

NAIC CLUB ACCOUNTING

Things You Should Know

NCA and IClub

ICLUB is NOT a part of NAIC. It is a company that owns the software we use. You order through NAIC, but the service is from ICLUB. And requests for help go directly to ICLUB. IClub now owns Toolkit, Stock Analyst, Classic, Prospector and NCA. Support is required for all of them.

The NCA Software is a unique program with a finite market. It is designed for Investment Clubs. There are only a specific number of Investment Clubs. This program must not only be kept up-to-date with new and better computer systems, etc. but it **MUST** keep up to date with the Federal Tax requirements. That means not only a new and different Federal Tax Program **EVERY** year, but they must do updating of the Accounting program itself to include these changes. And, unfortunately, they often can't make these updates until the IRS has them finalized.

Complaints are frequent about the cost of Support - "why do I need to pay for it if I don't use it for problems." And for the Tax Program. I think the above explains this. You may not have problems that you need help with, but you **DO NEED** their updates to support the Tax Requirements. To be able to give you all of this requires an income for the company. - from those who use it. The cost of the software and support is a tax deductible item. For your club.

ICLUB gives **GREAT** service to those who have purchased **SUPPORT**. The problem lies with those who don't buy support and those who do not know how to request support.

When you purchase the NCA software, it comes with a **SERIAL NUMBER**. Write this number on your CD (use the kind of pen that writes on photographs.) You will need this number **every time** you request support or download an update. When you register while installing your software, you will receive a registration number. Write that on the CD also. And when you order and pay for support, you will receive a support number. These numbers will be needed when you request

support. You will be asked what operating system you have on your computer, what update you are one, etc.

Know all this when you submit your request. Word your question so that they know what you are asking. When you do it right - they are great and fast with their help - they will work with you. And they do have help that does not require support. See below.

Help - how to get it? Help is available in several ways.

- For standard "How do I do it?", go to **HELP** in the NCA program. Almost every type of transaction is available step-by-step - along with explanations and some problem solving.
- For problems, such as "I made an error on a withdrawal. How do I fix it?" use *IClub's FREE HELP*
- **Go To (on-line)**
- www.IClub.com/support - brings you to: "**IClubcentral Customer Support**
- Click on "Need help with Accounting?" On the left of the screen is a menu beginning with FAQ (Frequently Asked Questions.) This menu has a world of helpful answers to problems. Take time to go through it so you will know just what and where it can help. Et even walks you through most of the actual spin-offs of companies. Helps you out of many error problems. Gives you good hints on other areas.
- If you are in the NCA program and on-line, you can click "**Check for Updates.**" It will bring you into a page telling you how to update. The same menu is on the left.
- You can also reach "**Frequently Asked Questions**" by clicking on *Hot Topics* in that menu. *****Go there for the **BEST** explanation of **Compound Annual Rate of Return**.

Remember - there is no charge for this Help.

Notes on Accounting Program

Accounts: There are 4 categories of accounts into which you may deposit (or withdraw) **cash**.

- 1) Bank - this would be your cash account
- 2) Broker - for Securities
- 3) Suspense - Seldom used
- 4) Petty Cash

Cash and Broker - Brokerage accounts usually have a cash or money market account that is used to sweep money in and out of when buying and selling securities. If this account has check writing privileges, you may not want to have a "bank" account also. (With the 2.1 vs. you may have multiple bank and brokerage accounts although I don't know why an Investment club would want that.)

- **ALL payments** (contributions) and **fees** are deposited into these accounts.
 - In the **NCA Program**, **Payments (Monthly contributions)** and **money collected for tax-deductible expenses** go into "**Payments**" in the **Member Section**. **Money** collected for a late fee, bad check charge, new member start-up fee, etc. and used for **non-tax deductible expenses** go into "**Fees**" in the **Member Section**. No actual deposit is made into Bank or Broker on the Cash screen. **The program does that.**
- **Money Market** interest or dividends are deposited into the **appropriate** account in the **CASH** section.
- All **tax-deductible expenses** are taken from these accounts.
 - Tax-deductible **expenses** include:
 - Florida Intangible Taxes
 - NAIC dues
 - Any software used by club - Accounting, tax, even one copy of *Toolkit*, Investing related subscriptions etc.
 - Copies of taxes, reports to members, stamps, etc.)
- **Contributions** and **fees** will **both** be included in what you have paid into the club (shown in the "**paid In**" columns on **Member Status Report** However - **payments** will "buy" units, **fees** will **NOT** buy units. (I *always* put the **date** for "**Show Member Contributions Since**" (column 1 in the Report) as the 1st of Jan of current year - that shows who is paid up for the year.)
- **Suspense** is used with certain types of transactions - Drip, gifts of stock, etc. When needed, the Software Manual or the program's **HELP** will direct you.

