

Notes to Financial Statements

Notes to financial statements are governed by the GAAP principle of **full disclosure**, which calls for financial reporting of **any fact significant enough to influence the judgment of an informed reader**.

The notes to financial statements serve as a means for the auditor to amplify or explain items presented in the main body of the statements. Auditors are responsible for reporting all of the following elements if they exist:

Disclosure of Accounting Policies: a statement identifying the accounting policies adopted and followed by the reporting entity should be presented as an integral part of the financial statements (APB Opinion No. 22). The disclosure should be given as the initial note or in a separate Summary of Significant Accounting Policies section preceding the notes to the financial statements. The Summary of Significant Accounting Policies answers such questions as: what method of depreciation is used? What amortization policy is followed in regard to intangible assets? What is the accounting treatment of cash and cash equivalents? Have assets been re-valued due to functional obsolescence?
***A disclosure of accounting policies is a requirement for all projects.**

Changes in Accounting Methods: If accounting methods or treatments have changed from prior periods, the auditor should discuss the changes.

Credit Claims: The nature and cost of creditor claims on assets of the project. How is the entity financing its operations? For each mortgage, the auditor should list the terms of the mortgage (name of creditor, expiration date of mortgage, interest rate, HUD insurance), and the principal payments expected to be made in each of the next five years. For other types of debt, the auditor should disclose the name of the creditor and the terms of the loan (interest rate, maturity, terms for repayment) and whether or not the loan places a lien on project assets. ***A full disclosure of credit claims is required for all projects that have mortgages or loans and notes payable.**

Contingencies and Commitments: These can include things like gains or losses not reported within the body of the financial statements, potential litigation, contingent revenue (e.g. HAP contract with an expiration date), possible tax assessments, sales contracts pending for the sale of the project, etc. The auditor should also discuss major contracts such as the management agreement (fee percentage, term of agreement, etc.). For capital advances, the auditor should list the terms of the capital advance (how long it is in effect, what conditions must the owner satisfy, and that the grant will convert to a mortgage note if the owner does not abide by the terms of the use agreement).
***If there is a management fee expense on the statement of profit and loss, the auditor should disclose the terms of the management agreement.**

Subsequent Events: This would include events or transactions that occur after the balance sheet date but before the audit is issued. This could include prepayment of the mortgage, assignment, sale of the project, etc.

Related Party Transactions: If the owner conducts business with a related party then the auditor should disclose:

1. The nature of the relationship
2. A description of the transaction(s)
3. The dollar amount of transactions
4. Amounts due from or due to related parties

Errors or Irregularities: Auditor should disclose unintentional mistakes made in report (usually reported as prior period adjustments), or intentional irregularities committed by the owner or his agents.

Illegal Acts: Auditor should disclose violations of laws or regulations. These should be disclosed on the schedule of findings and questioned costs, but may also appear in the notes.

NOTE: Each financial statement will not necessarily contain *all* of the notes and disclosures noted above. Certain notes will not be applicable to all projects. For example, some project may not have related party transactions. Some projects may not have any contingent agreements or other potential risks to their revenue stream.