1 SPECIFIC ORDER COSTING

This is a broad costing system, which is applicable where work jobs consist of separate jobs, batches or contracts. Each job, batch or contract is a cost unit and in most cases, it is different from another. Each order made can be identified separately and the system is designed to find the cost of each order. Specific order costing is subdivided into:

a) Job costing
b) Batch costing
c) Contract costing

6.1.1 JOB COSTING

This is a costing method which is applied when a job/cost unit is relatively of **small size**, is undertaken to fit the **customer's specifications**_ and is of comparatively **short duration:** Each job moves through the operations continuously as an identifiable unit. The method is usually adopted by businesses, which receives orders for work peculiar to the needs of individual customers.

a) Features of Job costing

Product is against the customer's order and not on job stocks
Each job has its own characteristics and requires special attention and skills.

b) Procedures of Job Costing

The application of job costing method begins when a customer's order is received. After accepting an order, an individual work/job order number is assigned to each job for or separate order identification.. Production order is then made giving authority for the job to start. A job cost account for each job is then opened. In this account, all costs relating to that particular job are recorded and this account closed only when the job is complete. After completion of the job, an invoice is prepared and served to the customer.

- Materials for each job are made using material requisition forms
- Labour is charged on the basis of the amount of time used to complete that particular job as recorded in time-keeping records.
- Overheads are charged on the basis of an predetermined overhead absorption rate.
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Applied Overhead absorption rate = Budgeted Overheads ÷ Denominator value
The Denominator value where the denominator value refers to units of some specified overhead absorption base e.g. machine hours, direct labour hours.

6.1.2 Accounting for Job Order Costing

1. (a) Direct materials

(i) Dr Stores ledger control A/c Cr Cash A/c – for cash purchasers X

(ii) Dr Stores ledger control A/c Cr Creditors A/c – for credit purchasers X

(b) Return of materials to suppliers

Dr Cash A/c or creditors control A/c X

Cr Stores ledger control A/c X

(c) Issue of materials from the store

Dr – W.I.P. Control A/c X

Cr stores ledger control A/c for direct materials. X

Indirect materials: Dr Factory overheads control A/c X

Cr Stores ledger control A/c X

2. Direct Labor

Dr W.I.P. Control A/c

Cr Cash A/c

3. Accrued Direct Wages

Dr W.I.P. Control A/c

Cr Wages Control A/c

Indirect Wages

Dr Factory overheads control A/c

Cr Wages Control A/c

1. Production Overheads

(i) (not yet paid) Dr Factory overhead control A/c

Cr Expenses/Creditor control A/c

(ii) (When paid) Dr Expense/creditors A/c

Cr Cash A/c

Note

Overheads entries apply when there is an interlocking accounting system.

5. Finished goods transferred to the store:

Dr Finished goods stock control A/c

Cr W.I.P Control A/c

6. Sale delivery of finished goods to customers:

(i) On Credit: Dr Debtors control A/c Cr Sales A/c

(ii) In Cash: Dr Bank/Cash A/c Cr(Sales A/c

7. Cost of goods sold to customers:

Dr Cost of sales A/c

Cr Finished goods control A/c

8. (i) When there is over absorption of production overheads:

Dr Factory overheads control A/c

Cr P & L A/c

(ii) When there is under absorption of production overheads:

Dr P& L A/c

Cr Factory overheads control A/c

9. When there are non-manufacturing overheads:

Dr P & L A/c

Cr Non-manufacturing overheads control A/c or non-manufacturing overheads/expenses are regarded as period costs & are therefore not changed To W.I.P control A/c.

Job Cost Account

	Dr		Cr
Direct materials issued from stock	X	Materials returned to the store	X
		Materials transferred to other jobs	
Direct wages	X		X
		Cost of completed jobs transferred	
Production overheads absorbed	X	to finished goods A/c	X
Materials transferred from other jobs	X	Balance c/d (Total cost of that job)	X
	XX		XX

Illustrations:

The following transactions were made by Z limited in the month of December.
Direct Materials

- 8,000/= was bought on credit, out of these, materials worth 5,000/= were returned to the suppliers.
- 50,000/= was issued from the store
- Indirect materials issued amounted to 5,000/=
- Direct wages allocated to production amounted to 20,000/=
- Goods worth 200,000/= were sold
- Finished goods worth 100,000/= were transferred to the store.
- The cost of goods sold was 140,000/=

