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COST AND WORKS ACCOUNTING
(Overheads and Methods of Costing-II)
T.Y.B.COM

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● Topic- VI: Contract Costing
Contract Costing: Meaning, Definitions, Features, Accounting Entries)
CONTRACT COSTING:

Meaning:

Contract is a special type of Job Costing where the unit of cost is a single contract. This method is also termed as ‘Terminal Costing’ as when the work is terminated the cost-sheet has to be completed. It is a variant of Job Costing. In this method it is desired to find out the cost of carrying out a complete contract for a customer involving numerous jobs and batches of jobs. The costs are ascertained and analysed with respect to the contract accepted for execution. This method of costing is adopted by those concerns undertaking definite contracts e.g. long-term projects like construction of roads, bridges, houses, large estates, irrigation schemes etc.

Contract Costing also adopted by the concerns where the unit of output is heterogeneous. e.g. ship building companies, turbines and boilers manufacturing companies etc.
Definitions: (Job Costing)

1. Institute of Cost and Management Accountants, London:

“Contract Costing is that form of specific order costing which applies where work is undertaken to customers’ special requirements and each order is of long duration”.

2. According to Certified Institute of Management Accountants:

“Job Costing is the aggregated costs relative to a single contract designated a cost unit”.

In short, Contract Costing is that form of specific order costing under which each contract is treated as a separate cost unit and costs are accumulated and ascertained separately for that contract.
Features of Contract Costing:

1. The work is carried out away from contractor’s premises i.e. at the contractee’s work site.
2. A contract is usually a big job of long-duration and may continue over more than one accounting period.
3. As the contracts are of large size, a contractor usually carries out a small number of contracts in the course of a year.
5. A contract undertaken is treated as a cost unit.
6. A separate account is prepared for each contract to ascertain profit or loss on each contract.
7. Apportionment of profit on contract to different accounting periods is very difficult.
8. In case the contract is undertaken of long-duration, a percentage of notional profit depending upon the progress of physical work may be accounted for in each year.
9. Most of the materials are specially purchased for each contract.
10. Expenses chargeable to contracts are direct in nature, e.g. electricity, telephone charges, insurance etc.
11. Allocation and apportionment of overhead costs is a simple task.
12. Specialists sub-contractors may be employed for say, electrical fittings, welding works, glass work, plumbing work etc.
13. Plant and equipment may be purchased or hired for the duration of the contract.
14. Nearly all labour will be direct.
15. The payment is received depending on the stage of completion of work.
16. A contract usually includes clause for ‘penalty’ for delayed completion.
17. A contract usually includes ‘Escalation Clause’ under which the contractor is compensated for increase in costs on account inflation.
18. A percentage of the value of work done is deducted from the progress payment as ‘Retention Money’.
Accounting Entries:

Following are the Accounting Entries in Contract Account:

1) For materials issued to Contract:
   Contract A/C  ... Dr.
   To Materials A/C

2) For surplus materials transferred to another Contract:
   Receiving Contract A/C  ...Dr.
   To Supplying Contract A/C

3) For expenses incurred or payable on contract:
   Contract A/C  ...Dr.
   To Expenses A/C
   To Outstanding Expenses A/C

4) For Plant and Machinery and Equipments (at cost) issued to contract:
   Contract A/C  ...Dr.
   To Plant and Machinery/ Equipments A/C
5) For share of apportioned Overhead Expenses:
   Contract A/C
   To Overhead A/C
   ...Dr.

6) For sub-contract cost:
   Contract A/C
   To Sub-contract A/C
   ...Dr.

7) For materials at site at the end or materials returned to stores or supplier:
   Materials A/C or Material Returned A/C
   To Contract A/C
   ...Dr.

8) For Plant and Machinery and Equipments at site at the end at written down value:
   Plant and Machinery A/C
   Equipment A/C
   To Contract A/C
   ...Dr.
   ...Dr.

9) For Work Certified:
   Contractee’s A/C
   To Contract A/C
   ...Dr.
10) For Work Uncertified:
   Work-in-progress A/C  ...Dr.
   To Contract A/C

11) For cash received against Work Certified from Contractee:
   Bank A/C  ...Dr.
   To Contractee’s A/C

12) For materials or plant sold at site at profit:
   Bank A/C  ...Dr.
   To Contract A/C (cost of material/plant)
   To Profit and Loss A/C
   (If there is loss, then the Profit and Loss A/C is debited (with loss on sale)

13) For materials stolen or lost and insurance Co. admitted claim for certain account:
   Bank A/C (Recovery from Insurance Co.)  ...Dr.
   Profit and Loss A/C (loss on materials)  ...Dr.
   To Profit and Loss A/C
14) For Abnormal Loss of materials, Plant etc. on site:
   Profit and Loss A/C ...Dr.
   To Contract A/C

15) For sale of scrap:
   Bank A/C ...Dr.
   To Contract A/C

16) For Profit transferred to profit and Loss Account or Profit to be reserved:
   Contract A/C ...Dr.
   To Profit and Loss A/C
   To Work-in-progress/Profit Reserve A/C
Thank You