

CRITICAL AREAS WHILE AUDITING UNDER RERA



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Real Estate (Regulation & Development) Act, 2016 (hereinafter referred to as "Act") has been enacted on 1st May, 2016 and the procedural part viz registration of project, quarterly updation, complaint process, certification and audit is being notified i.e. 1st May, 2017.

As of July, 2021, nearly 29,898 projects are registered by Maharashtra Real Estate Regulatory Authority (hereinafter referred to as "Authority") of which 7210 projects have submitted Form 4 i.e certificate of completion of project leaving nearly 22688 projects which are currently going on in the State of Maharashtra.

The Salient Features of Preamble of the Act are:-

- Regulation & promotion of Real Estate Sector
- Efficient and transparent operation
- Protection of interest of consumers
- Speedy dispute redressal mechanism

Real Estate Sector has been under tremendous pressure and there are instances of delay in project completions owing to various reasons including diversion of funds from one project to another. As of now nearly, 5000 projects are termed as stalled projects in Maharashtra and Authority has now started displaying list of lapsed projects in terms of expired revised timeline on maharera portal in the interest of general public.

It is for this reasons, Central Government while enacting Act has put more emphasis on the following attributes in the interest of real estate project and to ensure that projects are completed in time bound manner.

- Restriction on withdrawal of funds received from allottee
- Use of project fund received from allottee for that project only
- Maintenance of separate bank account with schedule bank for deposit of allottee fund
- Certification by professional like Architect, Engineer and Chartered Accountant for the purpose of withdrawal from designated separate bank account

Role of Chartered Accountants cannot be undermined since the credit back up is most essential for completion of real estate project of voluminous nature which involves many stakeholders.

The certificate issued by chartered accountants has been under close monitor and scrutiny by Authority more particularly for the projects

- a. Having many complaints on account of delay in possession in spite of heavy collection from allottee
- b. Stalled projects where promoter have not been active since many years and certificates are issued by chartered accountants
- c. Complaint u/s 31 read with section 7 for revocation of registration of project is filed
- d. Multiple projects in the same lay out registered and where there are question on diversion of funds from one project to another

Section 4(2)(l)(D) requires promoter to file declaration supported by affidavit concerning following financial aspects namely: -

- 70 % or 100%, as the case may be, (based on feasibility while registering ongoing project) shall be deposited in separate bank account with schedule bank.
- Withdrawal would be to cover cost of project and in proportion to the percentage completion of the project.
- Withdrawal would be after it is duly certified by three professional i.e Architect, Engineer and Chartered Accountants.
- Promoter shall get its account audited within six month from end of financial year and shall produce statement of account duly certified by chartered accountant
- During the course of such audit, chartered accountant is required to verify
 - That amount collected for particular project is utilized for that project only and if not amount of diversion of funds
 - That withdrawal are in proportion to the percentage completion of the project
- Chartered Accountants need to study the provisions of Act, Rules and Regulations and orders/circulars issued from time to time while issuing Certificates and Audit Report under the Act.
- Section 4(2) (l) (D) of the Act requiring promoters to get certificate and audit report.
- Rule 4 of Registration of Real Estate Project.. Rules, 2017 requiring promoter to have additional disclosure for ongoing projects.
- Rule 5 of Registration of Real Estate Project.. Rules, 2017 for withdrawal from separate bank account for ongoing and new projects.
- Regulation 3 and 4 of Authority Regulation, 2017 dealing with format of certificate and report and content thereof
- Office order dated 11th May, 2017 defining co-promoter
- Circular No.4/04-07-2017 for clarification on CA certificate
- Circular No.5 /28-06-2017 for clarification on operating designated separate bank account

- Revised Circular No. 12 and 13 dated 4th December, 2017 substituting co-promoter as promoter
- Circular No. 28 dt 08-03-2021 for reconciliation of sold inventory with Form 3
- Circular No.24Adt 23-07-2021 for financial information on assignment of rights and approval u/s 15 of the Act
- Order No.8/2019 28th March, 2019 for participation in preparation of financial blue print for projects which are revoked

