

RESERVE EXPENSES VS. OPERATING EXPENSES



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An important decision point for Managers and Boardmembers is to properly account for their expenditures. So when a sprinkler, light fixture, lobby chair, or roof repair is done, is it an Operating expense or a Reserve expense? By going through these decision points in order, you'll protect your Reserve Fund from being drained by inappropriate expenses, or save your Operating Budget from getting rocked by legitimate Reserve expenses.



Step 1: Refer to Your Reserve Study

Every Reserve Study that is prepared according to [National Reserve Study Standards](#) will have a Component List comprised of components that pass all four elements of the following four-part test:

1. It is a common area maintenance responsibility
2. It has a limited Useful Life
3. It has a predictable Remaining Useful Life
4. Its replacement cost is significant (typically between .5% and 1% of the annual budget)

See if your Reserve Study professional has already anticipated and documented that project in the Component List. If so, it is a Reserve expense. But what if the expense doesn't appear on the Reserve Study Component List?

Step 2: Amend the Component List

If the repair or replacement project doesn't appear on the [Component List](#) in your Reserve Study but passes the above four-part test, it is a Reserve Component. The higher authority is National Reserve Study Standards, not the Reserve Study.

So if you believe you have an expense that passes all four elements of the four-part test, be in touch with your Reserve Study provider. Ask them to create a note in the file to add the item to the Component List the next time the Reserve Study is updated. In the meantime, spend money for this project from the Reserve account.

Step 3: Maintenance that Extends the Remaining Useful Life of the Reserve Project

If maintenance (i.e., a significant repair to a roof, fence, or section of carpet) is proposed on a Reserve Component, figuring out whether to expense the work from the Operating or Reserves account can be tricky. There are two key questions to ask: Does doing the work extend the Remaining Useful Life (RUL) of the Component? Does doing the work make a portion of the component “good as new”? If the answer to either of these questions is “yes”, then the work should be considered a Reserve expense.

In the first case, advise your Reserve Study professional of the maintenance work that was done, so that when [the next Reserve Study](#) update is performed they will **increase** the component’s RUL, instead of reducing it, which would be the natural inclination.

If the work that is done serves to makes part of the component “new again” advise your Reserve Study professional when the next update is performed, so they can split the component into separate line items (i.e., an “old” part and a “new” part).

Step 4: Consider the Frequency of the Project

Finally, how often does the expense occur? Operating expenses are typically the daily, weekly, and monthly expenses that an Association faces. If the expenditure is, or will be scattered throughout the year (replacing light bulbs or sprinkler valves, local concrete sidewalk repairs, random plumbing repairs, etc.), it is an Operating expense.

But if the expenses are combined into a single event (buying a case of replacement light bulbs every other year, grinding and repairing 8-12 sidewalk areas every year, once-a-year gutter cleaning, proactively re-piping a section of the building each year), it can be a Reserve expense. If the project doesn’t appear in the Reserve Component List, create a note in the file to officially add the component the next time the Reserve Study is [updated](#).

Apply Reserve Experience and Consistency

Budget questions are not always black & white. Experience and consistency are key! The four-step approach will help you improve the consistency in applying invoices correctly to Operating or Reserves. Keeping the association’s finances organized is one way to help guide them successfully into the future.