INTRODUCTION TO AN INCREASED COST ADJUSTMENT (ICA) FORMULA

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ABSTRACT

Purpose: This paper is aimed at identifying the shortcomings of the existing increased cost adjustment methods in terms of their non-suitability for use in a highly inflationary economic environment and develops the ICA formula as an attempt for a remedial solution. Design/methodology/approach: The literature focused on the shortcomings of the existing increased cost adjustment methods. A formula was developed based on practical and theoretical concepts and the breakdown of the main components of a contract sum. Informal interviews, thirty-three questionnaires were completed by relevant respondents and analysed. A case study on a construction project compared the profitability margin between the traditional method and the proposed ICA formula. Findings: The traditional method for increased cost adjustment was a predominant one used on almost contracts (91%). More than two-thirds (67%) of the contractors involved into fluctuating contracts were threatened with cash reserve and almost four-fifth (79%) of the contractors were affected in terms of cost recovery owing mainly to the inefficiency of the traditional method. A case study was done on a project where 5% was used as adjustment for increased cost. The contract sum escalated from ZS1,170,000.00 to ZS61,401,000,000.00 in 22 months. ICA formula was tested and displayed more potential for profit recovery than the actual profit the contractor generated using the traditional method. The profit margin of 13.60% calculated through ICA formula was closer to the allowable profit margin of 15% on the contractor's own works while the contractor generated only 3.31%. Research limitations/implications: Contracts adjusted with Consumer Price Index methods were not available for analysis. The case study was conducted on one project under construction before the settlement of the final account. Further studies of the ICA formula would focus on the determination of parameters associated with its application in relation to the allowable percentage mark-ups applicable in different countries. Practical implications: ICA formula can be an alternative method for increased cost adjustment appropriate with high inflationary environments. ICA formula is anticipated to be a consultation tool serving as a guideline to ascertain the margin for adjustment of increased costs where disputes arise in this regard. ICA formula is also pledged to be applicable to other sectors of business to predict the level of mark-up required for cost increase in volatile market conditions. Originality/value: The improvement of increased cost adjustment methods is necessary especially at this time where the inflation and the continuous increase in construction input cost have become a global challenge to the construction industry.

Keywords: Consumer Price Index based formulae, increased cost, shortcomings, and traditional method.