

## BEST PRACTICES FOR MASS UPDATING THE COST BASIS ACCOUNTING METHOD

The Emergency Economic Stabilization Act of 2008 included new tax reporting requirements that have and will continue to dramatically change the way investors and financial advisors think about cost basis. Beginning January 1, 2012, Mutual Funds, ETF's and Dividend Reinvestment Plans (DRP) will become "covered" securities requiring custodians to report realized gain loss information on the 1099 reports. Given that these securities are eligible for average cost accounting, the new rules in regards to the use of average cost also become effective after January 1, 2012. One of the most impactful changes for PortfolioCenter® users is the taxpayers' ability to change to or from the use of average cost as-of a specified point in time.

There are several reasons to consider changing from average cost accounting to a non-average cost accounting lot selection method. They are:

- Application of consistent accounting rules across all portfolios
- Changes in tax strategy and use of Lot Selection methods allowing flexibility to harvest gains or losses
- Simplification of cost basis management across platforms:
  - Avoiding the complexity of Wash Sales and Average Cost
  - Avoiding the complexity of managing bifurcation of average cost

While you can move away from using average cost accounting at any time, to avoid encountering wash sales and the complexity of managing bifurcated average cost positions, there are steps to take prior to January 1, 2012 and after. This document will discuss how to prepare your PortfolioCenter database for updating the cost basis accounting method, contacting your custodian to update the cost basis account method in their records, executing the Cost Basis Reset wizard to create a split between the historical accounting method and the current accounting method, and updating the portfolios in the database with the new default lot selection method.



### Important

The custodian should be used as the source of record for client's tax reporting. Even if cost basis is reconciled in PortfolioCenter, unrealized and realized gain/loss figures from the database should only be used as estimates. All reports displaying cost basis information should contain a disclaimer directing the client to the custodian's 1099 for tax reporting.

## PREPARE YOUR DATABASE

Before you can update the cost basis accounting method in PortfolioCenter on January 1<sup>st</sup>, 2012, you need to prepare your database to help streamline upcoming steps. There are three steps that should be completed before you start updating the accounting methods. They are:

1. Verify that your cost basis accounting methods used in PortfolioCenter synchronize with your custodian for the mutual fund securities. If there are any discrepancies, you will need to reset the historical cost basis in PortfolioCenter to match the custodian. For more information about resetting historical cost basis, see [Resetting the Historical Accounting Method for Mutual Funds](#).

2. Use PortfolioCenter Data Management tools and custom fields to identify and analyze the portfolios that will be updated to a new cost basis account method. To help you streamline and better manage the process, there are some steps you can take in PortfolioCenter. They are:
  - a. Create a custom field in PortfolioCenter called “Continue Using Average Cost” that uses the True/False value type. If the majority of the portfolios will continue to use average cost accounting for mutual funds after January 1, 2012, set the default value for this field to “True”. On the other hand, if the majority of the portfolios will stop using average cost accounting for mutual funds, set the default value for this field to “False”. For more information on creating a custom field in PortfolioCenter, see [Defining Custom Portfolio Fields](#).
  - b. Create a view in the Portfolio Data Manager called “Portfolios Using Average Cost”. The criteria used should be all taxable portfolios whose Mutual Fund Matching Method field is using the Average Cost value. In addition to the default columns, add the Continue Using Average Cost custom field created previously. Analyze each portfolio in the Portfolios Using Average Cost view and determine which portfolios will continue to use the Average Cost accounting method and which portfolios will not. Then update the Continue Using Average Cost field to the appropriate True or False value for the necessary portfolios in the view. For more information about using the Data Manager, see [Working with the Portfolio Data Manager](#). Also, for information about bifurcating average cost, see [Best Practices for Bifurcating Average Cost for Mutual Funds](#).
  - c. Create a smart set based on the Continue Using Average Cost custom field called “Change Mutual Fund Sell Method”. This smart set is used when running the cost basis reset wizard to update the cost basis accounting method. The smart set criteria used should be all taxable portfolios where the Continue Using Average Cost custom field value is set to False. For more information on creating smart sets, see [Using Set Builder to Create a Smart Set](#).
  - d. Review your current workflow process and update your checklist to include analyzing new portfolios to determine whether the account will continue to use average cost for mutual funds in 2012. Then update the Continue Using Average Cost custom field to the appropriate True or False value. If you are not currently using checklists to manage your daily and quarterly processes, you can view a list of checklists to help you get started on [our website](#).
3. Make sure that you are running PortfolioCenter 5.4 or greater in your office. The cost basis accounting method features discussed in the following sections of this document were introduced in 5.4, so if you are running a previous version you may see inconsistencies with cost basis calculations across reports.

