

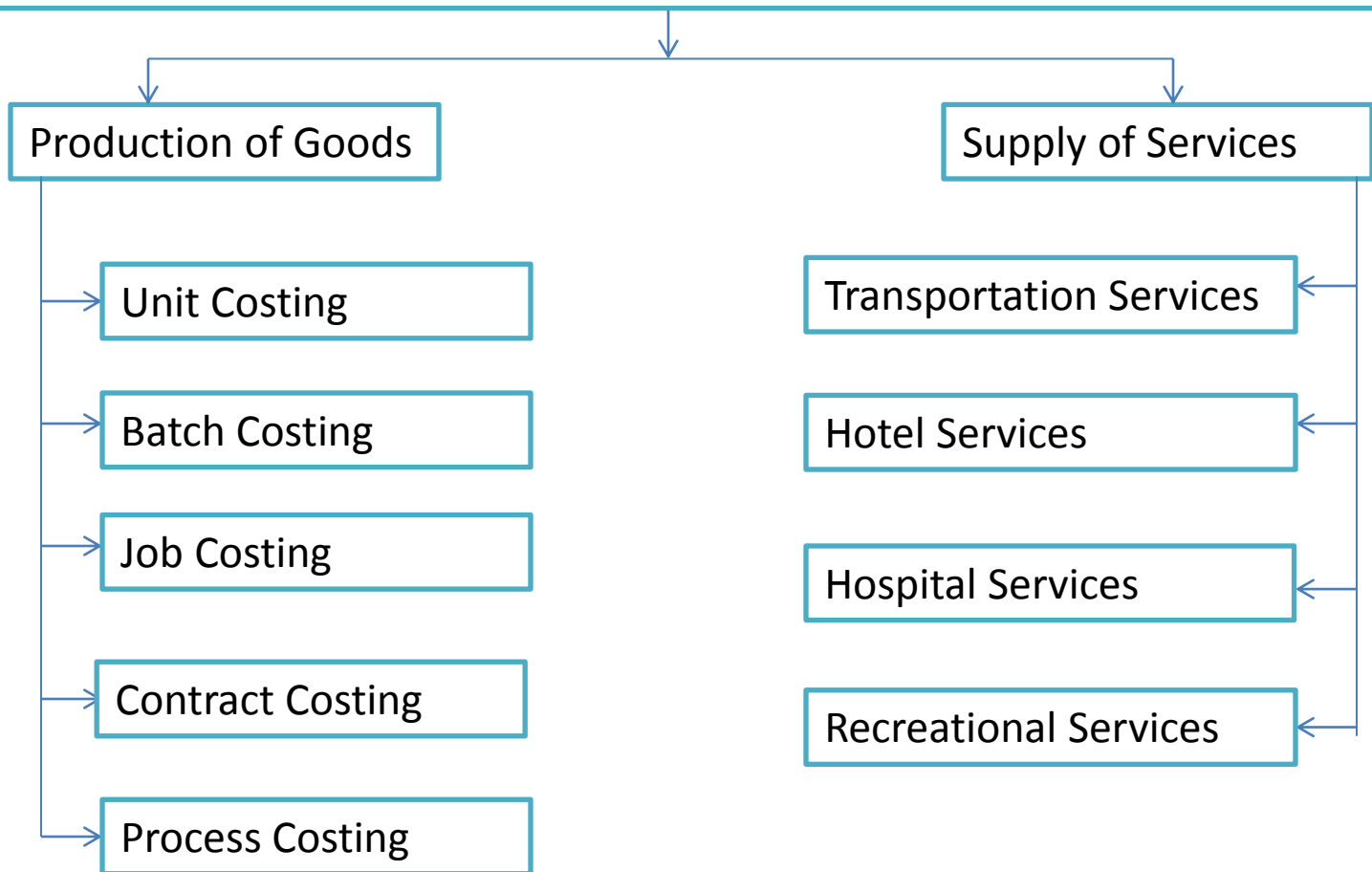
# Contract Costing

*For*  
***B.Com(H) IV Semester (All Sections)***

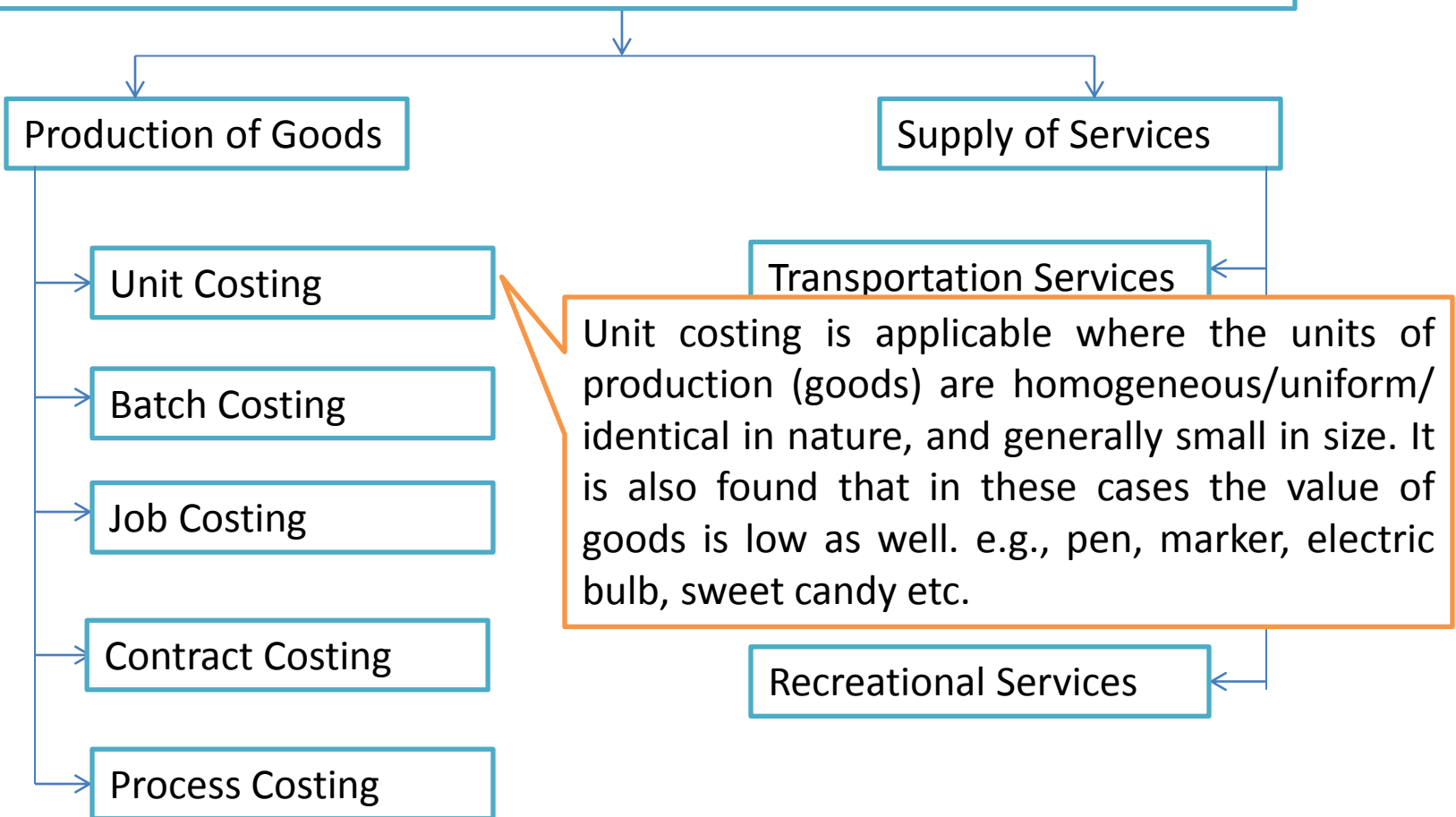
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