

PERFORMANCE PERSPECTIVES

with David Spaulding



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Since 1990, The Spaulding Group has had an increasing presence in the money management industry. Unlike most consulting firms that support a variety of industries, our focus is on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the CFA Institute (formerly AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is a frequent author and source of information to various industry publications.

Our clients appreciate our industry focus. We understand their business, their needs, and the opportunities to make them more efficient and competitive.

For additional information about The Spaulding Group and our services, please visit our web site or contact Chris Spaulding at CSpaulding@SpauldingGrp.com

HOW ABOUT THOSE SPREADSHEETS?

For close to two decades our firm has offered operational reviews, where we will visit a client and look at their systems, personnel, work flows, reports, etc.¹ A common discovery is in the area of those ancillary systems, that augment the firm's primary programmed systems.



It goes without saying (but say (or more correctly, write) it I will, anyway) that all firms have spreadsheet based systems that run alongside their primary packaged/programmed systems. In some cases, these spreadsheet "systems" have taken on a life of their own, and sometimes serve a very major purpose for the organization.

It is also typical that the firm lacks controls with these systems, while programmed systems have major controls in place to ensure accuracy and completeness. In some cases, these systems become extremely large and complex, making them difficult to maintain, though critical for the firm's operation.

Sometimes only the developer of the system really understands how it works, meaning that if that person departs, the firm is at risk. We learned a long time ago with programmed systems that the programs and systems need to be documented, and yet this is not usually what is done with spreadsheets.

My first encounter with an attempt to use spreadsheets for what should have been a programmed system was when I was responsible for technology for a NYC-based asset manager in the mid 1980s. Our portfolio accounting system was lacking in many respects, and so we took control of it and enhanced it significantly. One area that called for automation was management fee billing. Our comptroller informed me that it was her intent to implement a Lotus 123-based "system" to handle these requirements. I overruled her, and instead had one of our programmers develop a new system, that provided so many more features and functions than could have possibly been present in a spreadsheet. In addition, it included controls to ensure accuracy, and interfaced with our trading system that provided much more flexibility and provided for more timely invoicing of clients, improving our cash flow situation in a much needed way.

Over the years I've seen some pretty impressive spreadsheets. The beauty of this software is that "systems" can be implemented very quickly. Spreadsheets are very flexible and have great capabilities. Unfortunately, as I often recite in talks I give, they are:

- cumbersome
- time consuming
- error prone
- not databases.

In addition, they lack controls. Anyone can whip up a spreadsheet and perform calculations in seconds. Reporting can be done that may appear official, when it shouldn't be.

<http://www.SpauldingGrp.com>

¹ To learn about this service, please contact Christopher Spaulding (732-873-5700; CSpaulding@SpauldingGrp.com).

The Journal of Performance Measurement®

UPCOMING ARTICLES

Venture and Private Equity Performance Update: One Cheer for FAS157

– Susan Woodward

A New Choice in Multi-period Investment Performance Attribution: Effective Return versus Geometric Smoothing

– Ronald J. Surz

Analyzing Diversification Effects, Sector Allocations, Market Conditions, and Factor Tilts in Advanced Equity Beta Strategies: The Case of Efficient Indices

– Felix Goltz and Dev Sahos

Flows and Woes: The True Cost of Spot Trading Policy

– Matthew Lyberg and
Alexander Dunegan

Rethinking Portfolio Risk in Asset Management

– Charles T. Hage

When I left the military in the mid 1970s, my first job was as a programmer for a consulting firm. One of the major efforts at that time was to reduce the data redundancy which had overtaken too many firms. The huge problem with such redundancy is that one must ensure that the data is always in agreement. If an error is found, one must go around revising the data wherever it is, otherwise there might be serious problems. Spreadsheets only foster further data redundancy, as data is taken from one system, and then stored in various spreadsheet files, which can be difficult to track down when corrections are in order.

It is typical that when a new programmed or packaged system is introduced into a firm, that a series of tests be conducted before it's allowed to "go live." These tests can be extremely challenging, and require one to *jump through many hoops* in order to move a system into "production." The same set of controls are usually lacking when it comes to spreadsheets. And yet, it is so easy to introduce errors that can go undetected.

I am conducting a series of tests for my doctoral dissertation. My spreadsheets, while not overly complex, still have numerous formulas imbedded in them. As the spreadsheets have evolved, many formulas needed adjusting. But, as I recently discovered, when some of the data *just didn't look right*, I had overlooked several cells that had erroneous data, because the formulas needed some tweaking. Sadly, I probably wouldn't have suspected the errors had there not been results that were materially different than what I would have expected: there's the rub. We tend to look for outliers, and when we find none often assume that "all is well."

In a recent blog post² I began a list of what I think might grow to "best practices" for such systems.³ This topic grew from a question that was raised at this month's North America Performance Measurement Forum meeting in San Francisco. One member wondered about the extent and purpose for such systems.

Why do we need these systems?