Understanding modality of Business Enterprise:-

Real Estate Industry has complex nature of business operation wherein various kinds of arrangement and rearrangement are done by various stakeholders. It is utmost important for auditor to analyze the cost and revenue sharing arrangement between two or more promoters. Real Estate Development can emerge from any of the following situations:-

- Greenfield Purchase of Land
- Joint Development under area or revenue sharing
- Redevelopment of Housing Societies
- Slum Rehabilitation
- Development Manager Module

The following table illustrates various situations and applicable cost to the relevant promoters. Auditor should closely monitor the cost incurred qua promoter as the Form 3 and Form 5 i.e CA Certificate and Annual Audit relates to promoter but in overall it is to be kept in mind that project is registered with maharera wherein various promoters are having their respective stake.

			FORM 3					
			CLASSIFICATION OF LAND COST					
SR NO			NATURE OF COST	LAND	JOINT	SOCIETY	SRA	LAND
				PURCHASE	DEVELOPMENT	REDEVELOPMENT	DEVELOPMENT	OWNER
1	i	a	LAND COST					
			PURCHASE PRICE	YES	NA	NA	NA	YES
			PREMIUM FOR DEVELOPMENT RIGHTS	NA	YES	YES	YES	NA #
			LEGAL COST AND PREACQUISITION OF LAND TITLE	YES	YES	YES	YES	YES
			COST OF CLEARANCE OF LAND , CORPUS FUND , RENT ETC	YES	YES	YES	NA	YES ##
			BROKERAGE	YES	YES	YES	YES	YES
			INTEREST COST	YES	YES	YES	YES	YES
		b	FSI COST					
			ADDITIONAL FSI PREMIUM	YES	YES	YES	YES	YES ##
			FUNGIBLE FSI PREMIUM	YES	YES	YES	YES	YES ##
		c	TDR COST	YES	YES	YES	YES	YES ##
		d	STAMP DUTY AND REGN CHARGES	YES	YES	YES	YES	YES ##
			LAND PREMIUM AS PER ASR FOR PUBLIC AUTH LAND					
		e		YES	YES	YES	YES	YES ##
		f	UNDERSRA					
		(i)	COST OF REHAB BUILDING AND RELATED INFRA COST	NA	NA	NA	YES	NA
		(iii)	COST OF CLEARANCE OF LAND , REHABILITATION COST ETC	NA	NA	NA	YES	NA
		(iv)	APPROVAL COST , DEPOSIT ETC	NA	NA	NA	YES	NA
			TOTAL LAND COST					
			CLASSIFICATION OF DEVELOPMENT COST					
SR. NO			NATURE OF COST	LAND	JOINT	SOCIETY	SRA	LAND
				PURCHASE	DEVELOPMENT	REDEVELOPMENT	DEVELOPMENT	OWNER
		ii a	DEVELOPMENT COST COST OF CONSTRUCTION					
		I & ii	MATERIAL COST, LABOUR CHARGES					
				YES	YES	YES	YES-SALEBLDG	NA
		iii	ALL OTHER EXPENDITURE	YES	YES	YES	YES-SALEBLDG	NA
			(Excluding Marketing cost) Salaries Offsite Staff Architect Fee, Engg Fee, Site overheads Water, Electricity, Sewerage , Drainage etc consumables					
			Hiring Cost of machineries all Such Direct & Indirect cost					
		b	APPROVAL COST	YES	YES	YES	YES-SALEBLDG	##
		c	INTEREST COST FOR LAND & DEVELOPMENT EXP	YES	YES	YES	YES-SALEBLDG	##

- subject to agreed terms

Apportionment of cost on various projects:-

Promoter enterprise may carry on multiple projects in same entity and there could be common expenditure which are incurred for various project going on at a point of time. It is utmost important to apportion common cost based on various scientific parameters viz. FSI consumed, stages of construction, no. of units etc

The prime objective of RERA law is to ensure that there is no diversion of funds from one project to another and therefore cost allocation to respective projects demands utmost care and scientific basis to ensure that project funds are used for that specific project only.

