SCHWAB PERFORMANCE TECHNOLOGIES®

BEST PRACTICES FOR BIFURCATING AVERAGE COST BASIS FOR MUTUAL FUNDS IN PORTFOLIOCENTER 5.5 OR HIGHER

With the new IRS tax reporting regulations many custodians, including Schwab Advisor Services, are changing how Average Cost is calculated for Mutual Fund positions. The Average Cost for positions will be bifurcated, or divided, into two categories:

- Uncovered Shares – shares acquired prior to January 1, 2012

- Covered Shares – shares acquired after January 1, 2012

Each category maintains a separate average unit cost. There are manual data entry tasks you need to complete in PortfolioCenter in order to maintain synchronization of cost basis data for both unrealized and realized gains and losses. This document discusses how to prepare your database to update the cost basis accounting method, execute the Cost Basis Reset wizard to bifurcate the average cost basis, and update the portfolios in the database with the new default lot selection method.

> **⚠ Important**
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> - 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.
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> - This document discusses the process of establishing bifurcated average cost basis for mutual funds in PortfolioCenter. Going forward, there are additional steps that need to be taken to maintain bifurcated positions and close out of bifurcated positions. For information on maintaining bifurcated positions as well as exhausting bifurcated positions, see Maintaining and Exhausting Bifurcated Average Cost Positions in PortfolioCenter 5.5.

DETERMINE BIFURCATION METHOD

This document was designed for the initial set up of bifurcated average cost positions starting in 2012. However, if you failed to bifurcate all you positions at that time, you can still follow the same steps to bifurcate today for positions with no sales since January 1, 2012. For positions that have sold lots since then, you have two options:

1. Bifurcate as of January 1, 2012 - Unpost all transactions on or after 1/1/2012 for each of the position with sales transactions and run the cost basis as of year-end. The benefit of this method is that it will make realized gain loss reporting in PortfolioCenter as close to the custodian as possible. The downside is depending on the activity per position, un-posting and reposting could take a considerable amount of time.

2. Bifurcate as of today's date – Follow the instructions in this document using the most recent custodial cost basis file. The benefit of this solution is that it is fast, easy and can be completed with a single transaction file from the Cost Basis Reset Wizard. The downside of this option is that it negates all realized gain loss reporting prior to the bifurcation date.

> **🖥 Online**
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> PortfolioCenter versions 5.5 and higher automates adjustments to accounting methods to more easily accommodate the blending of bifurcated and non-bifurcated positions, thus simplifying and consolidating the steps to setup and maintain bifurcated positions. If you are using PortfolioCenter 5.4, use the Best Practices for Bifurcating Average Cost Basis in PortfolioCenter 5.4 or Higher for the steps you will need to take to bifurcate average cost positions.

PREPARING FOR BIFURCATION

Before you can start the process of bifurcating the cost basis using the average cost accounting method in PortfolioCenter, 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 in PortfolioCenter reconciles with your custodian for the mutual fund securities. If there are any discrepancies you will need to reset the historical matching methods in PortfolioCenter to match the custodian. For more information about resetting historical cost basis, see the Resetting the Historical Accounting Method for Mutual Funds document.

2. Use Data Management tools and custom fields to identify and analyze the portfolios that will contain bifurcated average cost. To help you streamline and better manage the process, there are some steps you can take in PortfolioCenter. They are:

    a. If not already in PortfolioCenter, create a custom field 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". Otherwise, do not set a default value for this field. For more information on creating a custom field in PortfolioCenter, see Defining Custom Portfolio Fields.

    b. If not already in PortfolioCenter, 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 for each of the portfolios displayed in the Portfolios Using Average Cost view. For more information about using the Data Manager, see Working with the Portfolio Data Manager.

    c. Create a smart set based on the Continue Using Average Cost custom field called "Use Bifurcated Average Cost". The smart set criteria used should be all taxable portfolios where the Continue Using Average Cost custom field value is set to True. For more information on creating smart sets, see Using Set Builder to Create a Smart Set

    > **Note**
    >
    > You will want to maintain this set in order to simplify management of bifurcated cost basis going forward.

    d. Review your current workflow process and update your checklist to include analyzing new portfolios to determine whether the accounts bifurcated average cost for mutual funds. Then update the bifurcation settings in the Portfolio Details for those accounts. 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 5.5 or higher in your office. The cost basis accounting method features discussed in the following sections of this document were introduced in 5.4, but additional settings that help streamline the management of bifurcated positions were introduced in 5.5. If you are running a previous version you may see inconsistencies with cost basis calculations across reports.