## SUBMIT THE ACCOUNTING METHOD CHANGES TO THE CUSTODIAN

The process of changing the cost basis accounting method from average cost to another account method may vary between custodians. To ensure that everything is in order, contact your custodian to inquire about their current procedures for this process as well as any documentation that is required to submit the accounting method changes. If necessary, contact the clients whose accounts will be affected by the account method change to receive their authorization. Once you have received authorization from your clients, all documentation has been submitted to the appropriate custodians, and these accounting method changes processed on the custodian’s platform, the changes will be reflected in the custodian’s cost basis reconciliation files.



### Important

It is important to confirm that the accounting method has been changed on your custodian’s accounting platform before running the cost basis reset wizard or changing the default accounting method in PortfolioCenter. Running the cost basis reset wizard before the changes are reflected in the cost basis reconciliation file will cause the cost basis figures to be incorrect.

## RUN THE COST BASIS RESET WIZARD

PortfolioCenter does not store cost basis data in a table as do other accounting software platforms, but performs the cost basis calculations in real time using the transactions loaded from your daily interface files. As such, there is no way to change to or from average cost at a point in time as the new cost basis regulations allow, without altering historical transactions. To allow changes to the accounting methods in PortfolioCenter, the Cost Basis Reset Wizard will need to be run. The wizard closes out the position using the old accounting method and creates a new position allowing the accounting method to be changed as-of a specified point in time.



### Important

While running the cost basis reset wizard will automatically resynchronize your cost basis with the custodian, ideally you want to be reconciled prior to running the wizard. This way portfolios will reconcile on **realized** as well as the **unrealized** gains and losses. Discrepancies caused by Return of Principal (ROP) transactions or miscoded lot selection methods should be corrected first. If there is a discrepancy caused by missing or incorrect data with your custodian, contact the custodian directly for steps to resolve.

The cost basis reset wizard pulls the cost basis information from the cost basis reconciliation file provided by the custodian. If the custodian does not provide a file or provides position level cost basis instead of lot level cost basis, the wizard will not work. Review the raw reconciliation file or contact your custodian to verify that you are receiving lot level cost basis information.

- 1 Verify that the Cost Basis Reconciliation report has been run for the trade date you want to import cost basis.
- 2 While logged into PortfolioCenter, click the **Transaction Writer** tab
- 3 Click the **New...** button at the bottom of the window to create a new Transaction List.
- 4 In the Transaction List Information dialog, enter the list name and description. Use a name that is appropriate for the activity.
- 5 Click the **Create List** button to create and open the transaction list.
- 6 In the list details, click the Select Wizard button, located on the button menu bar.
- 7 When the Select a Wizard to Run dialog opens, select the **Cost Basis Reset Wizard** from the list, and then click **OK**.

Transaction list information

List Name:  
Discontinue Average Cost as of 12/31/2011

Description:  
Discontinue Average Cost as of 12/31/2011

Status: New      Creation Date:

Create List      Cancel

Global Transactions

Select a wizard to run

- Account Transfer Wizard
- Amortization Wizard
- Bond Maturity Wizard
- Cost Basis Reset Wizard**
- Global Copy Wizard
- Income Reclassification Wizard
- Interest Payment Wizard

OK      Cancel      Help

8 Click the drop-down menu for the Custodian field to select the custodian at which the average cost accounting method has been discontinued. By default, the Custodian field will automatically populate with the first interface listed on the Interfaces tab.

9 On the Cost Basis Reset Wizard: Select Date window, click the browse  button for the Trade Date field to select from the list of cost basis reconciliation files that have a status of Posted in PortfolioCenter.

10 Click the browse button for the Price Date field and select a price file that matches the Trade Date field.

11 In the **Note** field, enter a trade comment to be added to the resulting transactions. For example, enter a note that might explain why you are entering these cost basis reset transactions.

12 Click **Next**.

13 Click the drop-down menu for determining which transactions are pulled in the transaction list and select **Security Types**.

14 Uncheck the Equities box and select the **Mutual Funds** security type.

15 Uncheck the **Exclude Positions with Non-Certified Cost Basis** and **Exclude Reconciled Positions** fields.

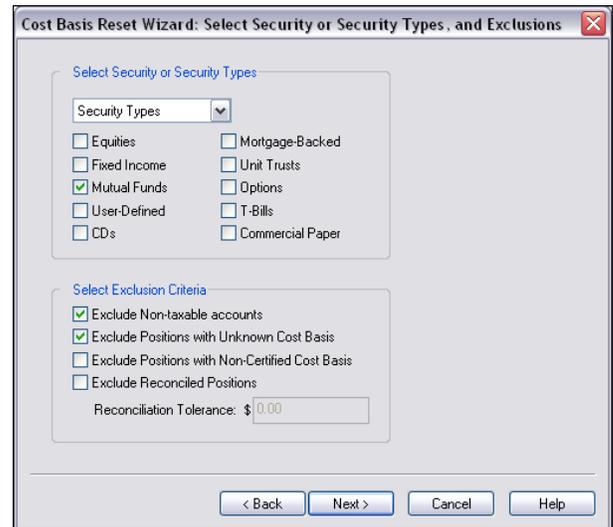
16 Click **Next**.

