuller description of the requirements, and suggests standard approaches to other aspects of performance measurement.

6.1.4 The AIPS are divided into two sections: the first section lists the requirements in order to claim compliance with the AIPS, while the second section lists recommendations. It is strongly recommended that firms adopt the recommended Guidelines in addition to the requirements. Certain elements in the AIPS that are recommendations may become requirements in the future.

6.1.5 No portion of the AIPS should be interpreted as inhibiting managers from providing supplemental information requested by prospective clients or consultants, or information that would clarify the firm's investment results.

7 Application of Materiality

7.1 Failure by a scheme operator to adopt or implement this Guidance Note is material if such failure has the potential to adversely affect the confidence of investors, prospective investors, other scheme operators, and other interested parties involved in the collective investment funds industry.

8 Definitions

8.1 In this Guidance Note:

- 'Associate' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';
- 'Assets' are defined in accordance with generally accepted accounting principles;
- 'Constituent documents' of a scheme means the rules and regulations under which the scheme exists;
- 'Gross assets' means the total assets of a scheme before allowances for costs of acquisition or disposal and before deduction of scheme liabilities;
- **'Interest' means an undivided portion of the equity of a scheme;**
- 'Investors' means those persons, whether they be natural persons or not and including responsible entities, managers and trustees, in whose name an interest in a scheme may be registered from time to time;
- 'Liabilities' are defined in accordance with generally accepted accounting principles;
- 'Market price' means the last sale price immediately prior to the valuation point or the best price available at the valuation point from a market maker;

- 'Member' means a member of the Investment and Financial Services Association;

- 'Net asset value' of a scheme means the result obtained by deduction of the value of liabilities of a scheme from the value of gross assets of a scheme;

- 'Offer document' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';

- 'Operator', in relation to a scheme, has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';

- 'Prices', in relation to a scheme, together mean the entry price and the exit price of that scheme;

- 'Scheme' has the same meaning as in FSC Guidance Note No. 5.00 'Industry Terms and Definitions';

9 Definition of the Firm

9.1 To claim compliance with the AIPS a firm must comply with the Standards on a *firmwide* basis. In addition, the firm must state exactly how it is defining itself for the purposes of compliance.

9.2 The Standards define a firm as:

- **an entity registered with the appropriate regulatory authority overseeing its investment management activities or**

- **an investment firm, subsidiary or division held out to the public as a separate and distinct business entity (for example a subsidiary firm may claim compliance for itself without its parent organisation being in compliance) or**

- **all assets managed to one or more base currencies. For example, a firm entity could be defined as all of the assets of a firm managed for clients whose base currency in the Australian dollar. For firm entities defined as such, all assets managed to the selected base currency must be included and presented in composites that meet compliance requirements.**

9.3 If an investment management company has one asset management division which manages both retail and wholesale portfolios, then the asset management division must define the "firm" for its presentations to include all the portfolios it manages - both retail and wholesale. However, if a separate wholesale entity or subsidiary of the company exists, it can prepare composites of wholesale portfolios only and define firm assets as the total assets of that wholesale subsidiary or entity.

9.4 Performance presentations for retail clients only do not need to conform to the *presentation* requirements and recommendations of the AIPS, which are designed for wholesale presentations only.

10. Definition of Total Firm Assets

10.1 Total firm assets are defined to include all discretionary and non-discretionary assets.

10.2 Total firm assets does not refer to assets underlying overlay investment strategies, such as currency overlays, options and futures overlays, securities lending programs, and asset allocation overlay strategies, *unless* the firm actually manages the underlying assets. Similarly, assets assigned to sub-advisers that are not part of the firm are not to be included in total firm assets. Conversely, if a firm gives a sub-adviser the mandate to manage some of its clients' assets and the firm retains control of the sub-adviser's mandate, then such externally managed assets would still be considered part of the firm's total assets.

10.3 Assets to which the AIPS cannot be applied are not to be considered by firms when claiming compliance with the Standards. For example, traditional guaranteed investment contract (GIC) portfolios or capital guaranteed and annuity business provide stable results that are not based on a marked to market valuation.

10.4 Unless the portfolio assets are marked to market, the portfolio results cannot be reported as being in compliance with the AIPS. In these cases the firm is exempt from reporting these assets in compliance with the Standards, and may claim compliance for the remaining assets.