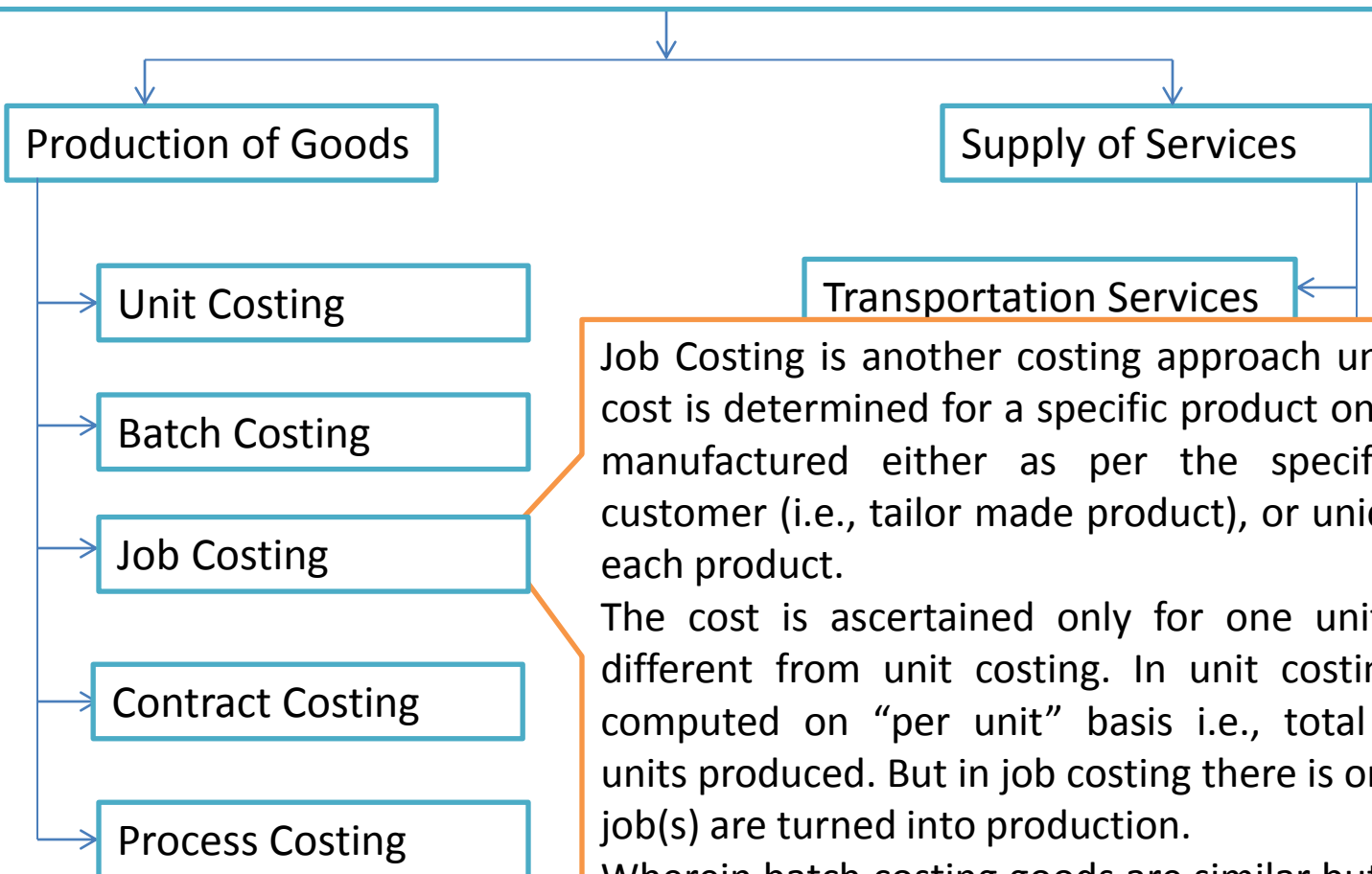
# Classification of Costing on the basis of Nature of Production



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Job Costing is another costing approach under which cost is determined for a specific product only which is manufactured either as per the specification of customer (i.e., tailor made product), or uniqueness of each product.