Issues before Auditor on cost incurred and operation of separate bank account are namely:-

- **Interest paid to partners on their capital** – The amended rules now provides that interest for money borrowed for construction can be taken into consideration in total cost incurred. Here, emphasis is on *money borrowed for construction* whereas capital contribution falls in equity basket. Therefore, it is difficult for auditor to consider interest paid on capital contribution as part of cost incurred for the project. However, if the terms of partnership provides for borrowing from partners in excess of agreed capital contribution, view can be taken that it is being borrowing cost is part of total cost incurred.
- **Remuneration paid to working partners** – Though it is termed as appropriation of profit under other law but still one can argue on the ground that if cost is incurred on salary to working partner devoting his time and energy for the project development is nothing but project cost. In case Engineer is taken to partnership and his core duty is to monitor the construction activities then remuneration paid for such services falls in the category of cost incurred for the project. *Estimated cost of real estate project is defined under Section 2(v) which means the total cost involved in developing the real estate project and includes land cost, taxes, cess, development and other charges.* The definition is inclusive definition and emphasize on total development of project.
- **Marketing cost and Selling cost** – Initially Authority by way of circular instructed that marketing cost cannot be part of project development cost. Later on , State Government vide amendment in rules in 2019 made specific rule stating that marketing cost cannot be part of project development cost and should not be considered for the purpose of withdrawal from separate bank account.

Central Legislation very clearly outlined that estimated cost of project **means total cost involved in developing real estate project** as per section 2(v) of the Act. The terminology **development of real estate project** needs to be analyzed in larger perspective and one need to answer the following questions before coming to conclusion.

- Whether project can be developed without marketing cost?
- Whether development means only actual progress of construction in limited sense or it suggests smooth development of activities?
- Whether there is any need to advertise the under construction projects for searching prospective buyers?
- Whether sources of funding projects comprise of allottee fund, borrowing and capital infusion?

If we closely analyze the development of real estate market in India, it can be observed that promoters primarily were relying upon allottee fund and have been incurring huge cost on advertisement and marketing etc and sometime it goes up to 15 % of the total project cost.

As of now, there is no challenge raised on any judicial forum on this aspect of marketing cost. It is well settled principle that Rules cannot go beyond the provisions of the Act. Further, business cannot be made law centric but laws of the country should be business centric. Management may take its view that marketing cost is also part of project development cost.

- **Barter Transactions with contractors:** - There has been trend in realty industry that contractors carry out development work based on barter allotment of units instead of monetary flow of funds. Here, separate bank account does not reflect the routing of transactions and therefore auditors should suitably disclose the facts in certificate as well audit report by grossing up transactions.
- **Conversion of loans into Sales:** - The lenders and promoters do sometime convert their loan transaction into equity by allotment of apartment in the project. Here also no monetary transaction gets routed through separate bank account and accordingly auditor needs to disclose the facts in certificate as well audit report by grossing up transactions.
- **Financials of Land Owner / Assignor of Development rights:**-It is to be noted that project is registered with maharera and therefore the financial data and other data should reflect project details and not only of particular promoter. There may be more than one promoter namely developer promoter, land owner promoter, assignor promoter , development manager promoter etc. It is , therefore, important to disclose the facts of certification relating to particular promoter and consolidated Form 3 and Form 5 needs to be prepared and uploaded which reflect project financial data.
- **Replacement of ASR value for Land Cost:** - As per Amended Rules, now promoter is allowed to have benefit of replacing actual cost with ASR value for land cost. It is to be noted that interest paid on acquisition cost is also allowed to the promoter for consideration of cost incurred. There could be doubling effect when actual cost is replaced with ASR value. Auditor needs to take care of such situation and disclose the relevant facts while certifying Form 3 and Form 5. The Central Legislation definition of estimated cost requires cost involved on land cost which is different from replacement of ASR value of land.