17 Select the Portfolios in the set option and choose the “Change Mutual Fund Sell Method” set created in step 2 of the **Error! Reference source not found.** section on page 2.

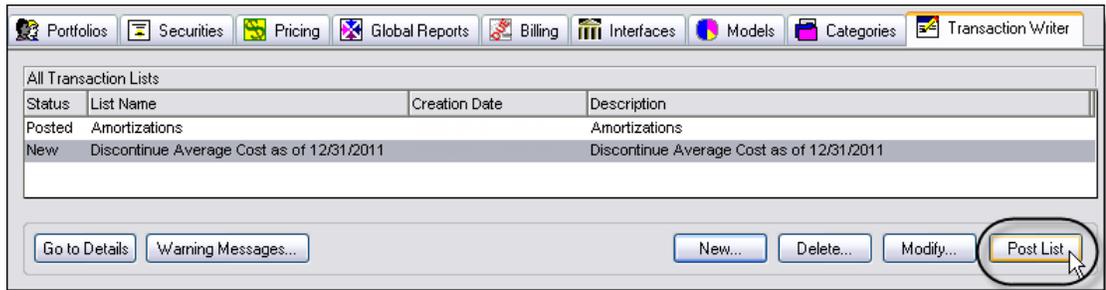
18 Click **Next**.

19 You will receive a warning message that calculations will be affected by running the cost basis reset wizard. The warnings about Realized Gain Loss discrepancies do not apply where positions are reconciled prior to running the wizard.

Click **Finish**.



- 20 The Cost Basis Reset Wizard will generate debit and credit transactions for every Mutual Fund position for the accounts in the "Change Mutual Fund Sell Method" set.  
Select the **Close** button to exit the Global Transactions window.
- 21 Verify that the transaction list you just created is selected in the Transaction Writer tab. Click the **Post List** button at the bottom-right of the screen to post the transaction to the appropriate portfolios.



Once you have posted all of the necessary transactions within the wizard, rerun the share and cost basis reconciliation reports to verify that your shares still balance and that cost basis is accurate.

## UPDATE YOUR PORTFOLIO SETTINGS

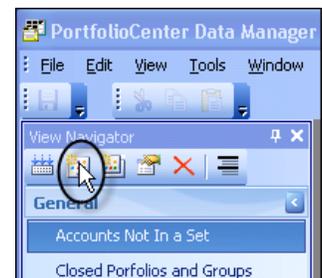
Once all portfolios have been updated to the new accounting method for mutual fund positions, to ensure that future mutual fund transactions use the correct accounting method the default value for the Mutual Fund Matching Method field will need to be updated. The following steps walk you through using the Portfolio Data Manager to update the Mutual Fund Matching Method field:

- 1 Open the PortfolioCenter Data Manager:

While on the Portfolios tab, click the Portfolios button at the upper left, and then click the **Data Manager** button at the bottom of the window.

- 2 Add a new view.

To open the new view dialog, click the **Add View** button, located in the View Navigator on the upper left side of the window.



- 3 Type a name for your View. The view name must be 30 characters or less.

- 4 If applicable, enter a view Category. View categories are used to organize your views.

- 5 Enter a description of the View. The view description can be up to 100 characters long.



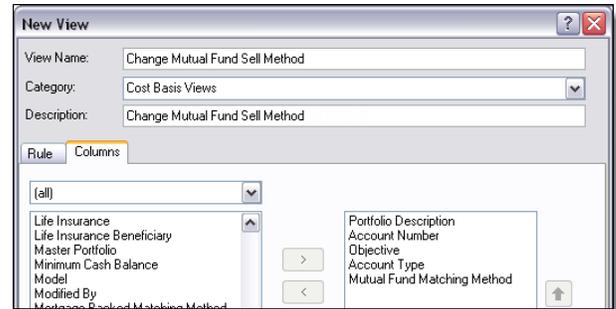
- 6 Click the browse icon in the Rule Name field and select the **Change Mutual Fund Sell Method** view from the list.

Click **OK**.

- 7 Click the columns tab and scroll through the list on the left for a list of all columns available. When you find the Mutual Fund Matching Method field, select the column, and then click the right arrow to move it to the selected columns side on the right.

- 8 Click **OK** to save the view.

- 9 Double-click the Change Mutual Fund Sell Method view to open it in the Data Manager.



- 10 From the menu bar in the Data Manager, select **Edit | Find and Replace**.

- 11 Select **Mutual Fund Matching Method** from the drop-down menu in the first field.

- 12 Click the drop-down menu for the “Find what” field and select **Average Cost**.

- 13 Click the drop-down menu for the “Replace with” field and select the appropriate accounting method.



- 14 Select the **Replace All** button and then click **OK**.

- 15 Close the Find and Replace window and save your changes to the Mutual Fund Matching Method field.

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