10.4.1 The AIPS recommend that managers set up separate composites for this type of business, with discretion as to whether the actual portfolio return is shown or the return credited to member accounts. The approach taken must be disclosed, and in particular the method of reserving.

10.5 Compliance cannot be met on a per composite or per product basis but can only be met on a *firmwide* basis. All firm assets that meet the requirements of total return and market valuation must adhere to the requirements of the AIPS in order for the firm to claim compliance.

10.7 Systems incompatibilities cannot be used as a reason for not claiming compliance for all assets (ie, a firm cannot make the claim of compliance for only those assets that are measured and monitored on compatible systems).

10.8 Firms with investment assets under management that adhere to all the requirements of the Standards when presenting their performance record may claim compliance with the AIPS. Plan sponsors, consultants and software vendors, on the other hand, cannot make a claim of compliance unless they actually manage the assets for which they are making the claim of compliance. These groups can claim to *endorse* the AIPS and/or *require* that the investment management firms they employ, from which they solicit information, or to which they sell be in compliance with the AIPS.

11 Claim of Compliance

11.1 To claim compliance, firms must meet all composite, calculation, presentation, disclosure and other *requirements* of the AIPS. Firms are also strongly encouraged to follow the *recommended* Standards.

11.1.1 Strict adherence to the basic requirements does not guarantee fair and adequate performance reporting. The Standards may not cover the specific circumstances in every situation. In preparing performance reports, firms must keep in mind the spirit and objectives of the Standards: fair representation and full disclosure. Meeting the intent of the Standards will likely require actions over and above simple satisfaction of the minimum requirements.

11.2 Compliance with the Standards also requires adherence to all applicable laws and regulations.

11.3 Firms must take all steps necessary to ensure that the firm has satisfied all of the requirements of the AIPS before claiming compliance with the AIPS.

11.4 Firms in compliance with the AIPS must use the following claim of compliance within a performance presentation:

11.4.1 "*[Name of Firm] has prepared and presented this report in compliance with the Australian Investment Performance Measurement and Presentation Standards*."

11.5 If the performance presentation does not meet *all* of the requirements of the Standards, firms cannot claim compliance with the AIPS "*except for* ….", except if the firm believes that its non-compliance with the Standards in this respect will not lead to a material difference in its performance presentation.

12 Verification

12.1 Third party verification of the presentation of investment performance results is strongly encouraged.

12.1.1 Third party verification brings credibility to the claim of compliance, and supports the overall guiding principles of full disclosure and fair representation of investment performance.

12.2 After determining that the firm has complied with all of the requirements of the AIPS on a firmwide basis, and that the performance results for specific composites are appropriately calculated and presented, a verifier may issue a written verification statement that the investment firm may include with its performance presentation. The verification statement applies to specific composites, which may be only a subset of the firm's composites.

12.2.1 Verifiers may check compliance with the AIPS using a selected sample of the firm's accounts within the composite being verified.

12.3 After performing the verification, the verifier may conclude that the firm is not in compliance with the AIPS, or that the records of the firm cannot support a complete verification. In such circumstances the verifier must issue a qualified verification report to the firm clarifying why a verification statement was not possible. However, verifiers cannot issue partial verification statements for use with the firm's performance presentations, except if the verifier believes that the firm's non-compliance with the Standards in this respect will not lead to a material difference in the firm's performance presentation.

12.4 A verifier may issue a partial verification statement for use with the firm's performance presentations where the historical record for periods before 1 January 1998 is not in compliance and the firm has satisfied all of the requirements for retroactive compliance.

12.4.1 The process of verification is under review as part of the development of GIPS and future versions of the AIPS are likely to reflect any changes that emerge.