Petty Cash- Treat this as a "Coffee Can." **THIS MUST ONLY BE USED FOR NON-TAX DEDUCTIBLE EXPENSES.** You may collect other money from members and deposit into this account to be used for things like refreshments, cards, dinner etc. This money will not show up on Member Status Report as money paid in. The program will not show it as part of the bank account. When balancing your accounts with the bank statements, you would thus have to "add" the two accounts together to reconcile. Unless you are collecting large amounts for parties, etc., I would just use a coffee can or envelope. **JUST DON'T MIX PETTY CASH WITH THE BANK ACCOUNT CASH!!!**

Non-tax Deductible Transactions

Non tax deductible transactions have no current tax consequences to the club's members. These kinds of transactions include:

Payments and Fees from members - These are capital contributions from the members.

Petty Cash Contributions from members - Petty cash contributions are not considered as part of the club's assets.

Beginning Balances - For members these are capital contributions and distributed earnings. Members should have declared and paid tax on any earnings distributed. Security and Cash beginning balances are a statement of the club's assets at a particular point in time.

Transfer of cash between accounts - only a rearrangement of the club's cash assets.

Return of Capital (distribution) - tax will be paid by members

Activity in the Petty Cash account - not included as part of the operation of the club.

Security purchase - reassignment of the club's assets.

Member withdrawal - Any taxable gain or loss is the responsibility of the individual withdrawn member, not the remaining members of the club. If

securities are received in a withdrawal, a portion of the gain or loss is not realized until the securities are sold. NCA 2.1 calculates the withdrawn member's basis in the transferred securities.

Mergers, Splits, Spin-offs - no tax on the reassignment of tax basis in most cases. There are tax consequences if a sale of fractional shares is involved with these transactions. Occasionally, a particular merger, split or spin-off is structured so that the transaction is not tax-free.

Interest on cash accounts and securities - only if the IRS specifies that the interest is tax-free and the broker account has been designated as "tax free" in the settings window (**Accounting > Utility Tasks > Settings**).

CLUB ACCOUNTING TERMINOLOGY

The list below contains definitions of certain words as they are used in Club Accounting.

Active - A member who owns units in the club, or a security in which the club owns shares. Check the "Active" box. When a member completely withdraws from the club or the club sells all shares of a security, the status of the member or security becomes inactive. The program automatically removes the check from "active" box.

Audit - Allows Club Accounting to check the current files for inconsistencies and correct the transactions or calculations that caused the inconsistencies. Consistencies may occur when corrections are made to transactions prior to current valuation update. You can run "Audit" at any time you feel it necessary. *ALWAYS* run an *Audit* before you do a *Valuation*

Block - A group of shares that were obtained at the same time. Sometimes "blocks" are called "lots."

Capital Gain - The sale price of the shares sold minus the cost basis. Members must pay taxes on their share of the capital gain.

Compound Annual Return (CAR) - The rate at which your money would grow if the same growth rate continued for an entire year from a specified date.

Cost Basis - the amount paid for an investment plus any associated expenses that the IRS allows you to include in the investment's cost basis such as commissions. (Also called **COST**)

Current Files - The data files that contain your club's information. You place information in these files when you save the information you enter on the Club Accounting forms. Club

Things You Should Know

Accounting uses the information in these files to perform calculations and produce reports. (Also called **Data Files**)

Dividend Reinvestment Plan (DRP) - A stock purchase plan in which the club buys shares directly from the issuing company, and in which the company automatically reinvests dividends for the club as additional shares.

Fractional Share Payment - A cash amount received from a company instead of a partial share (Also called **Cash-in-lieu**)

Inactive - a member who has withdrawn his entire holdings (units) in the club or a security in which the club no longer holds shares.

Operating Parameters - A set of rules that tell Club Accounting how to perform certain calculations and perform other tasks. You can specify some of Club Accounting's operating parameters.