Now we will deal with respective forms to be issued by chartered accountants:-

FORM 3 – CERTIFICATE FOR PROJECT REGISTRATION AND WITHDRAWAL FROM SEPARATE BANK ACCOUNT:-

The objectives of Form 3 are:-

- **To ascertain cost incurred till date**
- **To understand feasibility of the project in terms of balance cost to incur and balance receivable from sold and units**
- **To know the withdrawal limit of the promoter**

Form 3 is in two parts:-**1. Estimated Cost and cost incurred till date, withdrawal limit considering amount withdrawn till date.****This mainly covers:-**

- Land Cost including legal cost but excluding marketing cost
- Additional FSI cost in nature of Premium, TDR etc
- Slum Rehabilitation cost of development including ancillary cost
- Development cost as certified by Engineer in Form 2
- All other project cost including on site and off site expenditure for the development of project
- Approval charges payable to competent authority
- Interest on borrowed fund

2. Additional information on project feasibility i.e matching of future receivable with balance cost to incur.**It comprises of:-**

- Receivable from sold units
- ASR value of unsold units
- Total receivable of the project
- Balance cost to incur i.e estimated cost – cost incurred till date
- If receivable > balance cost to incur – 70% deposit ratio applicable
- If receivable < balance cost to incur – 100 % deposit ratio applicable
- Gross withdrawal limit = cost incurred
- Amount that can be withdrawn = Gross withdrawal limit – amount already withdrawn

It is to be noted that additional information on project feasibility applies only to those project which are termed as ongoing within the meaning of section 3 of the Act which has not obtained completion certificate as of 1st May, 2017.

Further, the deposit ratio once fixed i.e 70% or 100 % cannot go on changing every time when Form 3 is issued.

This requirement of feasibility study does not apply to project registered as New Project. However, recent circular of maharera as made reference to reconciliation with Form 3 for disclosure requirement of sold/unsold units unit number wise.

The issue remains whether Form 3 issued for New Project should contain additional information?

Chartered Accountants are facing challenges on the following technical issue on Form 3:-

- Whether Form 3 is required to be obtained compulsorily on quarterly basis in spite of fact that promoter has not exhausted its withdrawal limit? Recent circular on Quarterly Progress Report (QPR) requires Form 3 to be uploaded on quarterly basis but rules and regulation are silent on this issue.
- Whether Form 3 with additional information for feasibility data should be uploaded even for Form 3 for new project?
- Whether to certify change in deposit ration i.e 70% or 100 % every time Form 3 is certified or it should be based on 1st certificate issued while registering the project?
- Whether to upload standalone Form 3 of developer promoter or consolidated Form 3 of all promoters?
- Whether cost incurred till date should be taken net of outstanding liabilities for such cost incurred?
- Whether project finance from FI/others is also relevant for computation of amount already withdrawn?
- What is amount withdrawn till date? - Ideally amount withdrawn means cost incurred which is actually paid off. The issue arises for computation of amount withdrawn till date for ongoing projects which were registered owing to requirement of section 3 of the Act for non-receipt of completion certificate. Here, we have two period namely

Period prior to 1st May, 2017 – there was no concept of 70% or 100 % of deposit ratio and hence maharera circular specifies that 100 % to be considered or the purpose.

Period after 1st May, 2017 – 70 % or 100 % of deposit ratio to be considered.

The relevant portion of maharera circular dated 4th July, 2017 for clarification on CA certificate for 1st certificate for ongoing project is reproduced herewith.

“Amount withdrawn till date of this certificate as per books and Bank statement shall be **100 % of amount realized from allottee or cost incurred till date**, whichever is lower.”

The concept of separate bank account started with the notion that promoter shall deposit 70% of allottee fund in separate bank account (100 % if feasibility is negative).

Hence, amount withdrawn till date should have been 70 % of amount realized from allottee or cost incurred whichever is lower.

Reading of circular results in lower withdrawal limit for future.

We will understand this difference by suitable example:- Promoter received allottee fund say 5 crore , Cost incurred till date is 6 crore

Amount withdrawn till date would be

- a. As per maharera circular – 100 % of 5 crore or 6 crore whichever is lower i.e 5 crore
- b. Ideally and logically – 70% of 5 crore i.e 3.5 crore or 6 crore whichever is lower i.e 3.5 crore

Thus, the future withdrawal limit would get curtailed by 1.5 crore reading the maharera circular which itself is ambiguous in nature.

