



Are My Association's Replacement Reserves Fully Funded?

Has the Association's independent auditor ever told you that Replacement Reserves are not fully funded? Have you ever wondered why the Association's annual audit report includes a different amount for Replacement Reserves than the Association has in the available designated replacement reserve bank account balances? If so, these situations may be confusing to understand and it may not be easy to explain to the Association's membership how this has occurred. But, the following may be useful in understanding how Replacement Reserve balances are calculated and interpreted.

Replacement Reserve Program

First and foremost, the Association's replacement reserve program is essential to its financial health and stability and is the method by which it sets aside funding for future major repairs and replacements. These repairs are usually big ticket items that are not completed annually and/or the dollar amount involved is too substantial to be fully funded in one year. Examples of these future major repairs and replacements include roof replacement, elevator refurbishment, balcony replacement, parking lot asphalt rehabilitation, tot lot equipment replacement, etc. The Association should base its replacement reserve program on a study conducted by an independent engineer or reserve specialist. This study will provide the Association with a detailed inventory of common property components to be replaced, their estimated replacement costs and the estimated timeline when these repairs should be completed. Additionally, the study will provide the Association with a replacement reserve funding model, that includes a recommended annual contribution to replacement reserves, timeline and dollar amount of the major repairs and replacements to be completed, and a balance to be maintained. The Board of Directors should annually review the status of its accumulated reserve funds in connection with the study's funding recommendations. Also, the study should be updated periodically.

How the Replacement Reserve Equity Fund is calculated

Each year, the Association starts with a beginning balance in the Replacement Reserve equity fund. This amount can be found in the Members' Equity section of the Association's Balance Sheet. It represents the cumulative amounts allocated for replacement reserves in prior years. Next, the board approved contribution to reserves, which is included in the annual budget and based on the Association's replacement reserve study's recommendations, is added to the Replacement Reserve equity fund. Then, any board approved major repair and replacement costs are deducted from the equity fund balance. The ending result represents the total funds or Association equity that has been earmarked for Replacement Reserves. It is based on board approved actions and is calculated independently of the cash transactions that may be occurring in the Association's designated replacement reserve bank account(s).

Replacement Reserves Equity Fund is Not Fully Funded

The term "fully funded" as it relates to the Association's Replacement Reserves refers to the relationship between the Association's net assets and the Association's Replacement Reserve equity fund balance. The Association's net assets is the difference between total assets, such as bank accounts, assessments receivable and prepaid expenses, minus total Association debts or liabilities, such as fees due to vendors for services provided and assessment income received in advance by homeowners. When the Replacement Reserve equity fund balance is greater than the Association's net assets, reserves are not fully funded. When this occurs, the Association will have a deficit in its unappropriated members' equity fund balance as shown on the Balance Sheet. For example, below is an example of an association balance sheet where replacement reserves are not fully funded.

Association Balance Sheet	
Bank Account—Operating	\$70,000
Bank Account—Reserves	\$175,000
Assessments Receivable	\$50,000
Prepaid Expenses	\$5,000
Total Assets	\$300,000
Accounts Payable	\$175,000
Prepaid Assessments	\$25,000
Total Liabilities	\$200,000
Replacement Reserves	\$200,000
Unappropriated Members' Equity (Deficit)	(\$100,000)
Total Equity	\$100,000
Total Liabilities and Equity	\$300,000

Based on the above, once the Association satisfies its total liabilities of \$200,000, there will only be assets of \$100,000 remaining [\$300,000 total assets less \$200,000 total liabilities]. However, the Association has a total of \$200,000 earmarked or designated for Replacement Reserves. This results in the Replacement Reserves not being fully funded because the available Association net assets of \$100,000 is less than the amounts earmarked for Replacement Reserves of \$200,000. It is important to remember that the amounts earmarked for Replacement Reserves equals what the Board of Directors has approved through the annual budgeted contribution to reserves less the approved major repairs and replacements completed during the year. Underfunded reserves generally occurs when the Association has decreased cash flow due to non-payment of assessments by the membership, consistent delays in the payment of vendor invoices, and/or excessive operating losses due to unexpected budget overages, such as utility rate increases, excessive snow removal, or unreimbursed property damage repairs.



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With the outdoor temperatures dropping and the winter season in full swing, now would be the perfect time for all Association Managers or Board Members to make your clubhouse or complex common areas more inviting for your residents and their families, friends and visitors. Some possibilities include a fresh coat of paint, a new wall covering, drywall installation or repair, or a complete room or kitchen remodel.

Atlantic Maintenance Group (AMG), is much more than an award winning, excellent landscaping and snow removal contractor. We are proud to offer top notch interior and exterior painting and general contracting services for both commercial and multifamily properties throughout Maryland, Virginia, Delaware and DC. Our multiple services include, painting, wallcovering, drywall, carpentry, power-washing, caulking, roofing, siding, seamless gutters installation and maintenance, and complete room/tenant demolition and renovation.

Once you have contracted AMG for your wallcovering or painting project, we will thoroughly clean and prepare the surface area before priming and painting with premium quality paints or wall coverings, and they always inspect their work during and after the project, to ensure perfect results for their customers. Once the job is done, we will restore the work area, leaving it in its original condition with a flawless paint or wall covering application. This process ensures a well pleased customer. From wallpaper to wood paneling to vinyl wall coverings, we cannot only install wall coverings or drywall, but also make a variety of repairs on interior walls at your community facilities. The proposal is absolutely free, just give us a call at the contact information listed below.

★ AMG also offers complete room/tenant demolitions and renovations, power washing, drywall installation, including patching or replacement, interior/exterior carpentry projects, caulking to protect your investment from unwanted pests and water leaks, and unparalleled repair services accompanied by thorough follow-through

inspections and customer satisfaction on every job undertaken. And not only that, but AMG makes every effort to work around your schedule, for minimal impact on your time, and a minimal impact on your neighbors and neighborhood.

Before the spring rains arrive, contact AMG for a free roof inspection. Let our experts inspect your roof to identify any potential leaks or problems before they happen, recommend the remedy and possibly extend the life of your roof. Our repairs include everything from replacing roof flashing to patching flat roof membranes or shingle roofs to complete roof replacement. AMG also installs and maintains custom cut seamless gutters and vinyl, wood, fiber cement siding, along with a variety of other exterior surfaces for your commercial building. In conjunction with AMG's other top quality landscaping, snow removal, asphalt and concrete, tree services we offer, every proposal is absolutely free, so give us a call now.

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Designated Replacement Reserve Bank Accounts

Often times Associations will establish separate replacement reserve bank accounts to deposit the annual budgeted reserve contributions and to pay for the board approved major repair and replacement costs. These accounts are typically savings accounts, money market accounts or certificates of deposit at insured institutions. The easiest way to ensure that the Association's replacement reserves are fully funded is to establish these separate designated reserve bank accounts and to immediately transfer cash from the operating checking account to the separate reserve bank account in an amount equal to the budgeted reserve contribution. This process is typically completed monthly. Also, when replacement reserve projects are completed, the Association should fund these project costs from its designated replacement reserve bank accounts. This will result in the board approved transactions in the Replacement Reserve equity fund matching the cash transactions in the separate replacement reserve bank accounts. In

connection with this process, it is essential that assessment income is levied at appropriate and adequate levels each year to meet all operating needs and that the Association aggressively pursues any delinquent assessments in a timely manner.

Closing

In summation, it is important for Associations to have a reserve study conducted by an independent engineer or reserve specialist and that they have a replacement plan in place. The Board of Directors needs to periodically review their replacement reserve balances, compare them to the reserve study and finally, determine if additional funding is required for replacement reserve program.

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