Basic understanding of an EPC Contract

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EPC contract is a very popular type of contract in the contact management module. Full form of the word EPC is Engineering, Procurement & Construction. EPC module contract mostly used in infrastructure & Construction industries, thermal power project etc. Even though EPC module is a contract management module, it is very much required to understand by the person who is handling the finance & accounting for those contracts, since it typical nature of contract compares other contract module. In this article I would like to discuss about the basic concepts & features of EPC contract which required understanding the person in the finance & accounts.

What is EPC contract:

EPC contract will carry out the detailed engineering design of the project, procure all the equipment and materials necessary, and then construct to deliver a functioning facility or asset to their clients as prescribed by them with in the agreed period of time. The contractor work will start from design the project & prepare the drawings and get approved by the client and procure the materials & labour for complete the work according to the approved
drawing, execute the work and commission the project as per terms & condition agreed in the EPC contract with the client. The person carrying out the contract under EPC module called as “EPC Contractor”.

Features of an EPC contract:

1. **Single point responsibility**: Under the EPC contract, EPC contractor will be the single point responsibility for all the contract works and transaction to the client. Commonly the EPC contractor will subcontract the part works with other contractor, however the EPC contractor only will be the single point responsibility to the client for the work of subcontractors also. The EPC contractor shall be deemed to have obtained all necessary information as to risks, contingencies and other circumstances which may influence or affect the Works. By signing the Contract, the Contractor accepts total responsibility for having foreseen all difficulties and costs of successfully completing the Works.

2. **Mile stone basis progress**: Since EPC contract is involving the end to end contract arrangement, generally the works of EPC contractors will be measured by mile stone basis. Total contract activities will be segregated in to various set of activities and the activities will be linked to the particular mile stone and mile stone will be linked to the major contract work under EPC contract. EPC contractor billing to the client also will be based on the mile stone completion basis only.

3. **Prescribed time limit**: EPC contracts will be strictly follow with prescribed time limit for overall contract as well as each activity. It is contractor responsibility to complete the activity within the time line give to him for each activity. It also contractor requirement to complete the activity and raise the bills to the client for getting the payment for their financials requirements. In case contractor fails to meet the time limit, they may face the liquidity damages and deductions from their payments.

4. **Fixed payment terms**: In EPC contracts, contractor payment terms are very specific and fixed. The payment terms always linked to the milestone performance of the EPC contractor and also having some kind of retention on bills payment till the contractor execute the work perfectly.
5. **High degree of risk for contractor**: In EPC module, EPC contractor will play the role which having high degree of risk as I mentioned in the point .a. they will be the single point responsibility for all the activities of the project.

6. **High degree of control**: For client perspective, they will have high degree of control over the project since the single point responsibility. But it is cannot be treated absolute control in point of contractor perspective, because even though the EPC contractor, most of the contract having some activities need to completed by client side as well. Example contracts which involve public utility need clearances for the several government departments, as EPC contractor they can initiate the work but the final clearance need to be taken care by client only since they are the final owner of the project.

7. **Free from Cost variation**: Unless specifically mentioned in the contract, all the EPC contracts are free from price variation. The client will offer the contract at a fixed price and that is committed price by both the contractor and client. The cost which agreed is free from the market price variation. Hence EPC contractor is very careful at the time of fixation of prices.

8. **Limited risk for client**: EPC contract gives the maximum optimised risk to the client, because most of the EPC contracts are offered by the client base on performance bank guarantee by the EPC contractor, so there is itself the risk of the client will be reduced maximum and also the contract terms will be very specific with the contractor’s scope of work, roles & responsibility of the contractor which is linked in to financial terms. In case of non-performance or lack in performance will affect the EPC contractor only first finally only client.

**Conclusion:**

EPC contract is playing vital role in the contract management especially in the long term contracts of infrastructure and construction industries. It is essential for a person in finance in the construction & infrastructure industries to understand about the EPC contract and implication for the same.
Thanks

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