RUN THE COST BASIS RESET WIZARD

PortfolioCenter performs all calculations, including cost basis, through the transactions in each portfolio. Running the cost basis reset wizard on all your average cost positions eliminates the need for PortfolioCenter to calculate the average unit cost for your uncovered lots. The unit cost from the custodian is assigned to each lot, in effect freezing that value. Running the cost basis reset wizard also allows you to change the accounting method applied to these uncovered lots without impacting previous transactions, thus the trade lots are closed using First In First Out preventing PortfolioCenter from averaging the unit cost of the uncovered lots with the new covered lots.

The ideal date on which to run the cost basis reset wizard is 12/30/2011, the last business day of 2011. However, if you did not run the wizard on this date and you are current with your posting, you can run the cost basis reset wizard on a more recent date. By doing so, any closing transactions for bifurcated mutual fund positions will likely not reflect the correct realized gain in PortfolioCenter.

The following section walks you through running the cost basis reset wizard for the mutual funds currently using the average cost accounting method:

> **Important**
>
> While running the cost basis reset wizard will automatically resynchronize your cost basis, 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.

1 Validate that all accounts using the average cost accounting method have a "True" or "False" value in the **Continue Using Average Cost** field. This can be done easily by using the **Portfolios Using Average Cost** view in the Data Manager discussed in step 2 of the Preparing for Bifurcation section on page 2.

2 Update the "Use Bifurcated Average Cost" smart set.
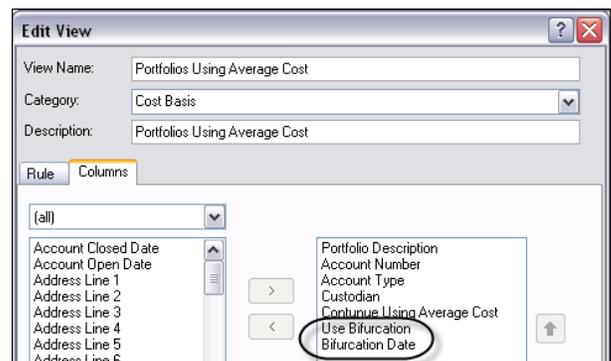
3 Open the PortfolioCenter Data Manager:

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.
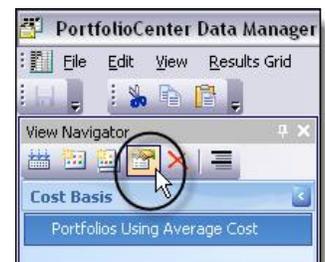
4 Edit the Portfolios Using Average Cost view.

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

5 Click the columns tab and scroll through the list on the left for a list of all columns available. When you find the **Use Bifurcation** and **Bifurcation Date** fields, select the column, and then click the right arrow to move them to the selected columns side on the right.

6 Click **OK** to save the view.

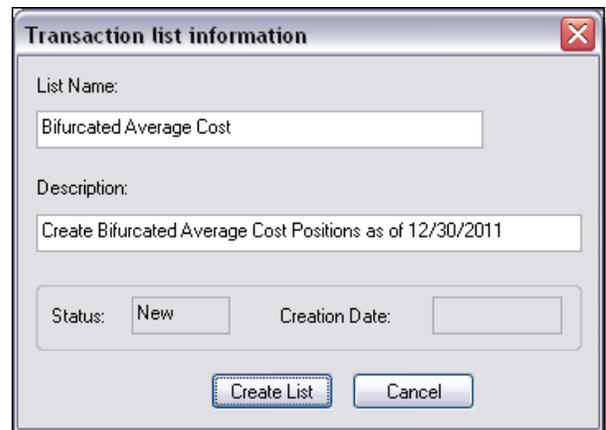**7** Double-click the Portfolios Using Average Cost view to open it in the Data Manager.

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

9 Select **Use Bifurcation** from the drop-down menu in the first field.

10 Click the drop-down menu for the "Find what" field and select **True**.

11 Click the drop-down menu for the "Replace with" field and select **False**.

Find and Replace

Search in:	Use Bifurcation
Find what:	True
Replace with:	False

☑ Match entire cell contents

[Replace All] [Replace] [Find Next] [Help] [Close]

12 Select the **Replace All** button and then click **OK**.

13 Close the Find and Replace window and save your changes to the Use Bifurcation field.
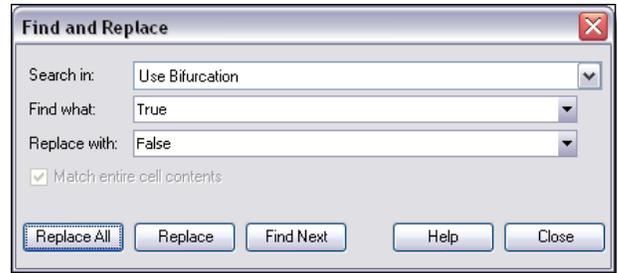
14 Verify that the Cost Basis Reconciliation report has been run for the trade date that you want to run the Cost Basis Reset Wizard and that all errors and discrepancies are resolved.

