

CONTRACT COSTING

Contract costing is “A form of specific order costing; attribution of costs to individual contracts”.

A contract cost is “Aggregated costs of a single contract; usually applies to major long term contracts rather than short term jobs”.

Features of long term contracts:

- By contract costing situations, we tend to mean long term and large contracts: such as civil engineering contracts for building houses, roads, bridges and so on. We could also include contracts for building ships, and for providing goods and services under a long term contractual agreement.
- With contract costing, every contract and each development will be accounted for separately; and does, in many respects, contain the features of a job costing situation.
- Work is frequently site based.

We might have problems with contract costing in the following areas

- Identifying direct costs
- Low levels of indirect costs
- Difficulties of cost control
- Profit and multi period projects

The source of the following has eluded me: my sincere gratitude for whoever the author might be.

"Contract Costing such jobs take a long time to complete & may spread over two or more of the contractor's accounting years”.

Features of a Contract

- The end product
- The period of the contract
- The specification
- The location of the work
- The price
- Completion by a stipulated date
- The performance of the product

Collection of Costs :

Desirable to open up one or more internal job accounts for the collection of costs. If the contract not obtained, preliminary costs be written off as abortive contract costs in P&L In some cases a series of job accounts for the contract will be necessary:

- to collect the cost of different aspects
- to identify different stages in the contract

Special features

- Materials delivered direct to site.
- Direct expenses
- Stores transactions.
- Use of plant on site

Two possible accounting methods:

Where a plant is purchased for a particular contract & has little further value to the business at the end of the contract

Where a plant is bought for or used on a contract, but on completion of the contract it has further useful life to the business

Alternatively the plant may be capitalised with Maintenance and running costs charged to the contract."

Format:-

Particulars	Rs.	Particulars	Rs.
To Materials		By materials returned	**
a. Purchased directly	**	By Material sold (cost	
b. Issue from site	**	price)	**
c. Supplied by contractee	**		
To Wages and salaries	**	By WIP	
To Other direct Expenses	**	Work certified	**
To Sub-contractor fees	**	Work Uncertified	**
To Plant & Machinery (purchase price/Book value)	**	By Materials at site	**
To Indirect expenditure (apportioned share of overheads)	**	By Plant and machinery(WDV)	**
To Notional profit (Surplus)	**		
Total		Total	**

Profit of Incomplete contract :-

- 1) When % of completion is less than or equal to 25% then full Notional profit is transferred to reserve.
- 2) When % of completion is above 25% but less than 50% following amount should be credited to profit & loss a/c = $\frac{1}{3} \times \text{Notional Profit} \times \left\{ \frac{\text{Cash received}}{\text{Work certified}} \right\}$
- 3) When % of completion is more than or equal to 50% then the amount transferred to profit is = $\frac{2}{3} \times \text{Notional Profit} \times \left\{ \frac{\text{Cash received}}{\text{Work certified}} \right\}$
[Balance is transferred to reserve a/c]
☺ % of completion = $\left\{ \frac{\text{Work certified}}{\text{Contract price}} \right\} \times 100$
- 4) When the contract is almost complete the amount credited to profit & loss a/c is
 - a) Estimated total profit * $\left\{ \frac{\text{Work certified}}{\text{Contract price}} \right\}$
 - b) Estimated total profit * $\left\{ \frac{\text{Cash received}}{\text{Contract price}} \right\}$
 - c) Estimated total profit * $\left\{ \frac{\text{Cost of work done}}{\text{Estimated total profit}} \right\}$
 - d) Estimated total profit * $\left\{ \frac{\text{Cost of work done} \times \text{Cash received}}{\text{Estimated total cost} \times \text{Work certified}} \right\}$

- 5) Work-In-Progress is shown in Balance Sheet as follows:-

Skeleton Balance sheet

Liabilities	(RS)	Asset	(Rs)
Profit & loss a/c (will include) Profit on contract (Specify the contract number) Less : Loss on contract (Specify the contract number) Sundry creditors (will include) Wages accrued Direct expenses accrued Any other expenses (Specify)		Work-in-progress Value or work certified Cost of work uncertified Less :- Reserve for unrealized profit Less :- Amount received from contractee	

- 6) Escalation Clause = This is to safeguard against likely change in price of cost elements rise by and certain % over the prices prevailing at the time tendering the contractee has to bear the cost.