

# Effective Monitoring of Cost Accruals in Capital Projects





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- Experience – Internal Audit, Finance and Accounting, Project Cost Management, System Implementation
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# FRS 111: Construction Contracts

- Financial Reporting Standard (FRS) provision is that “contract revenue and contract costs associated with the construction contract shall be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period”<sup>[1]</sup>
- The method of measurement for the “stage of completion”, may include:
  - project expenditure to date;
  - surveys of work performed; or
  - completion of a physical work.

[1]Financial Reporting Standard 111: Construction Contracts, MASB

# Completion of a physical work

The following methods may be used to measure physical work completion<sup>[2]</sup>:

- 1) Units completed – count units completed over the total units
- 2) Incremental milestone – assign percentage completion for the sub-activities
- 3) Start/Finish percentage – assign percentage at the start and end of activities
- 4) Ratios – percentage completed based on associated hours or cost spent
- 5) Supervisor opinion – supervisor fair judgement of progress
- 6) Equivalent unit – use of common unit of measurement across activities

# Project Cost Accrual

Cost accrual is the difference between cost incurred based on completion of a physical work, against expenditure to date:

## **Example:**

Contract Amount	USD 1,000,000
Physical work completed	40%
Expenditure to date	USD 350,000

Cost incurred = 40% x USD 1,000,000 = **USD 400,000**

Cost accrual = USD 400,000 – USD 350,000 = **USD 50,000**

# Project Cost Accrual Days

Project cost accruals days is calculated as follow:

$$\frac{\text{Accrual Amount}}{\text{Annual Incurred Cost}} \times 360 \text{ Days}$$