FORM 5 – ANNUAL REPORT ON STATEMENT OF ACCOUNTS

The Objective of asking promoter to obtain Form 5 within six month of end of the financial year is to find out whether :-

- Project funds are used for that project only
- To cross check the certification done by another CA for Form 3
- To ascertain diversion of funds by the Promoter

The current format of Form 5 involves reporting of :-

- a. Amount collected till date
- b. Amount collected during particular financial year
- c. Amount withdrawn till date
- d. Amount withdrawn during particular financial year
- e. Diversion of funds, if any

However, the format prescribed fails to bring the desired result and data pertaining to collection and withdrawal during financial year are irrelevant for the purpose of determining diversion of funds.

The Central Legislation requires promoter to give account of 70% or 100%, as the case may be, of amount realized from the allottees and out of this amount if promoter has diverted funds for other purposes then the same is required to be reported by the chartered accountants. It is further to be noted that on the principle of independence the CA signing Form 3 cannot sign Form 5 and vice versa.

Whether it is Audit or Certification:-

Section 4(2)(l)(D) which prescribes the requirement that

- Promoter shall get his account audited
- Promoter shall produce statement of accounts duly certified by CA
- During the course of audit, it shall be verified that project funds are used for particular project and withdrawal are in proportion to the percentage completion of the project.

It, therefore, follows from above provisions that Form 5 is Certificate but emerging from the audit carried out by chartered accountant. Thus, it is one kind of statutory audit requirement in line with other statutes like Companies Act, Co-operative Societies etc. Therefore, the benefit of extended submission of Return of

Income will be available to promoter by virtue of provisions of section 4(2)(D) on account of statutory audit under statute i.e RERA law.

In line with Form 3, Form 5 needs to be uploaded for the project and not promoter and therefore consolidation of Form 5 for all the promoter needs to be done.

Form 3 and 5 needs to be redesigned to cover the following anomalies viz: -

- Incorporation of Project Finance used for cost incurred
- Outstanding liabilities for cost incurred
- Cost incurred formula should be based on central legislation section 4 of the Act i.e withdrawal is in proportion to the percentage of completion for the project and not on entire cost incurred which allows promoter to enjoy more withdrawal than due based on percentage of completion.

Maharera have not extended the due dates of uploading Form 5 since outbreak of covid 19 in spite of the facts that relevant audit dates under direct and indirect tax have been extended from time to time. However, maharera is not taking any coercive action against promoter for delay in uploading but whenever any new application like application for change, extension etc are filed, the same are withheld unless all the required compliances are fulfilled by the promoters.

There have been cases in other States calling for forensic audit of the project and thereby matters have been referred to disciplinary committee of ICAI but till now no such action is undertaken by maharera. However, looking at quantum of stalled project in Maharashtra, chartered accountant would be in first scanner list wherever there are complaints or matters coming before maharera question utilization of proceeds of allottees.

Challenges before Chartered Accountants owing to complex nature of realty industry:-

- Cost allocation for multiple projects carried out in one entity.
- Disclosure of contingent liabilities in statutory audit based on order concluded against promoter.
- Coordination amongst the other promoters for consolidation of certificate and audit report.
- Facing hearing from maharera for complaint against stalled project and enquiry for forensic audit.
- Participation in Designated Resolution Panel upon revocation of project u/s 7 or 8 of the Act in terms of Maharera order no.8/2019 dated 28th March, 2019 for preparing financial blue print for completion of remaining development work of stalled project etc
- Reporting of barter transactions
- Reporting of conversion of debt to equity/sales

Conclusion and way forward:-

Maharera is carrying out enquiry and exercises as to modification of Form 3 and Form 5 based on past experiences and representation received from accounting bodies, Builders Association etc. RERA law since 2017 has evolved with various judicial pronouncement of Tribunal, High Court and Supreme Court and this evolution will continue owing to complex nature of realty sector.

MahaRera is under process in revamping Form 3 and 5 on following propositions: -

- Removing concept of ASR valuation of land
- Outstanding liabilities while considering cost incurred
- Cost incurred formula redesigning to being in parity cost in proportion of percentage completion of work
- Separate Bank Account summary disclosure
- Application and sources of fund for the project while applying for registration of the project
- Clarification on amount withdrawn till date
- Quantification of diversion of funds and so on

It is, therefore, of utmost importance for accounting bodies like ICAI to represent on various front and suggest better way of financial disclosures to bring out clarification to enable chartered accountants to carry out certification and audit function without any ambiguity or confusion and in transparent manner.

