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**CHAPTER 6**

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**STATEMENT OF RETAINED EARNINGS IN DETAIL,  
OTHER REPORTS, AND NOTES TO THE FINANCIAL  
STATEMENTS**

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**6-1  
INTRODUCTION**

Corporations declare dividends to pay owners for their share of project income and provide them with a return on their investment. Many HUD projects are corporations. Cooperative housing projects are incorporated projects. A project cannot pay cash dividends unless retained earnings are available and there is enough cash on hand to cover the payment. If enough cash is not available a corporation can elect not to pay dividends, or it may pay dividends by distributing additional shares of stock. The Statement of Retained Earnings provides information regarding incorporated projects' ability to pay dividends and the impact of those payments on retained earnings. Projects that are not incorporated (i.e., partnerships and individually owned) do not submit a Statement of Retained Earnings, however similar information about ownership is contained in the Owners Equity section of the Balance Sheet, or is included in a separate schedule as discussed in Chapter 3.

**Why it is  
important**

Profit motivated, including limited dividend, projects that are incorporated are owned by the stockholders of record (Many corporate nonprofit mortgagors are non-stock companies.). Unless the mortgagor is a non-profit entity, these investors receive a return on their investment based on the number of shares of stock held when dividends are declared. On HUD projects, distributions can only be made if the surplus cash computation results in an amount sufficient to cover payments to owners and continue to meet other cash obligations throughout the year. For more information regarding surplus cash please see HUD Handbook 4370.1, Reviewing Annual and Monthly Financial Statements. The Asset Management/Loan Management staff can determine the financial efficiency of a project by evaluating the timing and amount of dividends declared. The Statement of Retained Earnings provides the information required to perform this task. An example of a Statement of Retained Earnings is found in Chapter 2, Exhibit 2-2.

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THE STATEMENT  
OF RETAINED  
EARNINGS

Prior Period  
Retained Earnings

What they are           The prior period's retained earnings is the amount of net income less net losses and dividends that remain from the prior year.

Why they are important   The prior period's retained earnings is important when performing comparative analyses from one year to the next and when determining the financial efficiency of the project.

How they are used        The Asset Management/Loan Management staff can compare the prior period's retained earnings with the ending period retained earnings to determine how well the project has performed in the current year. The Asset Management staff should also review these balances for prior period adjustments.

Net Income (Loss)

What it is               Net income (loss) is the amount the project earned in the current year.

Why it is important     Net income (loss) is important because it is a measure of the projects financial efficiency.

What it relates to       Net income (loss) relates to the Statement of Income.

How it is used           Net income (loss) can be reviewed to determine the profitability of the project.

Cash Dividends  
Declared

What they are           Cash dividends are payments to owners for their equity share (common stock) invested in the company.

How they                Dividends can be reviewed by Loan Management staff to

are used determine if the amounts are appropriate and in accordance with HUD requirements.

Retained Earnings  
Year End

What they are The retained earnings year end is the closing balance of a projects net income less net losses and dividends that remain at year end.

Why they are important The Loan Management staff can compare this with the prior years retained earnings to evaluate a projects financial efficiency during the current period.

How they are used The retained earnings year end balance is used to evaluate the ability of the project to continue as an ongoing concern based on its earnings per share of common stock. Adverse conditions such as insufficient balances in retained earnings should be researched. In most states it is improper for a company with a deficit balance in retained earnings to declare dividends.

The amount transferred to the residual receipts account should be debited to that account and credited to the General Operating account. The notes to the financial statements should include a discussion of residual receipts account activity and a disclosure that use of residual receipts account funds is contingent upon HUD's prior written approval. In addition, any funds transferred to or from the residual receipts account must be separately displayed in the Statement of Cash Flows.

The tax consequences for amounts that may subsequently transferred back to HUD from the residual receipts accounts of certain Section 8 projects may deserve special treatment.

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OTHER  
STATEMENTS  
(Schedules)

What they are Other financial statements and reports also are required with the submission of the four primary financial statements. We will only touch upon these briefly however, a more detailed discussion of these items can be found in HUD Handbook 4370.2 Financial Operations and Accounting Procedures for Insured Multifamily Projects. The following is a list of other reports including a

brief description of each:

- A. A Statement of Shareholders' Equity or Partners' Capital. This shall include a full explanation of origins, additions, and deductions during the operating period. This statement could also be shown as part of the Statement of Financial Position (Balance Sheet). This is most often found in projects that are not incorporated.
- B. Supporting data, in the form of explanatory comments or appropriate schedules. This must include the following:
  1. Accounts and Notes Receivable. A complete detailed analysis shall be included of any accounts or notes receivable other than regular tenant accounts, including date acquired, original amount, terms, name of borrower and balance due.
  2. Delinquent Tenant Accounts Receivable. A summary analysis shall be made of delinquent tenant accounts, including the number of tenants and amounts delinquent for 30 days, 30-60 days, 60-90 days, and over 90 days.
  3. Mortgagor Escrow Deposits. A breakdown shall be made of the items making up the total amount on deposit with the mortgagee in anticipation of future disbursements for Mortgage Insurance Premiums (MIPs), taxes, property insurance, etc. This amount shall be confirmed in writing by the mortgagee.

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4. Tenant Deposits. A complete, detailed analysis shall be included of funds maintained in any regular tenant accounts.
  5. Reserve Funds. An analysis shall be made of all required reserve funds, including:
    - a. A statement as to the amount required. If more than one fund is required to be established, a separate statement must be submitted for each fund.
    - b. A statement as to the form in which these funds are provided. If in cash, the names of the depository of each fund are required. If

invested in securities, full details are required.

