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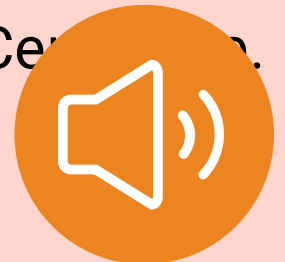
MEANING OF CONTRACT COSTING

- Contract Costing is also known as ' Terminal Costing ' as the preparation of contact account is terminated after the completion of the contract.
- Contract Costing is a form of specific order costing which applies where task or work is based on the requirements of the customers.
- It is a specialized system of job costing which is applicable on long term contracts, covering different accounting periods.
- The size of the contracts are huge.
- The work is done at the site. It is applicable in constructions of buildings, civil engineering works, ship building, construction of roads, dams , bridges, railway lines, etc.
- There are certain problems relating to exercise of control concerning usage of material, utilization & supervision of labour, damage to plants & machineries, pilferage issues, etc.,



FEATURES OF CONTRACT COSTING

- As the contracts are undertaken on the special requirements of the customers, they do not resemble to each other.
- For the purpose of accumulation of costs each contract is treated as a distinct cost unit.
- In contract costing, the substantial portion of the total expenditure is of direct nature (materials, labour, use of plant & stores, direct expenses, etc.,) and a very small chunk is treated as apportioned overheads.
- Separate contract account is prepared for each contract, as it is important to determine profitability separately.
- The stage of completion of work becomes the basis of payment to be received from the contractee.
- Completion of work is certified by Surveyor's Completion Certificate.



FEATURES OF CONTRACT COSTING

- The main contract may be fragmented into parts and some of these parts may be completed through sub-contracting. For example, work given related to lift, steel work, heating installation etc
- It is interesting to know that plants, machineries and equipments may be purchased specially for the contract or may be hired to be used for the work of contract.
- At the end of each accounting period proper calculation of the value of work-in-progress is required.
- At the end of each accounting year till the completion of the contract it is important to calculate the profit (a percentage of notional profit) which is transferred to profit & loss account.
- A distinctive number and name is given to each contract taken up simultaneously, for accounting and administrative purposes.
- A separate contract account is prepared for each contract.
- All costs relating to the contract are charged to their respective contract accounts.



DISTINCTION BETWEEN JOB COSTING AND CONTRACT COSTING

BASIS OF DISTINCTION	JOB COSTING	CONTRACT COSTING
Place of Work	Job work is carried in the factory premises.	Contract work is carried at the site.
Cost Unit	An order, an unit, batch of product may be taken as a cost unit	Each contract is a cost unit.
Fixation of Price	The prices of the jobs are fixed on the basis of nature of costs and policy adopted by the organization.	Bidding and other external forces have major influence in fixation of the offer price.
Nature of Expenses	Expenses are of both types- direct and indirect.	A substantial part of expenses are direct in nature.
Receipt of Payment	The selling price of the job is paid after completing the job.	Contract Price is paid in several installments based on the progress of the work.
Accounting of Profit	Profit on job is entirely taken to profit and loss account.	In case of incomplete contracts , only proportionate profit is taken to P&L Account.



TREATMENT OF MATERIAL COST IN CONTRACT ACCOUNT

- All the materials purchased specifically for the contract is debited to contract account.
- All the materials issued from the stores of the contractor on the basis of 'material requisition notes' is debited to contract account.
- The material which is received by way of transfer (on the basis of material transfer note) from another contract of the same contractor is **debited** to the **Transferee Contract Account** and is **credited** to the **Transferor Contract Account**.
- If any material is not used and is returned back to the stores (with material return note) is credited to the contract account.
- If any material is transferred to another contract site is credited to the contract account.
- The unused portion of the material lying at the site at the end of the accounting period, is credited to the contract account and is carried forward for charging against the next accounting period.
- If the materials are not required immediately, they may be stored and its cost is debited to Stock Account.
- The part of materials either stolen or destroyed by fire or other reasons, will be transferred to the Profit and Loss Account. It is shown in the credit side of the contract account.
- Normal wastage incurred in stores and materials should be charged to contracts by increasing the cost on materials.
- Stores used in manufacture of tools should be charged to works expenses account.
- In case the contractee supplies any materials, as per the terms of the contract , to be adjusted against the contract price, it should be debited to the contract account and credited to the contractee account
- In case the contractee supplies some materials, as per the terms of contract, over and above the contract price, the value of such materials should not be brought into the books , but a note is kept to account for the quantity received and issued.