Payment - An amount of money received from a member for the purpose of investing and operating the club. Members receive units for payments. (Also called **Contributions**)

Petty Cash Contribution - An amount of money received from a member to be used for **NON-DEDUCTABLE** expense (parties, cards, refreshments.) Members receive no units for this payment. The accounting for *Petty Cash* **MUST** be kept separate. Most clubs do not even use this account.

Price - The amount paid for an investment not counting any associated expenses (commissions, fees.)

Suspense Account - An imaginary account into which you can transfer money temporarily. This has the effect of making some of the funds in the Bank or Broker accounts unavailable until removed from the expense account.

Total return (TR) The percent increase or decrease in the value of an investment during a specified period of time.

Transaction List - A list of all the transactions in the current files for one or all members, one or all securities, or all cash accounts. *Example:* "Select View/Delete/Edit Security. Shows all the transactions for a selected security or all securities in the current files.

Unit - A method of measuring a member's ownership in the club. The number of units owned by a member increases when member makes a payment to the club. The value of the units increases or decreases as the value of the club's investments increase and decrease. A unit value is obtained by dividing the total value of the club by the total number of units outstanding.

Valuation - A value assigned to a single share. You must inter periodic valuations for the shares owned by the club in order to keep the calculation of the club's value current.

Withdrawal - The situation in which a member withdraws all or part of his/her holdings in the club in either cash, securities or a combination of the two. If a member completely withdraws, the member becomes inactive. The program will automatically make him inactive.

AREAS OFTEN MISUNDERSTOOD

Units

This is a good time to discuss Units. A Unit is a method for keeping track of a member's **ownership** in the club. Units do not equate with money paid into the club, rather units equate with the value that a member owns. At the time of the club's conception, the valuation for a unit is set and entered into the parameters. This value should be stated in the partnership Agreement. A value of \$10.00 is recommended, however, a club may set any value. If the value of a unit is set for \$10.00 and each member puts in \$20.00, each would own 2 units. From the *NAIC Accounting Manual*, "the valuation units of an investment club originate at the time the first funds are paid into the club by the members. It should be observed that the dollar value of one (1) Valuation Unit will in all probability, never again be worth an exact \$10.00." The **number** of units owned by a member increases as the member makes payments to the club. The **value** of a unit increases and decreases as the value of the club's investments increase and decrease.

The value of all securities plus the cash in the club is divided by the number of units owned by the members to get the unit value on the day of the valuation. Since the club is usually valued monthly, before each meeting, the unit value used for payments doesn't change between meetings. That means there is a window of time when one can buy units at the same price. The payments can be deposited anytime between valuations and they will be based on the last valuation. It would be ideal for everyone to have the same number of units - some clubs try hard to do this. But this is not a practical way to work. A member is bound to be late with a payment sometime. When the member does pay up, the value of the club's investments has changed and the number of units purchased by his payments will no longer be that of an earlier date. If the value of the investments - and thus the club - had decreased, the more units the member would receive at that time. If the value had increased since when his/her payment was actually due, the member would receive less units. Or a new member may join.

$$\frac{\text{Total Value of club Assets}}{\text{Number of Valuation Units Issued}} = \$ \text{ Value of 1 Valuation Unit}$$

The unit value is entered into the NCA Accounting program when the NCA Club Accounting Program is initiated: Utilities; Settings, Initial Unit Value at Startup (\$) - enter your \$ value. **NEVER CHANGE IT!**

MEMBER WITHDRAWAL

Most clubs have in their Partnership Agreement rules for full or partial withdrawal. *The NAIC Manual* has an example.

The value of the member's withdrawal is the same whether member withdraws in cash or in stock & cash (there is seldom a total withdrawal of stock as even number of shares seldom equals the exact withdrawal figure.) The member's cost basis consists of all of the money the member has invested in the club (less any withdrawals), plus whatever income from the club has previously been distributed to him/her for tax purposes. This figure is shown on Member Status Reports in the column "Paid In Plus Earnings" (Tax Basis.) When a member withdraws from the club, the difference between the member's Tax Basis and the cash (or cash and **current value of the securities**) the member receives is **Capital Gain or Loss** from selling his/her share of the club. The member is responsible for reporting this when his/her Federal Tax is filed. (The NAIC Accounting Tax Program will do this and the member will receive this K-1 when Club does the Taxes for the year.)

