



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

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JUL 2 1985

Mr. Carl Frank  
President  
1st Liberty Federal Credit Union  
P.O. Box 5002  
Great Falls, MT 59403-5002

Dear Mr. Frank:

This is in response to your letter of June 17, 1985, concerning 1st Liberty Federal Credit Union (FCU) accounting for its investment in a mutual fund.

As Ms. Ulan of this Office explained to you on the telephone, at the time of purchase, an FCU may record a mutual fund on its books at its net asset value plus the broker fee (the FCU need not immediately expense out the broker fee). In the example set out in your letter, the net asset value on the date of purchase is \$196,000 and the broker fee is \$4000. Therefore, the fund would be recorded at a cost of \$200,000. At the end of the accounting period, the market value of the investment in your example is \$201,000. The book value of the investment should be adjusted to the lower of cost or market. Since cost (\$200,000) is lower than market (\$201,000), no adjustment is necessary at this time. If the market price falls below cost, the investment must be adjusted down to the market price. This is in accordance with Letter to Credit Unions No. 79, a copy of which is enclosed.

I hope that we have been of assistance. If you have further accounting questions, please contact Jon Lander at our Region V Suboffice in Denver at (303) 844-3795.

Sincerely,

STEVEN R. BISKER  
Assistant General Counsel

Enclosure

cc: DRD, Region V Suboffice (Denver)

FOIA file: Vol. I, E, 2 - Mutual fund  
Vol. III, C, 1 - Acctg. Procedures

# LETTER TO CREDIT UNIONS

NCUA LETTER NO. 79

DATE: May 29, 1985

## TO THE BOARD OF DIRECTORS OF THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

Recently, there has been an increase in the credit union purchase of mutual funds. Since the mutual fund market is relatively new to credit unions and the market functions somewhat differently from other traditional investment vehicles, I would like to take this opportunity to briefly discuss these funds and to provide you with NCUA's position on accounting procedures.

### WHAT IS A MUTUAL FUND?

Mutual funds permit investors to acquire a pro-rata share of a diversified portfolio of securities. Part of the popularity of mutual funds is their ability to offer small investors some of the advantages otherwise limited to large investors: diversification of the portfolio and professional portfolio management. An investment in a mutual fund is actually the purchase of shares in a fund. The shares are purchased at a public offering price, which is the net asset value of a share in the fund at the time of purchase, plus, in some cases, a sales charge or commission. It should be noted that a common trust plan is a mutual fund.

Mutual funds and common trusts are usually open-end investment companies because they stand ready to sell the public as large a volume of shares as it wishes to buy. Whatever volume of money is drawn in is invested according to the formula or policy of the particular fund. When investors wish to cash in their shares, the fund sells a part of its portfolio to raise the money. It then pays off the investor on the basis of the value of its assets at the date of liquidation. In effect, you buy \$1,000 worth of shares in the fund and, when you sell your interest, you receive your proportionate share of the value of the fund's assets at the time of the sale. Therefore, you may realize a gain or a loss on your original investment.

### WHICH MUTUAL FUNDS CAN A FEDERALLY INSURED CREDIT UNION INVEST IN?

Section 107(7) and (8) of the Federal Credit Union Act (12 U.S.C. section 1757 (7) and (8)) and Part 703 of the NCUA Rules and Regulations (12 C.F.R. Part 703) specify the types of investments, investment activities, and deposits that are legal for federal credit unions. NCUA has taken the position that federal credit unions can invest in a mutual fund or a common trust if its portfolio is limited to investments, investment activities, and deposits authorized for federal credit unions. Federally insured state-chartered credit unions should determine the legality of a mutual fund investment by reviewing state statutes and regulations and, where necessary, by consultation with your state regulator. Prior to making any investment, you should obtain a prospectus and determine that all investments, investment activities and deposits are legal for your credit union. As with any investment, you should take into consideration both safety and soundness and the appropriateness of the investment for your credit union.

### ACCOUNTING PROCEDURES

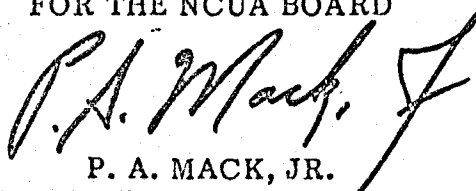
Unlike a direct investment in government securities, shares in a mutual fund or a common trust do not have a stated value at maturity or a specific maturity date. The value of shares changes based on the portfolio and market conditions. Therefore, market conditions play a more significant role in determining the ultimate recoverable value of an investment in a mutual fund or a common trust than in an investment with a specific maturity date.

Generally accepted accounting principles and Section 2040.1.4 of the Accounting Manual for Federal Credit Unions require that marketable securities be recorded at the lower of cost or market on the balance sheet. The amount of the cost of the marketable security which represents the "broker" fee or commission, if any, may be added to the cost of the mutual fund investment and recorded on the books as of the date of purchase. At the end of each accounting period, a federally insured credit union should determine the net asset value of a share in the mutual fund or the common trust and adjust the investment to the lower of cost or market. Adjustments to the book value of the mutual fund or common trust should be recorded to a Valuation for Losses on Investments account, with a corresponding charge to the expense account Provision for Investment Losses. Page 4-64 of the Accounting Manual for Federal Credit Unions provides information on other accounting entries.

If you have any questions about whether or not any of your present investments represent mutual funds or common trusts or about the legality of investing in a mutual fund, you may call the NCUA Investment Hotline (1-800-424-3205). If you have specific questions on accounting procedures, you should seek advice from a CPA or from other accounting professionals. If you still have questions, contact your NCUA regional office.

Sincerely,

FOR THE NCUA BOARD

  
P. A. MACK, JR.  
Vice Chairman

National Credit Union  
Administration  
Washington, D.C. 20456  
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