LABOUR COST

- All the labourers and workers employed at the site are treated as direct labourers irrespective of their nature of work and all costs related to them are considered as direct labour cost. All such cost is shown in the debit side of the contract account.
- The salaries and incentives of the supervisory and administrative staff of a specific contract is also charged to that specific contract.
- If some workers are rendering their services for multiple contracts of the same contractor then on the basis of their time record wages payable are determined .
- The wages accrued and outstanding at the end of the accounting year are shown in the debit side of the contract account.
- Wages paid to the workers for the period of stoppage of work due to abnormal reasons like breakdown of machinery, strike, lockout , etc., are debited to the profit and loss account



DIRECT EXPENSES

- All the expenses at site other than materials and direct labour are the direct expenses.
- Direct expenses are shown in the debit side of the contract account.



PLANT

- If the plant is specifically purchased for the contract , the value of plant is debited to the contract account.
- When a plant is taken on hire for a particular contract , the hire charges are charged to the contract account.
- If a plant or a machinery of the contractor is used on the contract for a short period of time then only the depreciation of that period is debited to the contract account.
- The written down value of the plant returned to store is credited to the contract account.
- The written down value of the plant remaining at the site is credited to the contract account.
- The balance between the amount debited and credited to contract regards to plant represents the value of plant used at site.
- The loss of plant & machinery due to theft , fire, accident, etc., is transferred to the profit and loss account and it appears on the credit side of the Contract Account.
- The depreciated value of plant or machine till the time it was used (in case of loss of plant & machinery due to theft , fire, accident, etc.,) is debited to the Profit and Loss account and credited to Machinery Account.



OTHER ITEMS

- **Sub- contract charges** : when some parts of the contract work are given on sub-contract basis, the payment made for the sub- contract work is debited to Contract Account. The work performed by the sub-contractor forms a direct charge to the contract account.
- **Cost of Extra Work** : Any work undertaken by the contractor which is not covered by the terms of contract shall be identified as extra work. the cost of this additional work is chargeable as cost of extra work.
If the additional work is minor, the expenses incurred on it shall be debited to the Contract Account. The extra amount which is agreed to be paid by the contractee, should be added to the contract price.
- **Cost of Maintenance of Asset** : The cost of maintenance of asset is debited to the Contract Account, subject to containment of clause.
- **Penalties** : For delay in completion of projects or for defect in construction of the project, the contractee may impose penalties on the contractor. If such penalties are anticipated and normal in nature ,then the amount will be debited to the Contract Account. If it is of abnormal nature then it is charged against Profit and loss account.



WORK IN PROGRESS

WORK IN PROGRESS : at the end of the accounting period if contract is not completed, the architect is required to value the work in progress. The amount of work In progress constitute the value of work certified and work uncertified. The value of WIP is shown on the Asset side of the balance sheet.

WORK CERTIFIED : it is that part of the WIP which has been approved by the contractee's architect for payment. It is valued at contract price . It also includes the profit. It appears on the credit side of the contract account and asset side of the balance sheet.

WORK UNCERTIFIED : part of contract work which is yet to be approved by the contractee's architect is known as work uncertified. It is valued at cost and does not include profit. It appears on the credit side of the contract account and the asset side of the balance sheet.



COST PLUS CONTRACTS

- Cost plus contracts in which the contractor is reimbursed not only the costs incurred by him in executing the contract, but also, remunerated a stipulated profit for rendering his services. The stipulated profit may either be a fixed amount decided in advance or determined subsequently with reference to certain percentage of costs to be incurred by him .
- Cost plus contracts are useful from both the points of view of the contractor/ manufacturer and contractee /customer.
- The manufacturer is assured of recovering all his costs and is ,therefore , protected against possible losses which may arise due to upward revision of material prices,wages and other items of costs. There is a built-in escalation clause to protect his interests in such contracts . They are equally beneficial to the n clients , especially those who are particular about the quality of work and cost is not a problem for them.
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PROFORMA OF CONTRACT ACCOUNT

