

UPDATING YOUR RESERVES

By Joseph Rodgers, CPA

If your association has its financial statements audited or reviewed by a CPA, you know that there is a requirement to disclose the association's policy for future major repairs and replacements with the financial statements. Most boards are now accustomed to this requirement – or at least are aware of the need for long-range planning.

Most important is the adequacy of planning and the availability of assets to fund these future costs. It is not unusual for an association to have a very limited plan – typically it will be a five year plan which covers only anticipated projects, or a plan which includes only the roofs and the roads. Some associations fail to include components that have recently been replaced, even though replacement is an ongoing process.

Plans should include two basic elements: first, a list of all the major components that will need replacement, and an accurate estimate of the remaining useful life of each one; second, a funding plan which will provide owners with a comparison between the eventual repair and replacement cost and the amount of money currently available.

Few associations can afford to fund the replacement plan at 100%. However, a “percent funding” calculation can be made which

will show the owners how to set aside annual funds to reach a percentage goal – perhaps 30% for a modest level of funding, compared with 70% for a plan which will provide a substantial portion of the future costs. The higher the percentage, the better the chance that the association will have the funds available when they are needed.

The board's policy should clearly identify which components are to be paid from the replacement fund accounts, and which repairs and replacements should be planned in the annual operating budget. The policy could also include a plan for any additional funds needed, such as authority for special assessments, or borrowing.

Adequate funding means more than just providing funds for one or two components. As buyers and realtors become more sophisticated about the financial condition of associations, inadequate reserves for replacement may affect property values, reduce the availability of mortgage financing, and turn away educated potential buyers. ■

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