- Unpaid indirect expenses were 32,000/=
- Indirect wages allocated amounted to 15,000/=
- Non-manufacturing overheads incurred amounted to 20,000/=
- Overhead expenses charged to the jobs – 60,000/=

Required

a) Prepare the stores ledger control A/c
b) Factory overhead control A/c
c) W.I.P. control A/c
d) Costing P & L A/c

Stores Ledger Control A/c

Creditors (material)	8,000	Creditors control	5,000
		W.I.P (Indirect materials)	50,000
		Factory overheads	5,000

Factory Overheads Control A/c

Stores Ledger (material)	5,000	W.I.P	60,000
Creditors (wages)	32,000		
Incurred wages	15,000		
P + LA/c			
Overabsorption	8,000		
	60,000		60,000

W.I.P Control A/c

Stores Ledger (material)	50,000	Finished goods stock control	100,000
Control (D wages)	20,000		
Overhead expenses	60,000		

Costing P and L A/c

Finished goods control	140,000	Sales	200,000
Non manufacturing Overheads	20,000	Factor overhead absorption	8,000
Costing profit	48,000		

6.2 BATCH COSTING

This is a type of job costing that is used when production consists of limited repetitive work and definite number of item manufactured in one batch. A batch is defined as a cost unit consisting of a group of identical item in particular sizes and colors of shoes, toys, spare parts etc. The total cost incurred in production is spread on the number of units made when the batch is completed.

a) Procedures:
    - Allocation of batch number
    - Production order is made
    - Creation of batch costs account
    - Completion of the work and closure of the batch cost account
    - Allocation of costs to individual units in the batch
    - Determination of selling price/batch and unit.

Illustrations

The budgeted variable overheads of Githurai Ltd for the year 2001 are given as below:

Department	Overhead(shs.)	Absorption base
A	150,000	15,000 direct labour hours
B	200,000	25,000 direct labour hours
C	120,000	20,000 direct labour hours
D	300,000	30,000 machine labour hours

Additional Information

- Selling and administering overheads are changed at 10% of total production costs while the profit mark up is 25 of total costs:
- An order for 2,000 units was received from a customer. The batch number of this order is 510. The following additional information in respect of this batch is provided below:
- Direct materials – 87,000/=
- Direct Labor – Dept A (150 direct labor hrs) – 12shs. Direct labor hour.
    - Dept B (40 direct labor hrs) @ 15shs. Per hr
    - Dept C (60 direct labor hrs) @20shs. Per hr
    - Dept D (100 direct labor hrs) @10shs. Per hr

A total of 50 machine hours were used in this job

Required

a) Calculated the total cost of the batch
b) Cost/Unit
c) Selling Price of the batch
d) Selling Price unit

Solution

Githurai Limited
Batch 510

Particulars			Shs.
D Materials			87,000
D Labour:	Dept A (150 x 12)	1,800	
	Dept B (40 x 50)	6000	
	Dept C (60 x 20)	1,200	
	Dept D (100 x 10)	1,000	4,600
Prime Cost			91,600
Variable Overheads:	Dept A –15,000/15,000 x 150	1,500	
	Dept B – 200,000/25,000 x 40	320	
	Dept C – 120,000/20,000 x 60	360	
	Dept D – 300,000/300,000 x 50	500	2,680
Total Production Cost			94,280
Selling and admin costs – 10% (94,280)			9,428
Total Costs			103,708
Mark-up: Mark-up @ 25% x 103,708			25,927
Cost/Unit = 103,708/2000 units = 51.854		Selling Price unit = 129,635/2,000 = 64.8175	

6.3 CONTRACT COSTING

This is a form of specific order costing that is applied to relatively large cost units, which normally take a considerable length of time to complete e.g. building or construction works. Contract jobs are undertaken in accordance with specific requirements of contractee/Customer. Contracts may be distinguished from job orders by the following features:

The money value of a contract is much **larger** than that of a job order.

- A contract consumes significantly larger amounts of resources than a job order.
- For a contract, special progress reports are usually made while in job costing, reports are made after the completion of the job.
- For a contract, indirect costs are relatively smaller in relation to direct costs but the vice versa is time for job order.

