

Percentage Completion Method

By Sandy Wendler

If your company has entered into Firm Fixed Price (FFP) government contracts, GAAP requires that you recognize revenue using the Percentage of Completion Method. While the methodology sounds straightforward, it can become quite complex in practice.

The goal of the Percentage of Completion Method is to recognize revenue to the extent of progress towards completion. Completion may be established using inputs such as costs (cost-to-cost) or outputs such as work performed (milestones). Cost-to-cost is the most common approach. To implement this approach, the project team must work with the company controller to develop a cost and profit budget for the job. This budget must be reviewed periodically and revised as needed. In each reporting period the ratio of total incurred costs to date to total budgeted costs is calculated. This percentage is then applied to the total budgeted revenue for the contract. Computations are always made on a cumulative basis and must include all incurred costs. In addition, cost estimates to complete must be up-to-date and as accurate as possible. Once inception to date revenue is calculated, it is compared to the revenue recognized to date to determine what is to be recognized in the current period. Finally, you must consider what has been billed to the customer since the inception of the contract. If billings are in excess of revenue, revenue will be deferred until a future period. If revenue is in excess of billings, an unbilled receivable will be recorded.

Many companies have a mix of contracts types with each requiring different accounting treatment. It is important for the contracts group to work with the accounting department to understand each contract and its unique requirements; this is particularly true for FFP contracts.