15 While logged into PortfolioCenter, click the **Transaction Writer** tab

16 Click the **New…** button at the bottom of the window to create a new Transaction List.

17 In the Transaction List Information dialog, enter the list name and description. Use a name that is appropriate for the activity.

18 Click the **Create List** button to create and open the transaction list.

Transaction list information

List Name:

Bifurcated Average Cost

Description:

Create Bifurcated Average Cost Positions as of 12/30/2011

Status: New   Creation Date:

[Create List] [Cancel]

19 In the list details, click the Select Wizard button, located on the button menu bar.

20 When the Select a Wizard to Run dialog opens, select the **Cost Basis Reset Wizard** from the list, and then click **OK**.

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
Management Fee Wizard
Merger/Exchange Wizard
Option Expiration Wizard
ROP Wizard
Security Income Wizard
Security Split Wizard
Spin-Off Wizard

[OK]
[Cancel]
[Help]

21 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.

22 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.

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

24 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.

25 Click **Next**.

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

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

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

Note: Keep in mind that the purpose of this reset is to lock in the average unit cost so that PortfolioCenter will no longer need to calculate average cost based on transactions. This will prevent PortfolioCenter from averaging the covered lots with the uncovered lots.

29 Click **Next**.

30 Select the Portfolios in the set option and choose the "Use Bifurcated Average Cost" set created in step 2 of the Preparing for Bifurcation section on page 2.

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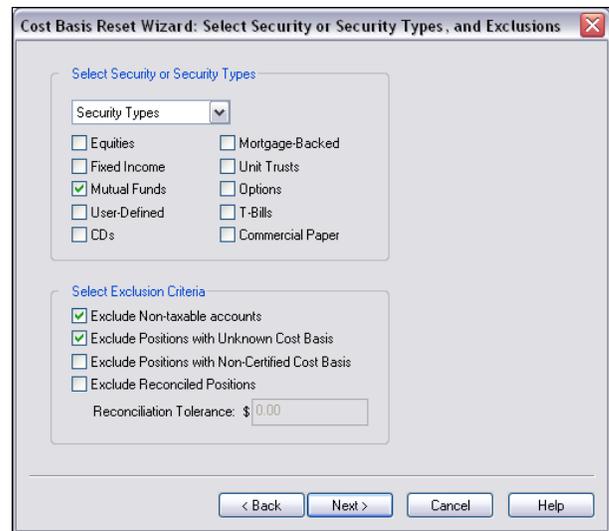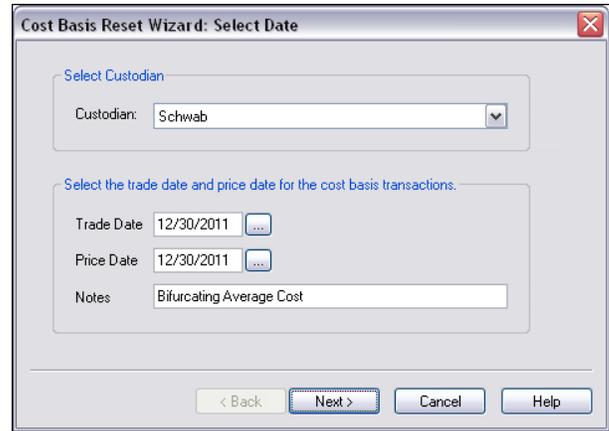
32 You will receive a warning message that calculations will be affected by running the cost basis reset wizard. The warnings about Realized Gain Loss discrepancies do not apply where positions are reconciled prior to running the wizard.

Click **Finish**.

33 The Cost Basis Reset Wizard will generate debit and credit transactions for every Mutual Fund position for the accounts in the "Use Bifurcated Average Cost" set.

Select the **Close** button to exit the Global Transactions window.