13 Australian Investment Performance Standards

13.1 Compliance Requirements

13.1.1 To be in compliance with the Australian Investment Performance Standards, a firm's presentation of its investment performance must comply with the following requirements on a *firmwide* basis:

13.2 Creation and Maintenance of Composites

13.2.1 General Requirements

- **All actual fee-paying discretionary portfolios must be included in at least one composite.**

- **Firm composites must be defined according to similar strategy or investment objective.**

- **Composites must include new portfolios within three months of the portfolio coming under management, and according to reasonable and consistently applied firm guidelines.**

- **Composites must exclude terminated portfolios after the last full performance measurement period the portfolios were under management, but composites must continue to include terminated portfolios for all periods prior to termination.**

- **Portfolios must not be switched from one composite to another unless documented changes in client guidelines make switching appropriate.**

- **Convertible and other hybrid securities must be treated consistently across time and within composites.**

- **Asset-only returns must not be mixed with asset-plus-cash returns.**

- **Sub-sectors or carve-outs of multi-sector portfolios may be used to create stand-alone composites only if the sub-sectors are actually managed as separate entities with their own cash allocations and currency management.**

13.3 Development Capital (Venture and Private Placements)

13.3.1 All discretionary pooled funds of funds and separately managed portfolios must be included in composites defined by vintage year (i.e., the year of fund formation and first takedown of capital).

13.4 Valuation & Calculation of Returns

13.4.1 General

- **Total return, including realised and unrealised gains plus income, must be used when calculating investment performance.**

- **All data and information necessary to perform the required calculations and to claim compliance must be captured and maintained.**

- **Time-weighted rates of return must be used (or an approximation to the time-weighted return). The acceptable methods are daily valuation, Modified Dietz, or Modified BAI.**

- **Accrual accounting is required for all marked to market investments.**

- **Trade date accounting is required.**

13.5 Composites must be asset weighted using weights calculated at the beginning of each period. Asset weights must be calculated at least monthly.

13.5.1 Returns from cash and cash equivalents held in portfolios must be included in return calculations, and the cash and cash equivalents must be included in the portfolio amount (total assets) on which the return is calculated.

13.5.2 For multi-sector portfolios where sub-sectors are considered in isolation as a carve-out, the cash or asset backing for any derivative investments must be included in the same sector as the exposure covered and the returns on these assets treated as a component of the return of the sub-sector in question.

13.5.3 Portfolios must be valued at least monthly.

13.5.4 Valuation of investments must be made at the close of business on the last trading day of a formal valuation period for the investments' associated markets.

13.5.5 As a minimum, returns must be calculated for periods of less than or equal to one month with daily weighting of cashflows. Returns for periods greater than the calculation period must be calculated by compounding the returns for each calculation period.

13.5.6 Performance must be calculated after the deduction of trading expenses (e.g., broker commissions, stamp duty and other trading related expenses), if any.

13.5.7 Market values used for performance calculations must be before any deductions for unrealised selling costs.

13.5.8 **When portfolios use leverage to purchase securities, return results must be calculated on both an actual basis and a restated "all cash" basis. For a composite that consists of externally leveraged and unleveraged accounts (for example, securities on margin), the leveraged accounts must be restated to all cash when the return of the composite is computed.**

13.5.9 **Unitised products must be valued using the Net Asset Value (NAV) price.**

13.5.10 **For unitised products, hard close unit prices that incorporate final valuations for all assets as at the end of the reporting period must be used for month end valuations, or if a hard close price is not available, the unit price that most accurately reflects the hard close price.**

13.6 **Where a valuation model or pricing model is used to value an asset, the valuation model must be applied consistently over time.**

13.7 **International**

13.7.1 **The benchmark for any currency overlay portfolio must be calculated in accordance with the mandate of the portfolio unless the benchmark is actually the currency return on a published benchmark.**

13.7.2 **A consistent source of exchange rates must be used.**

13.8 **After-tax Performance**

- **Taxes must be recognised in the same period as when the taxable event occurred.**
- **Taxes on income and realised capital gains must be subtracted from results regardless of whether taxes are paid from assets outside the account or from account assets.**
- **Return calculations and unit price valuations must make an allowance for tax on unrealised capital gains.**
- **The maximum national income tax rates appropriate to the portfolios must be assumed.**
- **The return for after-tax composites that hold both taxable and tax-exempt securities must be adjusted to an after-tax basis rather than being "grossed up" to a taxable equivalent.**

13.9 **Taxes on income are to be recognised on an accrual basis.**

13.9.1 **Real Estate**

- **Real estate must be valued through an independent appraisal at least once every three years unless client agreements state otherwise.**