The cost is ascertained only for one unit but it is different from unit costing. In unit costing, cost is computed on “per unit” basis i.e., total cost/total units produced. But in job costing there is only specific job(s) are turned into production.

Wherein batch costing goods are similar but produced in batches, but in job costing goods are not alike rather can be differentiated on the basis of minor or major changes in make. e.g., making steel doors may vary as per customer’s direction.

## Classification of Costing on the basis of Nature of Production

### Production of Goods

→ Unit Costing

→ Batch Costing

→ Job Costing

→ Contract Costing

→ Process Costing

### Supply of Services

Batch costing approach is followed in production where goods are produced in different batch due to nature of commodity or time involved in production, or production technique.

In this case goods are homogeneous but can be identified on the basis of make.

For example, biscuits, milk, car, chips, TV, etc. A set of goods produced in a given batch are gone through similar conditions.

Therefore, whenever question of quality of product arises then company ask for 'batch no.' of the make of particular goods.

The difference b/w unit costing and batch costing is that in unit costing, cost is determined on per unit basis. But in case of batch costing it is ascertain on the basis of per batch.

## Classification of Costing on the basis of Nature of Production

### Production of Goods

Unit Costing

Batch Costing

Job Costing

Contract Costing

Process Costing

### Supply of Services

Under process costing there are different process are involved in manufacturing of finished product. Each process has significant role in production. The output of each process may be sold in open market as an intermediate goods or may be transfer to next department with a pre-determined cost.

There are twin objectives of the process costing, one is to ascertain the cost.

Second, to determine the profit of the different processes involved in production of final goods.

For example, textile is considered a best example of process costing under which each process viz., spinning, weaving, finishing, painting/embroidery etc. are the different processes. And output of each product can be soled in open market.

## Classification of Costing on the basis of Nature of Production

### Production of Goods

Unit Costing

Batch Costing

Job Costing

Contract Costing

Process Costing

### Supply of Services

Contract costing is a specialised approach of costing wherein goods are produced unique in nature or each goods are different of another goods,  
Each goods are produced as per given specification of customer or standard requirement as per prevailing practices or law  
The above said two features make it just like job costing but it is different from it due to followings  
The time involve in job costing is less than one year. But under contract costing goods take time in years, at least more than one year.  
Examples, construction of building, bridges, roads etc.

# Classification of Costing on the basis of Nature of Production

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Batch Costing

Job Costing

Contract Costing

Process Costing

## Supply of Services

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There are twin objectives of the process costing, one is to ascertain the cost. Second, to determine the profit of the different processes involved in production of final goods. For example, textile is considered a best example of process costing under which each process viz., spinning, weaving, finishing, painting/embroidery etc. are the different processes. And output of each product can be soled in open market.

ascertain on the basis of per batch.



## Contract Costing

- Contract costing a special branch of costing where cost is ascertained for a contract of goods rather than job or batch costing.
- The difference between a job costing a contract costing is that of size. The job involves production of small goods and complete the given task within a year. But in case of contract costing given task is of a giant size and generally takes a period more than one financial year.
- Under job costing production takes place within factory, but in case of contract costing substantial or whole production takes place outside the factory, e.g., construction of roads, building, ship-craft etc.
- Unlike unit/job/batch costing preparing of cost sheet [or classifying expenses as prime cost, overheads etc.] under contract costing only one ledger account is opened named CONTRACT ACCOUNT.
- All expenses associated with particular contract is directly charged to that particular contract account irrespective of making differentiation of direct and indirect expenses.
- Similarly consideration in respect of completion of contract is credited to this account.
- The balance (either profit or loss) is transferred to costing profit and loss account.
- It is important to note that the profit of a particular period (i.e., a completed year) is transferred to costing P&L A/c but it does not mean that contract has been completed. The remaining work-in-progress part of the total contract assignment is kept as reserve until it is completed.