Let's consider the reasons we have such systems:

1. Sometimes these systems are, in fact, virtually complete systems. For example, for GIPS® (Global Investment Performance Standards) composite maintenance, many firms use spread-sheets. While I understand why this may have been the case in the 1990s, because packaged software was not available. However, today we have many systems available, so there is little need for such systems, except for those firms who can simply not justify the expense. We have a spreadsheet that we make available to our verification clients who require such a solution, though we always encourage them to obtain a packaged / programmed solution.

Another example is for attribution, such as fixed income attribution, for firms that perhaps have limited need for such functionality.

2. To prototype ideas, such as attribution models the firm wants to consider developing. This is a reasonable and quite appropriate use of spreadsheets. This allows firms to try out different formulae to determine what will work best for them.



² <http://investmentperformanceguy.blogspot.com/2012/12/getting-control-of-ancillary>

³ In fact, the list I present reflects some additions to what I posted, though this list can definitely be refined further.

The Journal of Performance Measurement has begun a series on performance measurement professionals, and we need your help to identify the folks we should include. We focus on one or two people in each issue, with the list driven by input from other PMPs.

And so, please contact our editor, [Doug Spaulding](mailto:DougSpaulding@SpauldingGrp.com) (732-873-5700) with your suggestions.

PERFORMANCE MEASUREMENT HALL OF FAME

The recently published Summer issue of *The Journal of Performance Measurement*[®] announces that we are seeking nominations for the Performance Measurement Hall of Fame. We credit our friend and colleague, Tim Ryan, for this suggestion.

Please submit names to Douglas Spaulding (DougSpaulding@SpauldingGrp.com), the Journal's editor. The Journal's advisory board will vote on membership. We expect the "inaugural class" to consist of five to ten names. The inductees will be announced in our Winter issue.

We thank Tim for thinking of this idea and for suggesting that we create the Hall.

Your suggestions and ideas are also invited.

3. To supplement programmed / packaged systems. This is also quite common, where a firm has needs that are not included in the system, and so they turn to spreadsheets to accomplish additional requirements they may have.

A preliminary list of best practices

Here are my ideas for "best practices" for such systems:

1. Develop rules for the use of such systems. Also, determine the firm's views on such systems. For example, are they encouraged or discouraged? Are there limitations as to how they can be used? If yes, then define the cases or conditions when they can be employed. Also, develop a formal approval process, with perhaps a request form to justify the need, and what is needed to implement such a "system."
2. Avoid having manual or spreadsheet based systems when packaged software can accomplish what you require. While there are cost benefits to such an option, the risks involved with them should strongly encourage firms to turn to software packages.
3. KNOW what systems exist within your organization. Construct an inventory of all systems, identify
 - who built them,
 - who's responsible for their maintenance,
 - who uses them,
 - and what they're used for.



This is critically important.

4. Know what data is used by these systems and what data comes out of them, to be used by other systems.
5. Identify the controls that are in place to ensure integrity of the information. If the data comes from another system(s), then what steps are to be taken to ensure it's updated when changes occur? What reconciliation procedures are done to add confidence in the integrity of the data?
6. Put in place a formal process by which such systems must go through a testing scenario before they can be implemented. Such testing should mirror what is required for programmed or packaged systems.
- 7 ...also, for changes! That is, as changes are introduced, have a testing process in place before revisions can "go into production."
8. Identify systems that are used as an alternative to programmed/packaged systems. Such systems can ideally be replaced by programmed/packaged systems. And if they augment programmed / packaged systems, what steps are being done for the primary system(s) to be enhanced so that the spreadsheets can be abandoned?
9. Detail the plans for each system:
 - is it a permanent system
 - is it to be replaced by a packaged or programmed system
 - why it's required.

KEEP THOSE CARDS & LETTERS COMING

We appreciate the occasional e-mail we get regarding our newsletter. Occasionally, we hear positive feedback while at other times, we hear opposition to what we suggest. That's fine. We can take it. And more important, we encourage the dialogue. We see this newsletter as one way to communicate ideas and want to hear your thoughts.

10. Documentation for each spreadsheet should include an explanation of how it works, including the use of macros.

We are aware that some firms do have formal procedures in place. We will continue to discuss this topic with members of the Performance Measurement Forum. If you have suggestions or wish to share details regarding your firm's policies and procedures for such systems, please let us know.

HAPPY HOLIDAYS!

As I write this Chanukah is in full swing, and Christmas is only a short time away. And, we are coming to the conclusion of a very busy year. On behalf of my colleagues at The Spaulding Group, we wish all of our friends a happy and blessed holiday, and a successful, prosperous, and happy new year.