- **APRA and ASIC regulations and guidelines must be adhered to.**

13.9.2 Development Capital (Venture and Private Placements)

- **General partners:**
  - **Cumulative internal rate of return (IRR) must be presented since inception of the fund and be net of fees, expenses, and carry to the limited partner.**
  - **IRR must be calculated based on cash-on-cash returns plus residual value.**
- **Intermediaries and investment advisors:**
  - **For separately managed accounts and commingled fund-of-funds structures, cumulative IRR must be presented since inception of the fund and be net of fees, expenses, and carry to the limited partners but gross of investment advisory fees unless net of fees is required to meet applicable regulatory requirements.**
  - **Calculation of IRR must be based on an aggregation of all the appropriate partnership cash flows into one IRR calculation - as if from one investment.**

13.10 Presentation of Results

13.10.1 General

- **A five year performance record (or a record for the period since firm or composite inception if inception is less than five years) must be presented.**
- **Annual returns for all years, and rolling three and five year returns, must be presented.**
- **Performance for periods of less than one year must not be annualised.**
- **Performance presentations must include the performance of a benchmark or index that parallels the investment style or mandate of the composite, where such a benchmark or index exists.**
- **The standard Compliance Statement must be presented indicating firmwide compliance with the AIPS.**
- **Composite results may not be restated following changes in a firm's organisation.**
- **Hybrid portfolios consisting of assets actually managed but not to a specific mandated mix must be presented as supplemental information rather than as a true composite.**
- **Composites must include only assets under management and may not link simulated or model portfolios with actual performance.**

- **For composites containing portfolios that use leverage:**

  - **If the use of leverage is discretionary, the performance presented must include the effects of the leverage. Performance on a restated, all-cash basis (i.e., removing the effect of the leverage from the return) must also be provided.**

13.11 If the use of leverage is non-discretionary (i.e., mandated by the client), performance must be presented on an "all-cash" basis.

- **Performance results of a past firm or affiliation must not be used to represent the historical record of a new affiliation or a new firm entity.**

13.12 Combining Composites

13.12.1 If a stand-alone composite is formed by combining returns from other composites, then the return must be presented with:

- **a list of the underlying composites used to create the new composite, and**
- **the percentage weighting of each underlying composite in the new composite.**

13.13 Development Capital (Venture and Private Placements)

13.13.1 General partners

- **Cumulative IRR must be presented since inception of the fund.**
- **Presentation of return information must be in a vintage-year format.**

13.13.2 Intermediaries and investment advisors

- **For separately managed accounts and commingled fund-of-funds structures, cumulative IRR must be presented since inception.**
- **The inclusion of all discretionary pooled fund-of-funds and separately managed portfolios in composites must be defined by vintage year.**
- **For calculating composite returns, the IRR must be based on an aggregation of all the appropriate partnership cash flows into one IRR calculation - as if from one investment.**

13.14 Disclosures

13.14.1 To be in compliance with the Standards, a firm's presentation of its investment performance must disclose the following information:

13.14.2 General

For all composites, a performance presentation must disclose:

- **the availability of a complete list and description of all of the firm's composites,**
- **the number of portfolios and amount of assets in a composite and the percentage of the firm's total assets the composite represents,**
- **the definition of "firm" used to determine the firm's total assets and firmwide compliance,**
- **total firm assets under management,**
- **the method adopted for calculating returns,**
- **whether balanced portfolio segments are included in single-asset composites and an explanation of how cash has been allocated among asset segments,**
- **any material differences in portfolio structure between the composite and the designated benchmark,**
- **whether performance results are calculated gross or net of investment management fees and other fees paid by the client to the firm or the firm's affiliate; the firm's fee schedules; and for net results, the average weighted management and other applicable fees,**
- **the existence of a minimum asset size below which portfolios are excluded from a composite,**
- **a measure of the dispersion of individual component portfolio returns around the aggregate composite return,**
- **the inclusion of any non-fee-paying portfolios in composites and included in the definition of total firm assets,**
- **the use and extent of leverage, including a description of the use, frequency, and characteristics of any derivatives used,**
- **a change in pricing formula or valuation model that has a material impact on the performance or leverage of a portfolio, and the size of its effect,**
- **a material change in personnel responsible for investment management,**
- **the effective date of firm compliance, and**
- **for historical performance records prior to 1 January 1998,**
    - **the performance that is not in compliance with the requirements of the Standards, and**

- a description of how any non-compliant performance history is out of compliance and how it was derived.

