BEST PRACTICES FOR RECONCILING COST BASIS FOR THE FIRST TIME

Many custodians provide cost basis files in the interface download. When this file is available, the cost basis information downloaded from the custodian will be compared to the cost basis found in PortfolioCenter and the discrepancies reported on the cost basis reconciliation report. The steps for reconciling cost basis within PortfolioCenter using the cost basis reconciliation report for the first time differs slightly from maintaining cost basis on an ongoing basis. This document covers the steps you must take to begin the process or reconciling cost basis.

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.

Online

This document assumes cost basis for accounts in your PortfolioCenter database have never been reconciled with the cost basis reconciliation report provided by the custodian. For more information on the process for maintaining cost basis in PortfolioCenter, see Resolving Cost Basis Discrepancies.

PREPARE YOUR DATABASE

Using data management tools and techniques can help you gain efficiencies when reconciling, managing and troubleshooting cost basis. This section guides you through some of the data management tools that can help you manage the reconciliation process going forward.

1. Confirm that the taxable status of an account is set properly in portfolio details. Cost basis reconciliation is generally most important for clients with taxable accounts. For that reason, it is a best practice to create a set of taxable clients to help you efficiently manage the data for only the clients that need it. For instructions in finding and editing taxable status on accounts, see Finding Taxable Status on Portfolio Details. Also, remember that any new accounts that are added to PortfolioCenter will need to have their taxable status verified at the time the account is created.

2. Validate the matching methods assigned to each account in PortfolioCenter is the same as matching methods assigned at the custodian. The matching methods for closing transactions ultimately determine the cost basis calculation – and reconciliation. For information about how the matching methods affect cost basis calculations, see How Matching Methods Affect the Cost Basis Calculation. For instructions on how to review your matching methods, see Verifying Portfolio Matching Methods. The custodian may be able to provide a report listing the matching method assignments for your accounts. If you find that the matching methods in PortfolioCenter did not match the custodian's matching methods you will need to correct both the defaults in the portfolio details (to address future transactions) as well as the matching methods for historical transactions. For more information on how to correct the matching methods in historical transactions, see Troubleshooting Cost Basis Reconciliation Issues: Matching Method Discrepancies.

3. Upgrade PortfolioCenter: the newest versions have the newest features, and cost basis features are constantly being enhanced – and upgrades are always free to current users. Cost basis management and reconciliation features were first introduced in 5.1 and enhanced in subsequent versions. See the document Checking the Current Version of PortfolioCenter. For access to the upgrade file, see the upgrade page.

POST ALL DATA AND RECONCILE SHARE QUANTITY

Before you can validate data, you must be sure you have all of it in the database. The following steps will help you ensure that you have a complete set of data.

1. Post all data into the database. Make sure all transaction files have a status of Posted.

2. Supplement any required transactions, such as corporate actions.

3. Reconcile Share quantities. If the positions are not correct – in terms of share quantity – the cost basis cannot be correct. Therefore, you must first reconcile the share quantities.

Online

For more information on reconciling the share quantity in PortfolioCenter, see What is Share Reconciliation and Why is it Important? and Share Reconciliation Tips and Best Practices.

CUSTOMIZE THE COST BASIS RECONCILIATION REPORT SETTINGS

Tip

As with any reconciliation, the number of unreconciled items can be affected by many factors, including the report settings of the Cost Basis Reconciliation Report. Before customizing the report settings, run the report with all settings unchecked and include all security types (except mortgage-backed). Review the settings below while looking at the report to determine which options work best for your firm.

You can customize the settings for the reconciliation report to show only the accounts and securities that you need to validate. Since this is the first time you are reconciling cost basis in PortfolioCenter, you should start by running the report to show all cost basis discrepancies to give you a good idea of the total work required to reconcile cost basis. In addition, it is helpful to start with the full report in order to identify issues that may apply to multiple portfolios such as missing cost basis or a corporate action. Then, you can use the report settings to narrow down the list and focus on certain types of issues if needed or prioritize your work so that you are focusing on critical issues first, such as discrepancies with taxable accounts. There are multiple ways to customize the report, but some of the main settings to be aware of are:

- Use Tolerance Setting check box and Reconciliation Tolerance setting – Use these settings to omit the smaller discrepancies from the report so you can focus on the larger discrepancies. Large cost basis discrepancies are more likely to be caused by significant accounting errors than smaller discrepancies, which may be a result of wash sales, income reclassifications, or rounding issues. After you run the first cost basis reconciliation report with all settings unchecked; if the report shows that there are a significant number of shares that are unreconciled with the custodian by large dollar amounts, you can use a larger tolerance amount in the settings to begin working on the larger issues first. As the unreconciled cost basis issues are fixed, reduce the tolerance setting dollar amount in increments until you reach the minimum tolerance amount for your firm. Due to rounding discrepancies, we recommend that a minimum tolerance of $.02 or higher be used.

- Exclude Non-Taxable Accounts – This setting will omit non-taxable accounts from the reconciliation report so you can focus your time on the taxable accounts. Reconciliation of taxable accounts includes reconciling the current cost basis as well as potentially reconciling historical cost basis for accurate realized gain/loss reporting. For this setting to work properly, all of the accounts in PortfolioCenter should have the correct taxable setting in the Portfolio Details.

Tip

If you want to report cost basis on non-taxable accounts, consider reconciling them after the taxable accounts are reconciled. The steps for reconciling non-taxable accounts are easier because you generally only have to reconcile for the currently held cost basis, and not for historical transactions affecting realized gain/loss.