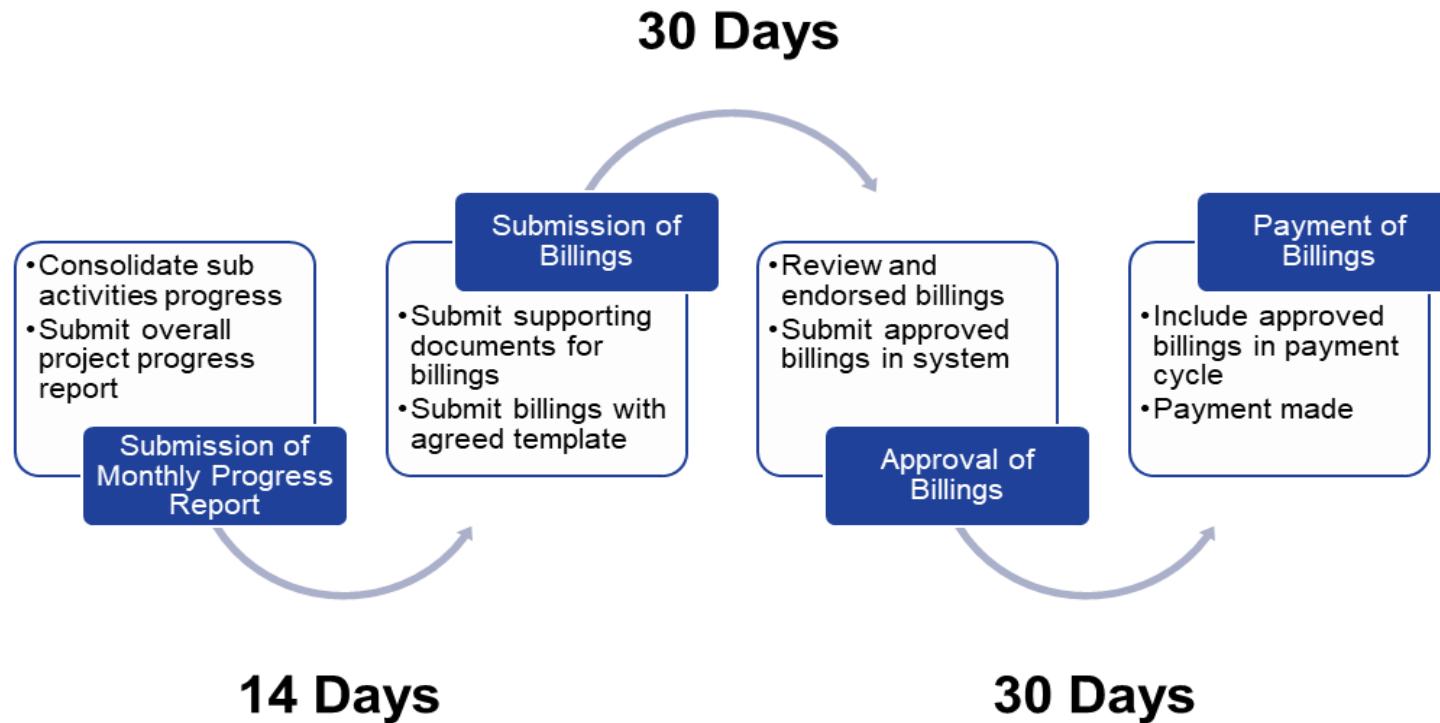
## **Example:**

Accrual amount = **USD 50,000**

Annual incurred cost = **USD 300,000**

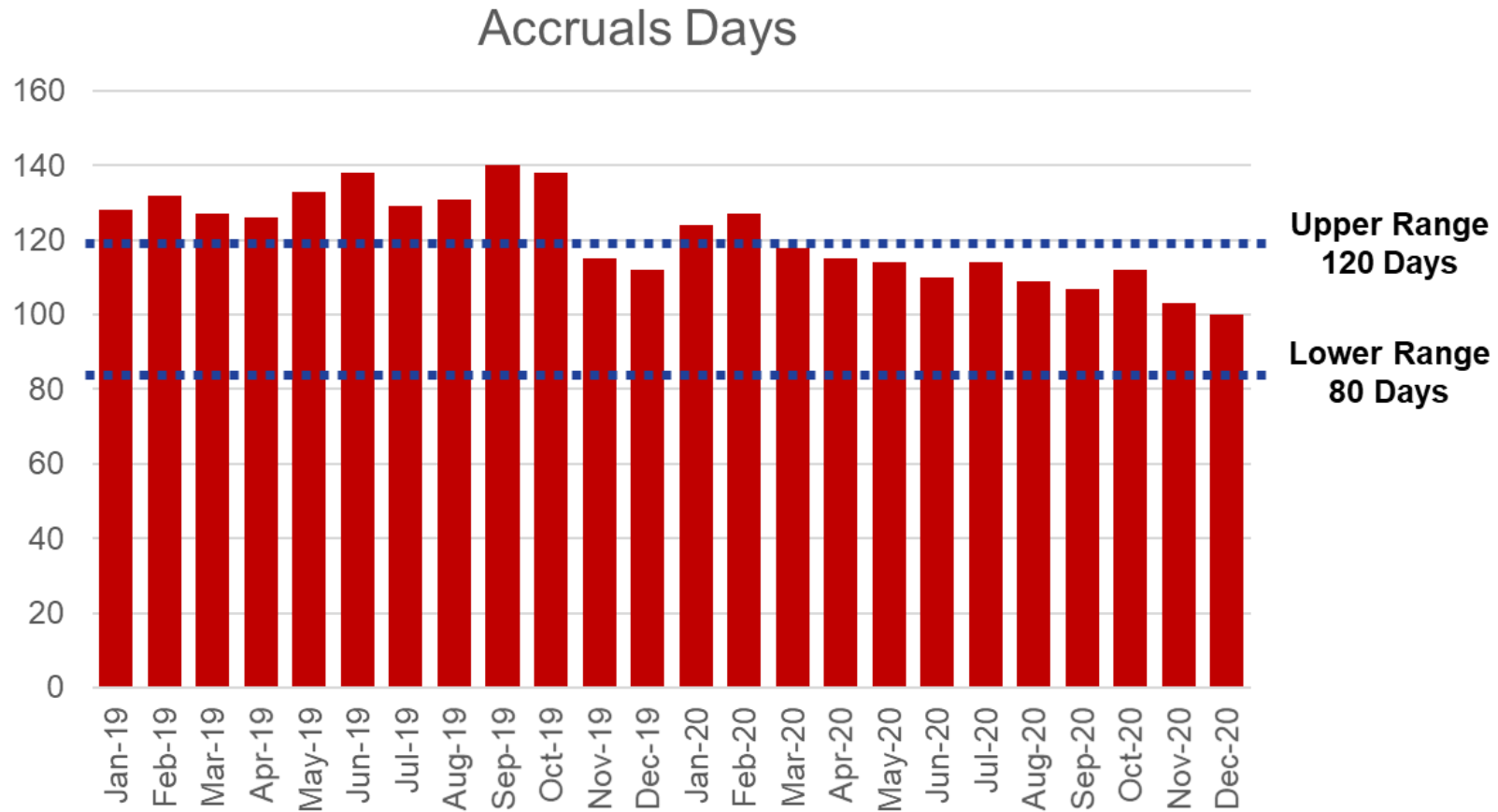
Accrual days =  $50,000 / 300,000 \times 360 \text{ days}$   
= **60 days**

# Contract billing cycle





# Project Cost Accrual Days Trending<sup>[3]</sup>



[3] Team Analysis

# Possible reasons for high accrual days

- Over-estimation of project progress;
- Manual recording and monitoring of project progress;
- Too many gate reviews for progress approval;
- Unavailability of authorized person to approve progress;
- Preparation of too many supporting documents;
- Procrastination of reviewers;
- Dispute of claims;
- Restrictive contract term of payment.

# Conclusion

Monitoring of project cost accruals is important to ensure:

- Sufficient cashflow at every level of project execution;
- Cashflow constraint does not impact overall project delivery objectives;
- Project cost incurred reflect physical completion of work;
- Project expenditure are processed for approval and payment expediently;
- Company identify systemic issues in managing project cost incurred;
- Change order claims are processed efficiently;
- Company receive a good credit rating;
- Good working relationship with all project players.



# THANK YOU