13.14.3 Verification

The performance presentation must disclose:

- **whether a Level I verification has been achieved; and**

- **whether a Level II verification has been achieved for the composite being presented.**

13.14.4 International

The performance presentation must disclose:

- **whether composites and benchmarks are presented gross or net of withholding taxes on dividends, interest, and capital gains,**

- **whether the composite is a sub-sector of a larger portfolio and, if so, the percentage of the larger portfolio the sub-sector represents,**

- **whether representative portfolios are used in the returns of sub-sectors shown as supplemental information,**

- **for returns that exclude the effect of currency, and are not shown fully hedged back to the base currency of that portfolio, disclosure must be made that the return is in the local currency and does not account for interest rate differentials in foreign currency exchange rates.**

13.14.5 After-tax Performance

The performance presentation must disclose:

- **for composites of taxable portfolios, the composite assets as a percentage of total assets in taxable portfolios (including non-discretionary assets) managed according to the same strategy for the same type of client,**

- **the tax rate assumptions if performance results are presented after taxes, and**

- **both client average and manager average performance if adjustments are made for non-discretionary cash withdrawals.**

13.14.6 Real Estate

The performance presentation must disclose:

- **the absence of independent appraisals,**

- **the source of the valuation and the valuation policy,**

- **total fee structure and its relationship to asset valuation,**

- **the return formula and accounting policies for such items as capital expenditures, tenant improvements, and leasing commissions,**

- **the cash distribution and retention policy,**

- **whether the returns**

  - **are based on audited operating results,**

  - **exclude any investment expense that may be paid by the investors, or**

  - **include interest income from short-term cash investments or other related investments, and**

  - **the cash distribution and retention policies with regard to income earned at the investment level.**

13.14.7 Development Capital (Venture and Private Placements)

- **For general partners, the performance presentation must disclose:**

  - **changes in the general partner since inception of fund,**

  - **type of investment, and**

  - **investment strategy.**

- **For intermediaries and investment advisors, the performance presentation must disclose:**

  - **the number of portfolios and funds included in the vintage-year composite,**

  - **composite assets,**

  - **composite assets in each vintage year as a percentage of total firm assets (discretionary and non-discretionary committed capital), and**

  - **composite assets in each vintage year as a percentage of total private equity assets.**

13.15 Verification

If a firm undertakes verification, the verification must be performed by an independent third party.

In order for a firm to claim that its investment performance has been verified, the verification process must consist of both Level I and Level II verifications.

13.15.1 Level I Verification

This level requires:

- **independent attestation that the requirements of the Standards have been met on a firmwide basis,**
- **that each of the firm's discretionary fee-paying portfolios is included in at least one composite and that the firm's procedures for assigning portfolios to composites are reasonable and have been consistently applied over time, and**
- **examination of the firm's procedures for calculating total time-weighted returns, taking into account lost accounts, making appropriate disclosures, and presenting results.**

13.15.2 Level II Verification

This level requires that:

- **performance results of specific composites have been calculated and presented according to the Standards, and**
- **all of the firm's composites include only appropriate, actual discretionary fee-paying portfolios and do not exclude any other portfolios meeting the same criteria representing a similar strategy or investment objective.**

13.16 Industry Standard Data Forms

Industry standard forms must be used for the provision of performance and related data to consultants and other research houses.

14 Recommendations

14.1 The Standards strongly encourage firms to comply with the following recommendations in addition to the requirements. For a particular firm to adhere fully to the spirit and intent of the Standards (namely, fair representation and full disclosure in performance presentation), adherence to these recommended Standards could very well be necessary. Certain recommendations may become requirements in the future. In situations of doubt, firms should fully disclose any assumptions and apply these recommendations in addition to the requirements as necessary.