To second the progress of contract works, a special account known as a contract account is maintained.

6.3.1 CONTRACT ACCOUNTS

This is a separate account that is opened and maintained for each contract undertaken for the purpose of accumulating cots. Each contract is given a number and all costs relating to that particular contract are recorded in this account. A typical contract account is as shown below:

Contract No. XYZ Account

Materials b/f	x	Materials returned to store	x
Materials purchased	x	Materials c/d	x
Direct wages	x	Machinery c/d	x
Indirect wages	x	Balance c/d: Cost of work done	x
Subcontractors fees	x		
Cost of special plant	x		
Machinery/Plant b/f	x		
Cost of work done b/d	x	Value of work certified	x
Notional Profit	x	Cost of work done but not certified	x
	xx		xx

Contract Costing Terminology
Principles of profit income recognition in contracts

The Notional Profit

It is a component of 2 items:

a) **Profit taken** = Notional profit x 2/3 x cash received/work certified
This formula of calculating the part of national profit taken in the year is used when substantial costs have been incurred on the contract but the contract is not near completion. But when the contract is near completion the profit taken is calculated as:
Profit taken = Estimated profit x cash received/contract price.
Where Estimated profit = Contract price – Estimated total cost and
Estimated total cost = Costs incurred to date and estimated future costs.

b) **Profit not taken** = refers to the part of the national profit that is not recognized in the current period. It is profit carried forward to be recognized in the years that follow.

c) **Retention Money**
This is a portion of the value of work certified that is retained by the contractor to protect himself from faulty work that might be evident at the time of progress payments or at the completion of the contract. This amount is released after satisfactory performance under the contract.

Illustration

XYZ limited has been awarded a contract to build a house. This is a contract No 45 for the company and the contract price is shs.2.65 million. At the end of the company's financial year, the contract was 85% complete and hence regarded as being near completion. You are also provided with the following information about the contract:

Particulars	Shs.
Materials purchased and delivered	580,000
Materials issued from store	60,000
Materials returned to stores	7,000
Site expenses	300,000
Site wages	200,000
Plant sent to site	100,000
Architect's fees	30,000
Plant returned from site	10,000
Subcontractor's fees	105,000
Head Office overheads absorbed	60,000

Valuation at the year ending disclosed the following:

	Shs
Materials:	19,500
Plant on site	50,000
Work done but not yet certified	60,000

Additional Information

1. The portion of the work which was completed during the year and certified by the architect was assessed as representing 75% of the whole contract price. The contractee made payments to this extent less 10% retention money.
2. The management of the company decided for the purpose of preparing the company's annual accounts to make a provision of a third of the national profit against the possibility of defects and other contingencies arising later in respect of the work already certified for payment.

Required

a) The contract account
b) Amount of profit or loss to be taken to the main profit and loss account of the company.
c) Value of work in progress.

XYZ LTD
Contract No 45 A/c

	Shs		Shs
Materials Purchased:	580 ,000	Materials Returned to stores	9,000
Materials issued from stores	6,000	Plants returned from site	10,000
Site expenses	300,000	Materials c/f	19,500
Site wages	200,000	Plant c/f	50,000
Plant set to site	100,000	Cost of work done	1,346,500
Architects fees	30,000		
Sub-contractors	105,000		
Head office overheads	60,000		
	1,435,500		1,435,500
Cost of work done b/d	1,346,500	Value of work certified	
National profit: 701,000		75% x 2,650,000	1,987,500
Profit taken:	473,175	Work done but not	
Profit in suspense	227,825	certified (closing stock)	60,000
Balances b/f: materials	19,500		2,047,500*
Plant	50,000		
Work not certified	60,000		

$$= \text{National Profit} \times \frac{\text{Cash Received}}{\text{Contract Price}}$$

Profit taken $= 701,000 \times \frac{(90\% \times 1,987500)}{2,650,000} = 701,000 \times \frac{1,788,750}{2,650,000}$

$= 473,175$

Profit in Suspense = 701,000 –473,175
= Shs. 227,825

Value of Work in Progress

	Shs.
Cost of work certified	1,346,500
Add: Profit taken	473,175
	1,819,675
Less: Cash Received	(1,788,750)
Work in progress valuation:	30,925