Contract Costing

Contract cost is the method of calculating the cost that is applied in a business where separate contracts of a non-recurring nature are executed. According to Shari, "Contract accounts or final costs apply to a concern that makes contracts specific and requires knowing the cost of each."

A contract is a large job that may extend even after one accounting period. The person executing the contract is known as the contractor and the person who is executed for it is known as the contractor.

Contract costing is the tracking of costs associated with a specific contract with a customer. For example, a company bids for a large construction project with a prospective customer, and the two parties agree in a contract for a certain type of reimbursement to the company. This reimbursement is based, at least in part, on the costs incurred by the company in order to fulfill the terms of the contract. The company must then track the costs associated with that contract so that it can justify its billings to the customer.

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.

  Materials sold at the contract site are credited to the Contract Account. However, if because of some extraneous reasons sale is made then the profit or loss incurred due to such a sale is credited to Profit and Loss Account. In case of sale of contract assets and property also for profit or loss the Profit and Loss Account is credited.

  In some cases, the contractee may himself supply the materials to the contractor. Here also the value of such materials should not be charged to the contract account. The unused materials are to be returned to the contractee.

- **Labor:** All employment used to complete the contract is direct labor and treated as such. In order to maintain an appropriate record and to control business expenses a wage summary is prepared.

- **Plant and machinery**. Where a factory, machine or special equipment is purchased for a specific contract and it will be exhausted on site. If this is the case, it is normal that it is deducted from the contract account and any amount of amortization is charged to the credit side of the contract account. However, if obtained for a shorter period; then the amount is deducted only with the usual depreciation of the assets. The proceeds of the sale, if any, are added at the end or middle of the contract to the contract account and the profit or loss from this sale is transferred to the profit and loss account.

- **Cost plus**. The company is reimbursed for the costs it incurred, plus a percentage profit or fixed profit. Under this arrangement, the company will be forced under the terms of the contract to track the costs related to the project, so that it can apply to the customer for reimbursement. Depending on the size of the project, the customer may send an auditor to examine the company's contract costs, and may disallow some of them.

Contract costing can involve a considerable amount of overhead allocation work. Customer contracts typically specify exactly which overhead costs can be allocated to their projects, and this calculation may vary by contract.

In some industries, such as government contracting and commercial construction, contract costing is the primary task of the accounting department, or may even be organized as an entirely separate department. Proper contract costing can contribute a considerable amount of profits, and so is typically staffed with more experienced contract managers and accountants.

Features of Contract Costing

The main features of Contract Costing may be summarized as follows:

1. A contract is undertaken according to the specific requirements of customers.
2. Generally, the duration of a contract is long period.
3. The contract is undertaken only at the site of the customer.
4. Contract work mainly consists of construction activities.
5. The specific order costing principles are applied in contract costing.
6. The size of a contract is usually large or bigger than jobs.

7. It requires a long time to complete a contract.

8. Each contract is an independent one, quite distinct from another.

9. A distinctive number is assigned to each contract to differentiate the contract from one another.

Types of contracts

There are 3 types of contract which are mentioned below:

a. **Fixed cost contract:** the contract that is executed amongst the fixed cost which is agreed past times the contract as well as the contractee is called the fixed cost contract. Under this contract, no modification is made inwards the agreed contract cost irrespective of the changes inwards the cost degree of fabric as well as labor inwards feature. In such type of contract, the contractor is benefited when the cost of fabric as well as labor decrease. In contrary to this, the contractee is benefited if the cost of fabric as well as labor increase.

b. **Fixed cost contract amongst escalation as well as de-escalation clauses:** escalation clause is a of understanding that that aims to trim down the risks that is causes due to the changes inwards the cost of materials, labor as well as other services. Under this, the contract cost is adjusted inwards accordance, amongst the changes inwards the cost of material, labor as well as other services. The additional cost raised due to the increment inwards cost is born past times the contracted. Similarly, the contract cost is reduced if the cost decreases below a sure percentage. It is called de-escalation or contrary clause. Escalation clause condom guides the involvement of both the contractor as well as contractor against unfavorable cost alter inwards future. Such clause may too apply where fabric as well as labor utilization exceeds a item limit. In this case, however, contractor volition guide hold to testify that excessive utilization is non because of decrease inwards efficiency. The contractor allows a rebate inwards the bills presented past times him to the extent of the decrease inwards price.

c. **Cost plus contract:** the contract inwards which the contract cost are determined past times adding a sure pct of lucre on cost is known equally cost plus contract. The cost plus contract is adopted to overcome amongst work of fixing the contract cost terms caused due to nature of contract, duration of completion of contract, uncertainly of material, alter inwards the cost level, novel technology scientific discipline etc. this type of contract is mostly followed past times the authorities for production of especial articles non commonly manufactured, urgent repairs of vehicles, roads span etc. nether this types of contract, the contract starts the go as well as payment is made past times the contracted gradually on the footing of the cost incurred inwards the go completed plus sure pct of profit.

Contract Ledger

A contractor maintains a Contract Ledger in which a separate account is opened for each contract undertaken by him. The Contract Ledger should be ruled out as to give maximum information.

A specimen ruling of the Contract Ledger is given below:

Contract Ledger

Contract No.____________________	Contract Price ____________________
Site ____________________	Terms of Payment ____________________
Started on ____________________	Retention Money ____________________
Completed on ____________________	Work Certified ____________________
Remarks ____________________	Date ____________ $ ____________
	Date ____________ $ ____________

Date	Particulars	Materials	Wages	Direct Charges	Indirect Charges	Total
		$	$	$	$	$
	Total					