Note on the revenue recognition of residential sales at One United Properties

The recognition of revenues from the sale of residential developments over the construction period, often referred to as the "percentage of completion method," is rooted in the principles outlined in the International Financial Reporting Standards (IFRS), particularly IFRS 15 "Revenue from Contracts with Customers."

One United Properties used this method of revenue recognition due to:

- **Matching Principle**: Recognizing revenue over the construction period is in line with the matching principle, which suggests that revenues and expenses should be recognized in the same period they are earned or incurred. This allows for better matching of the revenue generated from a development with the expenses associated with that development over time.
- **Reflects Economic Reality**: This method allows the financial statements to better reflect the economic reality of the construction process, which is ongoing. Instead of recognizing all the revenue at once, it’s recognized as value added to the development.
- **Smoother Earnings**: Recognizing revenue over the construction period can result in smoother earnings over multiple periods rather than volatile earnings that occur only when developments are completed.
- **Improved Cash Flow Prediction**: Recognizing revenue progressively provides stakeholders with a better understanding of incoming cash flows, leading to more informed financial planning and forecasting.
- **Risk Assessment**: Recognizing revenue over time provides better visibility into developments that may be at risk of delays or not meeting expected profitability. This can allow management to take corrective actions more promptly.
- **Incentive Structure**: When revenue is recognized progressively, it might provide a more consistent incentive for project managers and the management team to ensure developments stay on track rather than deferring all efforts and recognition towards the end.
- **Conformance with IFRS 15**: Adopting the percentage of completion method (where appropriate) ensures that a company is following international accounting standards, reducing the risk of audit concerns or restatements.

The disadvantage of the method is that, unlike the straightforward point-in-time recognition, the percentage of completion method adds layers of complexity, making financial statements harder to decipher for some investors and analysts, sometimes generating incorrect presumptions that the revenues or profitability of the Company is decreasing, while it is simply fluctuating due to many developments having different level of completion.

Recognizing revenues from sales of residential developments over the construction period aligns with the IFRS framework's underlying principles and offers various benefits in terms of financial reporting and economic representation.

<u>**Revenue and profit recognition example**</u>

Total Contract Value: €1,000,000

Land cost: €100,000

Development costs: €500,000

Profit Margin: 40% (or €400,000 for the whole development)

Year 0 (Start of Contract):

- At sales kick-off, the client makes a prepayment of 30%, which amounts to €300,000.
- No construction has been completed yet, so no revenue or profit is recognized at this point. The amount cashed in - €300,000 is recorded as a liability on One United Properties' balance sheet.

Year 1 (End of First Year):

- Assume 50% of the construction is completed.
- 50% of the total contract value less land amount, or €450,000, is the revenue that should be recognized by the end of Year 1 together with the amount of €100,000 related to land which is recognized as revenue for 100% from year 1 and in correspondence the cost of sale, no margin being recorded to land value.
- The cost of sale represents 50% from the development costs of €500,000, therefore €250,000 at which is added the land cost of €100,000 for 100% from year 1, as mentioned at the point above.
- As described above, €550,000 represents the revenue, €350,000 represents the cost, and €200,000 is the profit.
- In terms of profit recognition for Year 1, One United Properties would recognize €200,000 in profit (36% relative margin).

Year 2 (End of Second Year/Upon Delivery):

- The construction is 100% complete by the end of the second year.
- The total revenue to be recognized over the contract's duration is €1,000,000.
- Also, €600,000 (60% of €1,000,000) represents the total cost, and €400,000 (40% of €1,000,000) is the total profit.
- Since €550,000 revenue and €200,000 profit were already recognized in Year 1, the remaining revenue to be recognized in Year 2 by One United Properties is €450,000, with a profit of €200,000 and relative margin of 44%.

At the contract's conclusion, the revenue recognized by One United Properties aligns with the construction progress and payments received: €300,000 in Year 1 and €700,000 in Year 2 for a total of €1,000,000. From a profit perspective, One United Properties would recognize a profit of €200,000 in Year 1 and another €200,000 in Year 2, totaling €400,000 for the unit.

Net profit margin from residential sales

One United Properties recognizes revenues based on pre-sales, matched with the percentage of completion method. The mix of sold versus unsold units, as well as the timing of these sales, particularly in relation to the reporting period, can impact recognized revenues and the associated profit margins.

The cost structure of a construction is seldom linear. Initial stages might involve higher expenses related to excavation, laying foundations, and infrastructure development, whereas later stages have costs associated with finishing, fittings, and interiors. Thus, as revenue is recognized based on the stage of completion, the costs paired with that revenue can fluctuate, leading to varying profit margins.

Moreover, One United Properties manages construction of multiple developments in parallel, each being at the time of financial reporting a different construction phase, thus having different cost structures. Consequently, some developments could be in their initial phase with heavy infrastructure investments, while others could be in the final stages with different types of costs. When revenues from these developments under construction are pooled together, the blended profit margin can show significant variations.