



Inside Real Estate Audits: What Makes Them Unique & How to Get Them Right

Real estate audits play a crucial role in the financial oversight of an industry that involves substantial investment, long-term projects, and complex legal frameworks. As the real estate sector grows in size and complexity, ensuring that financial transactions are accurately recorded and compliant with legal standards has become more important than ever. Auditing in this space is not just about checking numbers—it involves assessing property ownership, valuations, construction progress, and lease management. Here we explore how real estate audits are conducted, their uniqueness and differences from audits in other industries, common challenges faced and how to overcome them. Real-life experiences from the auditing field are included to provide practical insight into the nuances of real estate audits.

Fundamentally speaking, a real estate audit requires a thorough examination of not just financial statements and records related to real estate assets and transactions, but various other aspects closely connected with this sector. These may include confirming the legal ownership of property, verifying income from leases, ensuring proper recognition of property sales and checking the accuracy of construction or development costs. A real estate auditor must ensure compliance with relevant accounting standards such as IFRS 15 or ASC 606 for revenue recognition and must often collaborate with legal and valuation experts to properly assess property documents, ownership issues and market-based valuations.

Key Differences from Other Industry Audits

One of the main differences between real estate audits and audits in other sectors lies in the nature of the assets being audited. Real estate involves fixed, immovable properties whose

values can fluctuate widely based on market conditions. This introduces a level of subjectivity that is not typically found in industries like retail or manufacturing, where asset values are more stable and easily measurable. In real estate, two valuation professionals may assign different values to the same property depending on their chosen appraisal method and assessment of external factors impacting valuation, all of which complicate the audit process.

Another key distinction is the complexity of revenue recognition in real estate. While in retail or service industries revenue is usually recognized at the point of sale or when services are delivered, real estate projects, especially construction and development projects, may span multiple years. Revenue might only be recognized once specific performance obligations are met, which requires careful judgment. Moreover, real estate entities often deal with long-term lease agreements, where terms such as rent escalations, tenant incentives, and leaseback clauses can significantly affect reported income.

In the real estate sector, the intricate legal and regulatory landscape adds to the complexity of audit. Each property is tied to legal documentation such as title deeds, zoning approvals, lease agreements, and environmental clearances. Any error or omission in interpreting these documents can lead to material misstatements in the financial records. In contrast, other industries typically have more standardized regulatory frameworks with fewer location-specific complications.

Unique Challenges in Real Estate Auditing

These differences give rise to unique challenges in real estate auditing, which are:

- **Valuations:** One of the most common challenges is the valuation of real estate assets, which is often based on assumptions about market trends, rental income, or future development potential. Since valuation impacts both the balance sheet and earnings, auditors must carefully evaluate the credentials and methods used by appraisers.
- **Physical verification:** A vital aspect of real estate auditing is physically verifying each and every property included as part of investments. This step is critical not only for

ownership confirmation but also for assessing the actual condition, usage, and accuracy of area measurements, which directly impact the fair market value (FMV). In our experience, there have been instances where a property's living area was overstated compared to actual site measurements. Since living area plays a significant role in valuation, especially in residential properties, this variation may lead to material misstatements in the investment valuation.

- **FMV assessment:** Determining the FMV claimed by the client can be challenging. A preferred method to address this is by using a comparable testing approach, where FMVs of neighbouring or similar properties are analysed. This method provides a benchmark, helping ensure the value reported for the client's property was reasonable and market-aligned.
- **Premature inclusion of properties:** Sometimes, the client includes multiple properties in the FMV calculation for their investment portfolio for a given year. However, on a deep dive, it may be noticed that these properties, while technically acquired within the financial year, were still in the planning and permit phase and had not yet moved into development or usage. This inclusion is not compliant with valuation standards. Properties that are acquired but not yet developed or operational should not be included in FMV calculations. Instead, such properties should be disclosed as advances or capital work-in-progress. Including them in FMV would artificially inflate asset value and mislead stakeholders.
- **Legal documents verification:** Another major issue is the verification of legal documents, which can be lengthy, jurisdiction-specific, and full of technical clauses. Misreading these documents can lead to incorrect conclusions about ownership, rights of use, or revenue obligations.
- **Inconsistent record keeping:** Real estate businesses, especially small or medium-sized developers, may also suffer from inconsistent record-keeping. Unlike larger corporations with integrated accounting systems, these businesses might use informal spreadsheets or third-party contractors, making it harder to trace financial data.

- **Related party transactions:** Additionally, related party transactions, where properties are bought or sold between entities controlled by the same person or group, are common in real estate and often not conducted at arm's length. This increases the risk of manipulation or fraud.
- **Projects under development:** These pose their own set of difficulties. Auditors may be asked to confirm the progress of construction, which involves not just checking invoices but also physically verifying site conditions or analysing engineering reports. In these cases, having a copy of the construction agreement becomes essential, which outlines the payment structure, milestones, and responsibilities, providing key support for both expense verification and asset recognition. Without it, the auditor cannot reliably confirm whether costs are being appropriately capitalized or whether the timing of recognition aligns with project progress. There may be situations where, based on need for significant technical assessment, external experts have to be called in and reliance on their report may be crucial.

Approach to be taken by Auditors

To overcome these challenges, auditors must take a multi-disciplinary and proactive approach. Collaborating with independent valuers ensures a more objective assessment of property values, while working with legal experts helps in decoding complex documents. The use of technology and data analytics is becoming increasingly common, allowing auditors to scan large datasets for inconsistencies, track project costs, and monitor compliance. Standardizing audit procedures and checklists tailored to the real estate sector also improves accuracy and efficiency.

Strong communication between auditors and the client's legal, financial, and project management teams is essential. Many challenges arise not from the complexity of data, but from misunderstandings or lack of documentation. Establishing clear audit plans that focus on high-risk areas, such as large transactions, revenue recognition, or intercompany dealings, helps ensure that resources are used efficiently and critical issues are addressed early in the process.

Real estate audits may not be as fast paced as audits in tech or manufacturing, but they demand a high level of attention to detail, legal awareness, and professional scepticism. These audits can significantly impact financial decisions, investor trust, and regulatory compliance. As the industry continues to evolve, with more complex financing structures, international investments, and environmental regulations, the role of the auditor becomes even more critical.

Conclusion

In conclusion, real estate audits are a vital part of ensuring the health and transparency of the real estate sector. Unlike other industries, they involve unique complexities such as subjective valuations, legal intricacies, and long-term revenue models. Auditors must be prepared to adapt, learn continuously, and work collaboratively across disciplines. By understanding these unique challenges and applying tailored audit methodologies, professionals can uphold the integrity of financial reporting in one of the world's most valuable industries.

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