34 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.
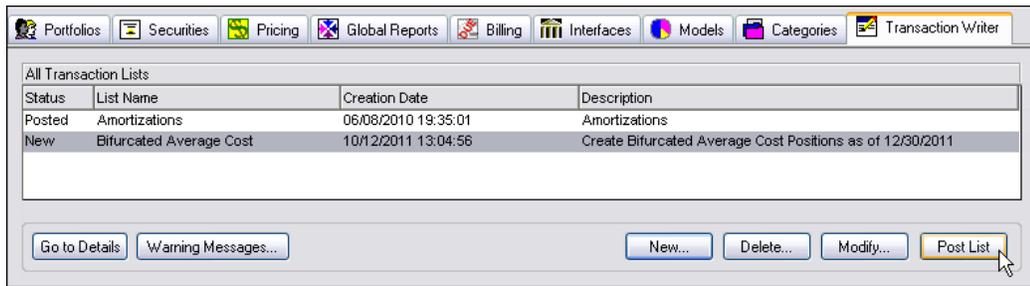
Once you have posted all of the necessary transactions within the wizard, rerun the share and cost basis reconciliation reports to verify that your shares still balance and that cost basis is accurate.

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 bifurcation settings for each portfolio will need to be updated. The following steps walk you through using the Portfolio Data Manager to update matching methods and the bifurcation fields:

UPDATE THE MATCHING METHOD SETTINGS

With the release of PortfolioCenter 5.5, settings were introduced to help manage bifurcated average cost mutual fund positions. Prior to 5.5, users were directed to update the portfolio settings to use the First In First Out matching method to handle bifurcation. Because of the new settings in 5.5, if you changed the matching methods to First In First Out, you will need to change the matching methods back to Average Cost. Then, follow the steps in the Update the Bifurcation Settings section below to complete your updates. If you did not update the matching methods, you can skip this section and go straight to the Update the Bifurcation Settings section below.

> **Tip**
>
> If you are updating a small number of portfolios, you can update the bifurcation settings directly in the Portfolio Details screen

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   Open the Bifurcated Sell Method view you created when establishing bifurcated positions in PortfolioCenter 5.4.

   See Best Practices for Bifurcating Average Cost Basis in PortfolioCenter 5.4 or Higher for more information on how to create this view.
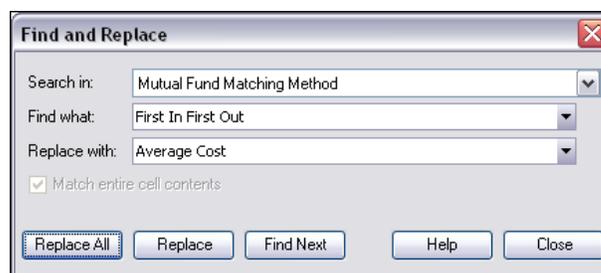
3   From the menu bar in the Data Manager, select **Edit | Find and Replace**.

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

5   Click the drop-down menu for the "Find what" field and select **First In First Out**.

6   Click the drop-down menu for the "Replace with" field and select **Average Cost**.

7   Select the **Replace All** button and then click **OK**.

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

UPDATE THE BIFURCATION SETTINGS

> **Tip**
>
> If you are updating a small number of portfolios, you can update the bifurcation settings directly in the Portfolio Details screen

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. Double click the Portfolios Using Average Cost view to edit the portfolios.

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

4. Select **Use Bifurcation** from the drop-down menu in the first field.

5. Click the drop-down menu for the "Find what" field and select **False**.

6. Click the drop-down menu for the "Replace with" field and select **True**.

7. Select the **Replace All** button and then click **OK**.

8. Close the Find and Replace window and save your changes to the Use Bifurcation field.

9. Review the dates in the Bifurcation Date field and make updates if necessary. By default, the Bifurcation Date field will populate with the 1/1/2012 date. This date is used to calculate separate average unit cost for positions held prior to the date from positions held after the date. For example, the following will occur when posting transactions for a portfolio using the 1/1/2012 bifurcation date:

   - If the sell transaction is closing uncovered mutual fund shares purchased prior to 1/1/2012, then the matching method will use First In First Out.

   - If the sell transaction is closing uncovered mutual fund shares purchased prior to 1/1/2012 and covered mutual fund shares purchased after 1/1/2012, then the matching method will using First In First Out.

   - If the sell transaction is closing covered mutual fund shares purchased after 1/1/2012, then the matching method will use Average Cost.

> **Important**
>
> This document discusses the process of establishing bifurcated average cost basis for mutual funds in PortfolioCenter. Going forward, there are additional steps that need to be taken to maintain bifurcated positions and close out of bifurcated positions. For information on maintaining bifurcated positions as well as exhausting bifurcated positions, see Maintaining and Exhausting Bifurcated Average Cost Positions in PortfolioCenter 5.5.