(WHEN THE CONTRACT IS COMPLETE)

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
To Materials (direct) To Materials (issued from the stores) To Wages and Salaries To Sub- Contract Payments To other direct expenses To indirect expenses (apportioned share of overhead) To Plant and Equipment (purchase price/ book value) To Profit and Loss A/C (surplus)		By Materials Returned to Store By Material Transferred to another contract site By Materials sold By Abnormal Loss (theft of materials, loss of plant due to fire. etc.,) By Closing stock of materials By Plant & Equipment (closing balance) By Profit and Loss A/C (deficiency)	



PROFIT DETERMINATION ON INCOMPLETE CONTRACTS

- Actual profits are known only on completion of the contracts.
- But the contractor is always interested to determine the profits periodically.
- **No profit** is accounted for in the early stages of contract.
- **No profit** is to be considered if **less than one-fourth (1/4) or less than 25% of the contract is complete.**
- However, if any **loss** is anticipated, it **should always be provided for.**
- **Profit** should be considered only on that part of the **work which is certified by the contractee's architect.**
- **No profit** should be reckoned on **work completed but not certified.**
- **Adequate provisions** should be made for **contingencies** likely to affect the completion of contract.
- **The profit to be considered** should be in **the proportion** which **the cash received** from the contractee bears to the **amount of the work certified.**
- The determination of profit on incomplete contracts which are credited to the profit & loss account are based on cost accounting conventions.



DETERMINATION OF PROFIT ON INCOMPLETE CONTRACTS

- When work certified is 25% or more but less than 50 % of the total contract :

$$\text{Estimated (Notional) Profit} \times \frac{1}{3} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

- When work certified is 50 % or more :

$$\text{Estimated (Notional) Profit} \times \frac{2}{3} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

- Equation applicable when at least 25 % of the work is complete :

$$\text{Estimated Profit} \times \frac{\text{Work Certified}}{\text{Contract Price}} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

$$\text{Estimated Profit} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$



ESTIMATED PROFIT

- Estimated Total Profit = [Contract Price – Costs already incurred + Estimated future costs + Margin for contingencies]
- Other methods of calculation of profit to be carried to profit and loss account on incomplete contracts :

$$\text{Estimated Total Profit} \times \frac{\text{Value of Work Certified}}{\text{Contract Price}} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

$$\text{Estimated Profit} \times \frac{\text{Value of Work Certified}}{\text{Contract Price}}$$

- In case of non-availability of information about work certified :

$$\text{Profit} = \text{Estimated Total Profit} \times \frac{\text{Cost of work to date}}{\text{Estimated Total Cost}}$$



PROFORMA CONTRACT ACCOUNT

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
(When the work is in process) To materials (direct) To materials (ex-store) To materials (transferred from another contract) To wages and salaries To sub-contract payments To other direct expenses To plant purchased To Profit and Loss A/C (realised profit being transferred) To Reserve for Contingencies		By materials returned to store By materials transferred to contract site (specify number) By materials sold By abnormal loss By closing stock of materials By closing value of plant By work-in-progress: work certified- work uncertified-	
To work-in-progress (opening) Work certified work uncertified To plant Opening balance Purchases To other items of expenses To profit and loss account (profit)		By reserve for future contingencies by materials returned By plant returned By any other item to be credited By contractee (Contract price)	



SKELETON BALANCE SHEET


LIABILITIES	AMONT	ASSETS	AMOUNT
Profit and Loss A/C (will include profit on contract) {specify the contract no. } Less : Loss on contract (specify the contract no.) Sundry Creditors Wages accrued Direct expenses accrued		Work in Progress: Work Certified Work uncertified Less: Reserve for contingencies Less Contractee (Payment Received) Materials in hand Materials at site	



CONCLUSION

- Preparation of Contractee's A/C in the books of contractor.
- Preparation of Work In Progress A/C .
- Preparation of Balance Sheet based on the balance of WIP A/C and the balance of Contractee's A/C (advances or payment received).



A vintage typewriter with a dark body and light-colored keys sits on a wooden desk. To its left is a dark notebook, and to its right is a light-colored envelope. In the bottom left corner, a pair of glasses is visible. The background is a warm, wooden surface.

Thank You

== For Your Attention ==

