

Contract Costing

B. Com (H) Sem IV

Contract Costing

- **Contract costing** is the method of costing which is applied in a business where separate contracts of non-repetitive nature are undertaken. According to Sharie, “Contract or terminal cost accounts are applicable to a concern which makes specific contracts and requires to know the cost of each.”
- A contract is a job of large size may extend even beyond one accounting period. The person executing the contract is known as a Contractor and the person for whom it is executed is known as Contractee.

- **Contract costing** is a special form of job costing wherein big jobs are involved which requires considerable time to complete and comprises a lot of activities. Herein a separate account is opened for each contract in the Contract Ledger (or in General Ledger). The account is debited with all direct and indirect expenses and is credited with the amount of contract price on completion of the contract. The balance of this account is transferred to Profit and Loss Account. However, if the contract is not completed before the end of the accounting period, a reasonable amount of profit (or loss) is transferred to Profit and Loss Account.



Specific Aspects of Contract Costing

Materials

- Here three specific accounting may be required to be done. In case materials are purchased for the contract and directly delivered at the site of the contract, naturally, there arises no specific accounting system. However, if the materials purchased are, first, delivered to the stores department, then the contract account will be debited and Store control account will be credited. If however, certain materials are charged to contract account but returned to stores, stores contract account will be debited and the contract account will be credited.

Labour

- All labor employed for the completion of the contract is direct labor and is treated as such. For maintaining a proper record and for having control over the labor expenses the wages abstract is prepared.

Plant and Machinery

- Where a plant, machinery or equipment is specially purchased for a particular contract and will be exhausted at the site. If it is so it will naturally be debited in the contract account and any amount of depreciation shall be charged to the credit side of the contract account. However, if it is acquired for a shorter period; then, the amount is debited only with the usual depreciation of the assets. The sale proceeds, if any, at the end or mid-way of the contract is credited to the contract account and profit or loss on such a sale is transferred to Profit and Loss Account.

Indirect Expenses

- Indirect expenses are, treated and apportioned in the same manner in which they are treated and apportioned in any costing system. If on three contracts No. 1, 2 and 3 Rs. 3,000, Rs. 2,000 and Rs. 1,000 have been spent respectively for materials, labour and plant and indirect expenses are \$1,200, the share in indirect expenses of contract No. 1, 2 and 3 will be \$600, \$400 and \$200 in the ratio 3 : 2 : 1 respectively.

Cost plus contract

- **Cost plus contract** is one wherein the contractee agrees to Pay to the contractor the cost price of the work done on the contract plus an agreed amount or percentage thereof by way of different overheads and profit.

Sub-contracts

- **Sub-contracts.** The contractor (if thinks proper and allowed to do so by the agreement entered into) may entrust some portion of the work to be done by one or more than one sub-contractor. The cost in this connection is the direct charge on the contract and is treated as such in the contract costing.

Escalation Clause

- In a contract agreement, there is a usual practice of making a provision for the escalation clause the contractor is interested in safeguarding himself against any change in the price level. The agreement itself specifies the procedure for the calculation of adjustment in order to avoid all disputes etc.

Payment

- In case of small contracts, the usual practice is to make the payment to the contractor in lump sum after the completion of the contract. However, in large contract the payment is made in instalment on the basis of progress made in the contract. The progress is judged by technical personnels —architect, survey. or, engineer, etc.
- Such personnels are required to issue a certificate certifying the complete work. Such work for which certificate is granted is known as Work Certified which may be expressed in terms of percentage. Here also the contractee may not pay for 100% work certified. He may withhold or retain some payment. This is called retention money. The work for which certificate is not granted is known as work uncertified.