From page 38 & 43 in the *NAIC Accounting Manual*, "Should the club decide to transfer selected Club owned securities to the withdrawing member, it should be remembered that this option has tax advantages to the club only when the **current price of the security exceeds the purchase price.** Since there is no sale of stock by the Club, there is no tax liabilities generated by the Club. If a club-owned security were to be selected that was less than the purchase price for transfer at a withdrawal, it would be more advantageous to sell that issue and pay the withdrawing member in cash. The remaining members would be able to pick up the tax loss in their personal tax records."

"From a member's point of view, there is no tax advantage to the receipt of club-owned securities when paid instead of cash to finance a full withdrawal. In

accordance with Treasury regulations, the securities are transferred to the withdrawing member at a tax basis equal to the members tax basis in the Club. (This means the member's new tax basis for the securities is as of the date of his withdrawal.) Thus, the only **tax liability** of the member will be his personal gain (or loss), **or the difference between his investment (cost basis) and the amount he received (current value of his portion of Club.)**

NOTE: In a **partial withdrawal** (member is not leaving club - just taking a part of his investment out,) **the tax situation is entirely different.** Treasury Department regulations direct that the club-owned **securities transferred in a partial withdrawal are to be valued at the Club's purchase price.** The withdrawing member is **required to recognize the gain generated by the transfer of the securities as of the date of the transfer** by immediately adjusting their tax basis.

Undistributed Earnings and Unrealized Gain

The difference between the member's tax bases and the club's tax basis consists of two components: Undistributed Earnings and Unrealized Gain.

Undistributed earnings consist of income such as interest or dividends that have been received, but have not yet been distributed to the members, i.e., have not been added to the members' tax bases.

An **asset's unrealized gain** is the difference between the cost of an asset and its current value. If the asset is sold, the gain becomes realized.

The **club's unrealized gain** is the difference between the club's tax basis and the members' tax basis plus any undistributed earnings. These unrealized gains occur only when a member withdraws from the club. Unrealized gain is never distributed to the members; it is merely used as a way to balance the books.

Return Calculations

Certain reports display return figures, Compound Annual Return and Total Return. Compound Annual Return and Total Return are calculated differently.

Compound Annual Return (CAR) figures use Internal Rate of Return (IRR) calculations. All cash flows into and out of an investment are considered when making these calculations. Timing of the cash flows are also a factor in the calculations. These calculations use annual compounding, not daily compounding. Annual Compounding makes the return figures easier to compare with market index return figures.

Total Return is calculated from the Compound Annual Return. NCA 2.1 first calculates the compound annual return. Total Return is then calculated by applying the Compound Annual Return for the entire holding period of the investment.

Due to the way these calculations are done, it is possible to be confused at times. Below are listed some times when the return calculations may be confusing.

Within a short time, the return calculations may look wrong. This is especially true of the Compound Annual Return. The problem is not the accuracy of the calculations but the usefulness of Compound Annual Return calculations when an investment has been held a short period. In this case, you can think of the CAR as the return you will receive IF the rate of gain received in the short period continues for a full year.

When a company is acquired through a spin-off or merger, NCA 2.1 uses the value of the company on the day the club acquired the stock (the

spin-off or merger date) as the starting point in the return calculations. The adjusted cost basis is not used as the starting value. It is therefore possible for your cost basis to be less than the current value of the stock but for NCA 2.1 to show a negative return for the stock. This occurs when the new stock loses value compared to the spin-off/merger date but is still above the cost basis in the stock.

When a stock makes a large move in price, either higher or lower, within a short time, the return calculations may look wrong. This is especially true of

the Compound Annual Return. The problem is not the accuracy of the calculations but the usefulness of Compound Annual Return calculations when an investment has been held a short period. In this case, you can think of the *CAR* as the return you will receive IF the rate of gain received in the short period continues for a full year.

Security, Member, and Club Basis

A **security's** cost basis is the amount invested in a security or other investment. When a security is sold the difference between the net proceeds from the sale of shares and the cost basis is called *Capital Gain* (or *Loss*). Members are responsible to report and pay any tax owed on their share of any *Capital Gain* in the tax year in which the gain was realized.

A **member's** tax basis consists of all the money the member has invested in the form of *Payments and Fees* plus all the income that has been distributed to the member for tax purposes. A withdrawing member is responsible for the tax on any cash received in the withdrawal that is greater than the member's tax basis in the club.

The **club's** tax basis is the combined cost basis of all the club's cash and securities. The club and members never pay tax on the difference between the current value of the club and the club's cost basis. The club's tax basis is not always equal to the combined members' tax bases as the members' tax basis includes all fees and all distributions credited to them over the years.