*Save
the
dates!*

The Journal of Performance Measurement®
Eleventh Annual International

PMAR

Performance Measurement,
Attribution & Risk

Conference

May 16th - 17th, 2013

The Journal of Performance Measurement®
In Association with RIMES Technologies

PMAR IV

Performance Measurement,
Attribution & Risk Conference

EUROPE

11 - 12 June 2013 – London

THE SPAULDING GROUP'S 2013 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
January 15-16, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
January 17-18, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
January 28, 2013	Fundamentals of GIPS Workshop	Los Angeles, CA (USA)
February 11-12, 2013	Fundamentals of Performance Measurement Training	Los Angeles, CA (USA)
February 13-14, 2013	Performance Measurement Attribution Training	Los Angeles, CA (USA)
March 11-12, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
March 13, 2013	Portfolio Risk	Boston, MA (USA)
March 14-15, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
March 18-19, 2013	CIPM Principles Exam Preparation	New Brunswick, NJ (USA)
March 20-22, 2013	CIPM Expert Exam Preparation	New Brunswick, NJ (USA)
April 15, 2013	Fundamentals of GIPS Workshop	Toronto, ON, Canada
April 16-17, 2013	Fundamentals of Performance Measurement Training	Toronto, ON, Canada
April 18-19, 2013	Performance Measurement Attribution Training	Toronto, ON, Canada
May 14-15, 2013	Fundamentals of Performance Measurement Training	Philadelphia, PA
May 15, 2013	Fundamentals of GIPS Workshop	Philadelphia, PA
May 25, 2013	Performance Measurement For Non-Performance Professionals	San Francisco, CA (USA)
June 10, 2013	Fundamentals of GIPS Workshop	London, England
June 13-14, 2013	Fundamentals of Performance Measurement Training	London, England
July 16-17, 2013	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
July 18-19, 2013	Performance Measurement Attribution Training	San Francisco, CA (USA)
July 22, 2013	Fundamentals of GIPS Workshop	Sydney, Australia
July 23-24, 2013	Fundamentals of Performance Measurement Training	Sydney, Australia
July 25-26, 2013	Performance Measurement Attribution Training	Sydney, Australia
August 19-20, 2013	CIPM Principles Exam Preparation	Chicago, IL (USA)
August 21-23, 2013	CIPM Expert Exam Preparation	Chicago, IL (USA)
September 18, 2013	Portfolio Risk	Boston, MA (USA)
September 23, 2013	Fundamentals of GIPS Workshop	Vancouver, BC, Canada
September 24-25, 2013	Fundamentals of Performance Measurement Training	Vancouver, BC, Canada
September 26-27, 2013	Performance Measurement Attribution Training	Vancouver, BC, Canada
October 21, 2013	Fundamentals of GIPS Workshop	London, England
October 22-23, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 24-25, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
November 18, 2013	Fundamentals of GIPS Workshop	Boston, MA (USA)
November 19-20, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
November 21-22, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
December 10-11, 2013	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 12-13, 2013	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2013 events, please contact Christopher Spaulding at 732-873-5700

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

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FUNDAMENTALS OF PERFORMANCE MEASUREMENT

A unique introduction to Performance Measurement specially designed for those individuals who require a solid grounding in all aspects of performance measurement. The Spaulding Group, Inc. invites you to attend Fundamentals of Performance Measurement on these dates:

January 15-16, 2013 – Chicago, IL

February 11-12, 2013 – Los Angeles, CA

March 11-12, 2013 – Boston, MA

April 16-17, 2013 – Toronto, ON, Canada

May 14-15, 2013 – Philadelphia, PA

June 13-14, 2013 – London, England

July 16-17, 2013 – San Francisco, CA

July 23-24, 2013 – Sydney, Australia

Sept. 24-25, 2013 – Vancouver, BC, Canada

October 22-23, 2013 – Chicago, IL

November 19-20, 2013 – Boston, MA

December 10-11, 2013 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 12 PD credit hours as granted by CFA Institute.



PERFORMANCE MEASUREMENT ATTRIBUTION

Two full days devoted to this increasingly important topic. The Spaulding Group, Inc. invites you to attend Performance Measurement Attribution on these dates:

January 17-18, 2013 – Chicago, IL

February 13-14, 2013 – Los Angeles, CA

March 14-15, 2013 – Boston, MA

April 18-19, 2013 – Toronto, ON, Canada

July 18-19, 2013 – San Francisco, CA

July 25-26, 2013 – Sydney, Australia

Sept. 26-27, 2013 – Vancouver, BC, Canada

October 24-25, 2013 – Chicago, IL

November 21-22, 2013 – Boston, MA

December 12-13, 2013 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 12 PD credit hours as granted by CFA Institute.



IN-HOUSE TRAINING

The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, close to 3,000 individuals have participated in our training programs, with numbers increasing monthly.

We were quite pleased when so many firms asked us to continue to provide in-house training. This saves our clients the cost of transporting their staff to our training location and limits their time away from the office. With the discounted tuition for in-house training, it saves them even more! We can teach the same class we conduct to the general market, or we can develop a class that's suited specifically to meet your needs.

The two-day introductory class is based on David Spaulding's book, Measuring Investment Performance (McGraw-Hill, 1997). The attribution class draws from David's second book Investment Performance Attribution (McGraw-Hill, 2003).

UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit www.SpgShop.com today to order your set.

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