14.2 Creation and Maintenance of Composites

14.2.1 General

- **Balanced portfolios should be grouped by allowable range of asset mix.**
- **Composites may be defined according to a similar benchmark.**
- **Accounts with significant cash flows (into or out of portfolios) may be treated as temporary "new" accounts.**
- **An appropriate benchmark should be selected and determined for each composite when the composite is created. Benchmarks should not be changed unless pursuant to client agreement.**

14.2.2 International

For international composites, separate composites should be created for:

- **portfolios that allow currency hedging (versus those that prohibit currency hedging) unless the use of hedging is judged to be immaterial and**
- **portfolios that are managed against hedged benchmarks (versus those that are managed against unhedged benchmarks).**

14.2.3 After-tax Performance

- **Portfolios should be grouped by tax rate.**
- **Portfolios may be grouped by vintage year, or similar proxy, to group portfolios with similar amounts of unrealised capital gains.**

14.3 Valuation & Calculation of Returns

14.3.1 General

- **Equal-weighted composites should be calculated in addition to, but not instead of, asset-weighted composites.**

- **Accrual accounting is recommended for illiquid unlisted investments.**
- **Portfolios should be valued on a daily basis or, if not daily, whenever cash flows and market action combine to materially distort performance.**
- **Returns should be calculated before income taxes.**
- **Returns should be calculated before management fees.**
- **For unitised products, hard close unit prices that incorporate final valuations for all assets as at the end of the reporting period should be used for month end valuations.**
- **The return for a pure derivative overlay portfolio should be calculated including either the actual or theoretical underlying portfolio. An incremental return calculation should be used for comparison of the underlying portfolio excluding overlay and the underlying portfolio including overlay.**

14.3.2 International

- **Where possible, the source of foreign exchange rates used to value portfolios should be those produced by WM/Reuters at 4pm London time each day.**
- **Returns should be calculated net of withholding taxes on dividends, interest, and capital gains.**
- **Returns should be quoted in Australian dollars for presentations to Australian clients.**
- **Whenever the currency overlay manager is notified of changes in the underlying currency exposures as a result of a shift in the underlying assets, the currency overlay portfolios should be revalued (e.g., for attribution purposes).**

14.3.3 After-tax Performance

- **Cash-basis accounting is to be used if required by applicable law.**
- **Calculations should be adjusted for non-discretionary capital gains.**
- **Benchmark returns should be calculated using the actual turnover in the benchmark index, if available; otherwise, an approximation is acceptable.**
- **If returns are presented before taxes, a total rate of return for the composite should be presented without adjustment for tax-exempt income to a pre-tax basis.**

14.3.4 Real Estate

- **Real estate should be valued through an independent appraisal at least once every twelve months or when a material change in the market has occurred, unless client agreements state otherwise.**

- **Valuations should be adjusted for any capital expenditure.**

- **Real estate valuations should be reviewed at least quarterly.**

- **Income earned at the investment level should be included in the computation of income return regardless of the investor's accounting policies for recognising income from real estate investments.**

- **Returns from income and capital appreciation should be presented in addition to total return.**

14.3.5 Development Capital (Venture and Private Placement)

- **General partners**

  - **Australian Development Capital Industry Association valuation guidelines should be used for valuation of development capital investments,**

  - **Valuation should be either cost or discount to comparables in the public market for buyout, mezzanine, distressed, or special situation investments, and**

  - **IRR should be calculated net of fees, expenses, and carry without public stocks discounted and assuming stock distributions were held.**

- **Net cumulative IRR (after deduction of advisory fees and any other administrative expenses or carried interest) should be calculated for separately managed accounts, managed accounts, and commingled fund-of-funds structures.**

13.4 Presentation of Results

13.4.1 General

- **Composite performance should be presented gross of investment management fees and before taxes (except for international withholding taxes).**

- **Equal-weighted composite results should be presented as supplemental information.**

- **Supplemental information the firm deems valuable should be presented.**

- **Where appropriate, a "health warning" should accompany a presentation of performance results, pointing out that past performance is not a good predictor of future performance. This is particularly the case where the performance**

report is distributed widely. Suggested wording of the "health warning" is as follows:

"Past investment performance is not an adequate test of comparative performance, nor a reliable indicator of the expected absolute level of returns in the future."

13.4.2 International

For presentations of returns excluding currency (e.g., for attribution purposes), local currency returns should be calculated using spot rates and hedged returns should be calculated using forward rates.