# Important Points Before Making Discussion on Contract Account

## 1. Treatment of Material

- Material issued from store
- Material directly sent to site
- Material return back to store or transfer to another site
- Sale of material

## 2. Treatment of Labour

- No difference of direct and indirect labour is made
- If any supervisor or managerial staff is engaged at more than one location then apportionment of wages are done.

## 3. Plant

- Plant is generally issued in full to specific location instead of using one machine at different location. After use of such plant /machinery it is transferred to another plant after charging depreciation on such used plant/ machinery for the period during which it is used following accounting policy.
- If plant is purchased specifically for given contract then full plant is debited to contract account and value left after a financial year or completion of contract is credited to contract account.
- When plant is not exclusively purchased for a given contract, then only depreciation is charged to contract account.

## 4. Escalation Clause

- In some cases, an escalation clause is put in the agreement to make it assure that in case if price of raw material /labour etc. rises beyond given level then contractor will charge extra amount in addition to total agreed amount of consideration due to changes in price of material or labour.

## 5. Work Certified and Payment

- As discussed earlier that contracts are not completed within a year. And a contractee does not make payment to contractor unless former receive a certification of quality completion. If completed contract is not up to the standard of quality then definitely payment will not be released.
- On the other hand, contractor cannot wait for received full and final payment only on the completion of contract, which certainly takes time [a year or more], and since work is get completed day by day therefore release of proportionate consideration for the completed work is justified.
- The work is certified by contractee's surveyor, engineer or architect and approve accordingly.
- Since work is done on a continuous basis , therefore, whenever a piece of work is handover to surveyor for certification, on the same point of time work is being done. It means whatsoever work completed at the last of the year is not necessary is certified due to time taken by surveyor in certification. The work beyond the certification will come under UN-CERTIFIED WORK.

## 6. Profit on Incomplete Contracts

- One has to follow accounting policy irrespective of that the contract is finished or not. The accounting concept of a financial year is also followed in contract account. At the end of each financial year, profit earned for that particular year is computed and transferred to P&L A/c.
  - The major challenge before cost accountant is that how to determine profit.
  - Following points have due weightage for profit computation.
- (i) Profit is computed against certified work. However, uncertified work is kept as reserve.
  - (ii) If work-certified is less than  $1/4^{\text{th}}$  of the total work price, then no profit is transferred, as it gives unclear picture of contract completion.
  - (iii) If work-certified is more than  $1/4^{\text{th}}$  but less than  $1/2$  of the contract price then  $1/3^{\text{rd}}$  of the notional profits reduced on cash basis against work-certified is transferred to P&L A/c.
  - (iv) If work-certified is half ( $1/2$ ) or more than half ( $1/2$ ) of the contract price then  $2/3^{\text{rd}}$  of notional profits reduced on cash basis against work-certified is transferred to P&L A/c.
  - (v) If the contract is near completion, the estimated profit may be computed on the whole contract. The profit to be transferred to P&L A/c should be reduced in ratio of cash received against contract price.
  - (vi) In case of completed work, full amount, after charging expenses of work-certified is transferred to P&L A/c.

## Contract Account

*(for the year ending.....)*

**Dr.**

**Cr.**

| Particulars                | (Rs.) | Particulars                  | (Rs.) |
|----------------------------|-------|------------------------------|-------|
| To Material                |       | By work-in-progress          |       |
| To Wages                   |       | > Work- Certified            |       |
| To Plant (Cost)            |       | > Cost of work Uncertified   |       |
| To Overheads               |       | By Cost of materials damaged |       |
| To Profit transferred to : |       | By material in hand          |       |
| > P&L A/C                  |       | By Plant in hand (WDV)       |       |
| > Reserve                  |       |                              |       |
|                            |       |                              |       |

*Kindly refer attached pdf file for assignment questions. Do practice of questions already solved in class.*