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Is Your Real Estate Entity Ready for an Audit?

If you are in the process of securing permanent financing or raising common or preferred equity from an institutional investor for your real estate entity, you might have been asked to provide audited financial statements. That could sound daunting for those unfamiliar with the audit process, but it doesn't have to be.

The very first step is to understand what a financial statement audit is. A financial statement audit is the examination of an entity's financial statements and accompanying disclosures by an independent auditor. An audit is the highest-level assurance service a certified public accountant (CPA) performs to provide "reasonable assurance" about whether the financial statements are free from material misstatement.

While selecting and engaging the CPA firm that will be performing the audit is essential, designating a team within your company that will oversee and facilitate the audit process is also of utmost importance. This team should be comprised of accounting and finance professionals as well as IT professionals.

Once the company's and audit teams are selected, a planning meeting should be held, preferably in person, if conditions allow. This is an opportunity for the teams to get to know each other and establish clear lines of communication that are instrumental in ensuring the audit process runs efficiently. The teams should collaborate on an agenda for the meeting.

At a minimum, the topics below should be addressed:

- 1:** Overview of the company's operations and overall market conditions. It is essential for the auditor to understand the business and the industry in which the company operates.
- 2:** Current year activity: Were there any significant transactions during the year? Transactions typically have accounting and auditing implications. Property acquisitions/dispositions, refinances, re-capitalizations and similar items should be discussed in detail and will be focus areas for the auditors.
- 3:** Substantial development/construction, changes in operations, loss of significant tenants, pending or threatening litigation and any other factors that could have an impact on financial reporting.
- 4:** Ensuring that the auditors provide a clear list of requested items subsequent to the meeting.

- 5:** Establishing a clear timeline for when requests are due to the auditor and when the auditors' report is expected to be released to satisfy lender or investor deadlines.

After this meeting and once the auditors' request list has been provided, the company's audit team should re-group to discuss the list in detail and assign responsibilities. Most of the auditors' requests will be items that any accounting department will have readily available.

However, some might require additional preparation; therefore, it is important to review the list early on and have sufficient time to ask the auditor any follow-up questions.

A typical auditor wish list for a real estate entity would include the following:

- 1:** Trial balance and general ledger.
- 2:** Internally prepared financial statements.
- 3:** Approved budgets.
- 4:** Internal control system narratives.
- 5:** Management's going concern assessment.
- 6:** Cash reconciliations, AR and AP aging.
- 7:** Fixed assets, debt, and equity roll forwards.
- 8:** Rent rolls, schedule of straight-line rent and future minimum rents.
- 9:** Schedule of related party transactions.
- 10:** Partnership and debt agreements.

While the above list is not comprehensive, it should provide a solid starting point for the auditors. Once their planning phase has been completed, the auditors will make selections from these documents and request additional support. Additional requests typically include invoices, canceled checks, leases, bank statements and any other documentation that can be used to support the company's accounting records.

A company going through its first financial statement audit is not a simple task; however, the audit process will be much smoother with careful planning and preparation.

Establishing a dedicated team and consistent communication with the auditors will ensure timely completion of tasks and allow for financial statement delivery within the established deadlines.