- Exclude unknown and non-certified cost basis – Custodians keep records of security lots considered certified as accurate – typically when the trades were placed at the custodian. They also keep records of lots missing cost basis information or lots considered not to be certified. All this information is provided in the cost basis files downloaded for PortfolioCenter. By excluding unknown (missing) and non-certified (not verified) securities from the report, you can focus on the securities that need to be reconciled first. If one lot out of many has unknown or non-certified cost basis, the entire position is excluded from the reconciliation report. When reconciling for the first time, check these boxes to narrow the list of discrepancies. Once the discrepancies are fixed, uncheck the Exclude Unknown Cost Basis box and start reconciling the portfolios by looking for securities missing cost basis on the initial Receipt of Securities transactions. Finally, uncheck the Exclude Non-Certified Cost Basis setting to finish reconciling the issues on the report.

> **Important**
>
> - The cost basis reconciliation report compares the unamortized values for fixed income security types with the custodian. If you are amortizing your securities, the amortized values may differ but the discrepancies will not show on the report.
>
> - Do not include mortgage-backed securities on the cost basis reconciliation report. The custodian's cost basis values are amortized but the PortfolioCenter cost basis values are unamortized, so the cost basis numbers will not match.

- Security Type Selections – The report settings default to only display cost basis issues for Equities. When first running the cost basis reconciliation report, add the remaining security types, except mortgage-backed securities. The report can be generated later with some of the security types excluded if you are looking for a way to prioritize the work. For example, focus first on equities and user-defined securities since these were the first securities covered by the legislation. Once these are reconciled, add mutual funds to the report. Finally, add the remaining security types to the report for reconciliation.

> **Online**
>
> For information on the settings that are available when running the cost basis reconciliation report, see Customizing the Cost Basis Reconciliation Report. Once you have run the report, learn more about what the report is showing you by reviewing the document Understanding the Cost Basis Reconciliation Report.

UPDATING COST BASIS TO MATCH THE CUSTODIAN

Incorrect cost basis in PortfolioCenter can be caused by many things, such as incorrect matching methods, ROP transactions, corporate actions, amortization discrepancies, wash sales or cost basis is missing entirely from the system. How you update cost basis in PortfolioCenter depends on the amount of incorrect securities. If you only have a handful of accounts to correct, you should consider manually adjusting the cost basis information. When the majority or all of the positions contain unreconciled cost basis, it is recommended that you use the Cost Basis Reset Wizard. The Cost Basis Reset Wizard will push in the cost basis information provided by the custodian, overwriting the missing or incorrect cost basis in PortfolioCenter. You can also take a hybrid approach, where you correct as much as possible manually and then correct the remaining cost basis discrepancies using the Cost Basis Reset Wizard. If there are universal issues or issues that are easy to correct, the manual approach will provide more flexibility and accuracy in historical reporting. The Cost Basis Reset Wizard may also be a good choice for non-taxable accounts since historical tax estimation reporting is not necessary. For smaller or more complex issues or situations where historical reporting is not critical, the Cost Basis Reset is a quick and efficient method for synchronizing data. Before you decide to use the Cost Basis Reset Wizard, you should be aware of the pros and cons that are associated with using the wizard.

PROS OF USING COST BASIS RESET WIZARD	CONS OF USING THE COST BASIS RESET WIZARD
Updating the cost basis numbers is an automated process that is much faster than manually updating cost basis.	Does not correct the Realized Gains/Losses report for historical events such as wash sales, income reclassifications, or matching method discrepancies
Corrects the Unrealized Gains/Losses report for events such as wash sales and allows you to reconcile cost basis for open positions with the custodian	If you are currently using, or plan to use, the Amortization wizard for receipted bonds, you cannot use this feature for fixed income securities

Online

For information on correcting cost basis using either of these methods, see Using the Cost Basis Reset Wizard and Troubleshooting Cost Basis Reconciliation Issues Checklist.

TOOLS TO HELP YOU RECONCILE COST BASIS

Once you have the Cost Basis Reconciliation report, you have access to several tools that can assist with helping you determine the reasons why the cost basis does not match.

- Understanding the Cost Basis Reconciliation Report – this document provides information to help you understand what you are seeing on the report.

- Troubleshooting Cost Basis Reconciliation Issues Checklist – this document gives you a step-by-step guide for determining the most common causes for cost basis reconciliation issues. Print the document as you go through the Cost Basis Reconciliation report for the first time.

- Trade Lot Reconciliation Tool – found in the custodial interface, this tool will help you reconcile the lots by providing a side-by-side analysis of the trade lots in PortfolioCenter with those at the Custodian in the Cost Basis Reconciliation file. For more information, see Using the Trade Lot Reconciliation Tool.

- Run Reports to Understand Discrepancies – there are several reports you can use in PortfolioCenter to help you identify discrepancies in cost basis. For more information see the documents Generating PortfolioCenter Reports for Troubleshooting Cost Basis and Resolving Cost Basis Discrepancies document to understand the most common causes that your accounts may be out of balance as well as see the steps you can take to resolve these discrepancies.

Tip

As a best practice, it is recommended that you rerun the share reconciliation report to make sure that while updating cost basis, the share quantities were not affected. Then rerun the cost basis reconciliation report to make sure that the updates were correct. Because much of the reconciliation process is done manually, there is always a margin for error and running the reconciliation reports will identify any error that occurred in the reconciliation process. If cost basis was updated at the custodian, it might take a couple of days to show up in the PortfolioCenter cost basis reconciliation file.