RESERVE FUNDS – HOW BEST TO ACCOUNT?

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"How do I reserve? Let me count the ways" is not exactly what Elizabeth Barrett Browning had in mind when she penned her famous poem about love, but if you have 37 different Reserve components, how many Reserve contributions do you make and track each month? One or 37? There is a good answer.

Generally Accepted Accounting Principles (GAAP) written by the American Institute of Certified Public Accountants (AICPA) do not require the Reserve Fund to be broken down on a component-by-component basis. GAAP states that the fund must be broken down "to the extent designated by the board". If the board has chosen to not break down the fund, the fund can be accounted for as a total dollar amount. There are Practical considerations, Reserve Study considerations, and Tax considerations that support this simple accounting approach.

PRACTICAL CONSIDERATIONS

Reserve funds are to be used for the maintenance and repair of all the major assets of the Association. Practically speaking, there is no such a thing as a "roof fund" or a "paint fund", there are only "Reserve" funds. If $50,000 is needed for a roof project that was budgeted at $45,000, the $50,000 should be spent. Boardmembers do not need to levy a special roof assessment for the shortfall or "re-distribute" funds from other projects. Of course, spending more on one project means there are less Reserves for other projects. But a well-crafted Reserve Funding plan, adjusted annually for accuracy, should be able to accommodate these normal discrepancies.

It is likely in a credible Reserve Study that there are as many projects that will come in under budget as those that come in over budget. When a project comes in under-budget, the remaining funds should not be allocated towards that project's next occurrence. Those "excess" funds are available for use by all other Reserve projects. On a practical level, there is just one Reserve Fund, from which cash is expensed for legitimate Reserve projects.

RESERVE STUDY CONSIDERATIONS

Reserve professionals generally use software that does not allocate Reserves towards one component or another. The money is presumed to be shared, and used as needed by all components. So from a Reserve Study point of view, there is no merit to having a variety of separate "accounts" into which the budgeted Reserve contribution is distributed, and from which individual expenditures are made. Your Reserve professional may create a table showing the distribution among components of the total Reserve Balance and the Reserve contribution, but it is for the benefit of your CPA at the Association's Fiscal Year End and not part of a monthly reserve fund management strategy. A literal distribution to individual line-item funds is inappropriate. After all, the Reserve fund, and the Reserve contributions, will be re-balanced and re-distributed by your Reserve professional's software each year.

TAX CONSIDERATIONS

There is some merit to concerns about segregating the Reserve fund for tax purposes. If you file Federal Form 1120, you may have been told that you need to account for some components differently than others. This is because the IRS views some components (such as painting) as non-capital projects and will treat them differently from capital projects (such as re-roofing, or carpet or fence replacement). This doesn't affect how you track your contributions or the preparation of your monthly financial statements. You can still report the Reserve Fund balance as a total dollar amount through the course of the year. However, your CPA may wish to see the component-by-component breakdown to make the necessary adjustments or allocations between capital and non-capital funds for tax-compliance purposes. If you file the shorter, simpler form 1120-H, these tax concerns do not apply.

It may not be what William Shakespeare had in mind when he wrote, "That which we call a rose by any other name would smell as sweet," but dollars are dollars - they don't have a specific component identity!