- c. A statement of any withdrawals during the year, including the purpose of and authority for such withdrawals.
6. Change in Fixed Asset Accounts. A schedule in the form required shall be included, showing full details and explanations of any changes in fixed asset accounts.
7. Accounts Payable. A list shall be included of accounts payable, other than trade creditors, segregated by those payable within 30 days, 30-60 days, and more than 60 days, with detailed analysis of the latter group, to include date incurred, original amount, purpose, terms, creditor, and balance due. Accrued expenses shall be shown separately from accounts payable.
8. Accrued Taxes Payable. A statement shall be attached supporting any accrued taxes shown, including each type of tax, basis for the accrual, and date due.
9. Notes Payable (Other than Mortgage). Details shall be included of loans or notes payable, other than the

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insured mortgage, including date incurred, original amount, purpose, terms, creditor, and balance due.

10. Stock Actively Reports - Initial Submission. In the initial report (the first report submitted on the project), full details shall be included concerning the issuance of all stock and/or investments, including names of stockholders or individuals interested, proportionate interest of each and whatever consideration is received by corporate or noncorporate projects (considerations shall be itemized to show amount of cash, land, services, etc.). Initially, a list shall be furnished consisting of officers, directors, and individuals having a financial interest in the project. Thereafter, details shall be furnished of any changes in these positions occurring during the year. If no changes have occurred, it should be so noted.
11. Distributions to Owners or Stockholders. If any dividends were paid or if other distributions were

made to owners or stockholders (including purchase or redemption of any stock of the corporation), the amount declared on each class of stock shall be shown along with the period for which it was declared, the date of declaration, and the date of payment. For limited distribution mortgagors, a statement is required as to both the cumulative and the current (fiscal year) amount of return on equity earned.

12. Unauthorized Distribution of Project Income. If any unauthorized distribution of project income is revealed during the audit a separate schedule must be prepared detailing the amounts involved, date of such distribution and any other relevant information.
13. Comments on Statement of Financial Position (Balance Sheet) Items. Comments on and explanations of all other Balance Sheet items not fully explained by the title of the account shall be a part of the report.
14. Residual Receipts. For all projects required to make

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deposits to a residual receipts fund, a computation shall be included showing the amount of any such receipts at the end of the fiscal year and the date of their deposit to the fund. An analysis of this fund and the computation are required regardless of whether or not residual receipts have actually been generated. The format for the Computation of Surplus Cash, Distributions and Residual Receipts at the Balance Sheet Date can be seen in Appendix 2 of HUD Handbook 4370.2.

15. Compensation of Partners or Officers. If a project is owned by a corporation or partnership, a statement detailing the compensation of officers or partners is required. If no compensation was paid, a statement to that effect will suffice.
16. Listing of Identify of Interest Companies and Activity. A listing of identity-of-interest (as defined below) companies doing business with the mortgagor and/or management agent of the project, along with a breakdown of services rendered and amounts received, shall be required if the payments for services performed for the project totalled \$1,000 during the operating period.

HUD assumes an identity of interest to exist between a vendor, a project, or a lender when (1) the project; or (2) any officer, partner, owner, or director of the project; or (3) any person who directly or indirectly controls 10 percent or more of the project's voting rights or directly or indirectly owns 10 percent or more of the project, is also (1) an officer, partner, owner, or director of the lender/vendor; or (2) a person who directly or indirectly controls 10 percent or more of the lender/vendor's voting rights or (3) directly or indirectly owns 10 percent or more of the lender/vendor.

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NOTES TO THE  
FINANCIAL  
STATEMENTS

Notes to the Financial Statements include notes relative to the mortgagor organization and policy changes affecting the preparation of financial statements and account balances, as well as significant accounting policies that have been followed in the

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preparation of the financial statements by the mortgagor's accountant. In addition, the notes should indicate the type of Section 8 project, if applicable, and basis for computation of distributions.

How they  
are used

Notes to the Financial Statement are to be reviewed by the Asset Management/Loan Management staff to determine if they offer insight into items that were not fully disclosed in the financial statements. The Asset Management staff should do research of and make inquiries about items that are not clearly understood after reading the Notes to the Financial Statements. Examples of items that might be contained in the Notes to the Financial Statements include comments on:

- o going concern basis difficulties,
- o significant accounting policies,
- o outstanding accounts receivable,
- o commitments and contingencies, including lawsuits,
- o manager's salary, and
- o increases in management fees.

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CHAPTER  
SUMMARY

The Statement of Retained Earnings is a valuable tool in evaluating the financial efficiency of a project. The mortgagor's ability to declare dividends and the amount of these dividends is critical to incorporated project owners (stockholders). The Asset Management staff can review the Statement of Retained Earnings to perform comparative analysis of retained earnings from one year

to the next. There are many other reports that can add additional information about HUD projects. In addition, the Asset Management staff can gain insight about unusual conditions or transactions by reviewing the Notes to the Financial Statements.

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CHAPTER 6

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ACCOUNTING KNOWLEDGE QUIZ

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QUESTIONS

1. A company's net income less net losses and dividends is \_\_\_\_\_.
  2. Amounts paid by a corporation to its owners are known as \_\_\_\_\_.
  3. Owners of a corporation are known as \_\_\_\_\_.
  4. Dividends can be compared with \_\_\_\_\_ to determine if the amount seems reasonable.
  5. Asset Management/Loan Management staff can gain insight about unusual conditions or transactions that were not fully disclosed in the financial statements by reviewing the \_\_\_\_\_.
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ANSWERS

1. Retained Earnings. (p. 6-3)
2. Dividends. (p. 6-1)
3. Stockholders of Record. (p. 6-1)
4. Net income. (p. 6-2)
5. Notes to the Financial Statements (p. 6-8)