13.4.3 Attribution

If an attribution forms part of a performance presentation then:

- **The method of constructing the attribution report should be consistent with the manager's style and investment process, and the client's investment objectives,**
- **Terminology and presentation should be as consistent as possible with standard industry practice,**
- **The interaction effect should be calculated separately to the other effects. For presentation purposes it may be included with one of the other effects in cases where it is not significant and there is a reasonable reason for including it with another effect.**
- **An attribution of a single portfolio may be shown as being representative of the composite.**

13.4.4 After-tax Performance

If returns are presented after taxes, client-specific tax rates may be used for each portfolio (but composite performance should be based on the same tax rate for all clients in the composite). The following presentations should be made for composites:

- **beginning and ending market values,**
- **contributions and withdrawals,**
- **beginning and ending unrealised capital gains,**
- **realised short-term and long-term capital gains,**
- **taxable income and tax-exempt income,**
- **the accounting convention used for the treatment of realised capital gains (e.g., highest cost, average cost, lowest cost, FIFO, LIFO), and**

- **the method or source for computing after-tax benchmark return (if a benchmark is shown).**

13.4.5 Real Estate

- **Equity ownership investment strategies should be presented separately.**
- **When presenting the components of total return, recognition of income at the investment level, rather than at the operating level, is preferred.**

13.5 Disclosures

Following are the recommended additional disclosures to fully meet the spirit and intent of fair representation and full disclosure in compliance with the Standards:

13.5.1 General

For all composites, a performance presentation should disclose:

- **the calculation method used eg: Modified Dietz, daily valuation, or Modified BAI**
- **a typical Management Expense Ratio for the composite (or a representative portfolio), including the impact of all investment related fees (eg: custody, audit, legal etc) that would be taken out in the calculation of a "net" return to the client. Further discussion can be found in the IFA Technical Practice Standard #2 dated 1 May 1995,**
- **the volatility of the aggregate composite return across time, and any additional returns presented, over a three and/or five year period,**
- **cumulative composite returns for all periods,**
- **portfolio size range for each composite (unless portfolios are five or fewer) and the percentage of total assets managed in the same asset class as represented by the composite,**
- **any change to the benchmark for the composite and reasons for the change, and**
- **if the manager determines that no appropriate benchmark exists, this should be disclosed.**

13.5.2 International

For composites, performance presentation should disclose:

- **the range or the average country weights of a composite that is managed against a specific benchmark,**

- **inconsistencies among portfolios within a composite in the treatment of exchange rates,**

- **the source of exchange rates used, and**

- **any inconsistencies between the chosen exchange rates and those of the benchmark.**

For presentations of returns excluding the effect of currency (e.g., for attribution purposes), whether the return is the hedged return (using forward rates) or the local return (using spot rates) should be specified. Local returns should be accompanied by a statement that the local return is in local currency and does not account for interest rate differentials in forward currency exchange rates.

13.5.3 Attribution

- **If an attribution forms part of a performance presentation and the interaction effect is not shown separately to the other effects, the way in which the interaction effect has been treated should be disclosed.**

- **If an attribution has not been performed according to these Standards then the differences from the Standards should be disclosed.**

- **If an interim benchmark or an approximation of a benchmark is used in an attribution then this should be disclosed.**

- **The method of attribution should be consistently applied from one period to the next and should be disclosed.**

- **The method of distributing error terms in the attribution should be disclosed.**

- **Where an attribution of a single portfolio is shown as representative of a composite, the fact that the portfolio is a member of the composite should be disclosed along with the percentage of the total composite represented by the portfolio.**

13.5.4 Development Capital (Venture and Private Placements)

For general partners, the following should be disclosed:

- **gross IRR (before fees, expenses, and carry), which should be used at the fund and the portfolio level, as supplemental information,**

- **the multiple on committed capital net of fees and carry to the limited partners,**

- **the multiple on invested capital gross of fees and carry,**

- **the distribution multiple on paid-in capital net of fees to the limited partners, and**

- **the residual multiple on paid-in capital net of fees and carry to the limited partners.**

Intermediaries and investment advisors

- **The number and size should be expressed in terms of committed capital of discretionary and non-discretionary consulting clients.**

13.6 Verification

- **The Standards recommend that firms verify their claims that performance is in compliance with the Standards. Verification consists of two levels: Level I verification applies to all firm composites; Level II verification applies to specific composites and may be performed only on a subset of the firm's composites.**

- **Where performance results are published or widely distributed, it is strongly recommended that verification is obtained.**