Mogbogu Chisom Zanetta

18/SMS02/035

Accounting

4: Features of Contract Costing.

a) The work is usually for long duration i.e often more than one accounting period.

b) The work is frequently constructional in nature.

c) Payment on account are usually made against work certified

d) A formal contract is made between the customer and the supplier i.e between contractor and contractee.

e) Contract may contain clause for penalty for delay in completion or bonus for early completion.

f) The method of costing is similar to job costing.

g) Retention fund may be deducted from progress payment.

h) Work is undertaken to customers special requirement.

Terminologies used in contract costing:

a) Contract price.
The agreed price of contract between contractor and contractee.

b) Retention fee.
This is the money deducted from progress payment to guarantee for anormalies. Amount agreed to be witheld on every progress payment as guarantee against bad or imperfect work which will be released to the contractor after a specified period.

c) Cost to date.
The sum/addition of all cost incurred to date on the output.

d) Estimated profit

Contract price – estimated cost of the contract

d) Work certified

This is the work done for which certificate of work done is issued.

e) Notional profit:

This is the profit earned on contract to date. It is the difference between value of work certified and cost of work certified.

4.ii) Objectives Of Service Costing.

a) To control the cost in the service department.

Control measures in service costing

4.ii) Objectives of Service costing

a) To control the cost in the service department; by comparing actual cost against standard or target cost; by comparing present actual cost against previous actual cost.

b) To control the cost of the user department; This is necessary to prevent arbitrary use of internal services. The charging of service cost on user department will; accurate establishment of overhead cost of user dept; It helps user department to achieve cost effeverey.

4.iii) Methods of Cost Estimation.

a) Scatter graph method.

It is a popular well known method of estimating the fixed and variable costs because it is a quick and easy method to use. It involves drawing a graph of number of units produced against the total costs incurred in the production process. A line of best fit is drawn passing on the data points in the graph. The total fixed cost will be the point at which the line drawn touches the y-axis.

b) High low method.

This represents an objective way of segregating the mixed cost into fixed and variable element by applying the following.

→ Determine the difference between the activity levels

→ Identify the corresponding costs to both the highest and lowest activity levels where inflation makes the costs in each period uncomparable, costs should be adjusted to the same level by means of a price level index

→ Determine the difference between the corresponding cost.

→ In order to determine the variable cost per unit or the level of variability, divide the difference in cost by difference in activity level

→ Use the variable cost per unit to determine total variable cost.

The difference between the total variable cost and the corresponding mixed cost will represent the total fixed cost

c) Regression analysis.

It uses a series of mathematical equations to find the best possible fit of the line to the data points and thus tends to provide more accurate results than the scatter graph approach. It tends to yield the most accurate estimate of fixed and variable costs assuming there are no unusual data points in the data set

d) Statistical Modeling.

For the largest of small businesses; statistical modeling can be a very accurate method of cost estimation.

1)

SALAMANDER PLC

Contract Account as at February 28, 2011.

	₦		₦
Direct materials issued	75000	Materials c/f	25000
Materials bought on site	195000	Cost to date c/f	486 650
Direct expenses	55000		
Wages paid	150 000		
Head office expenses	10 500		
Plant depreciation (20% × 100 000)	20 000		
Accrued expenses:			
Wages 5000			
Direct exp 1150	6150		
	511 650		511 650
Cost to date b/f	486 650	Value of work certified	545 000
Notional profit:			
Profit taken 35 010			
Profit not taken 23 340	58 350		
	545 000		545 000
Material b/f	25 000	Profit b/f	23 340

b) Calculation of work in progress.

	₦
Cost to date	486 650
Profit taken.	35 010
	521 660
Cash received	(490 500)
	31,160.

Workings

Cash received ₦490 500.

$$\text{Value certified} = \frac{490\,500}{0.90} = ₦545\,000$$

Notional profit = ₦58,350.

$$\text{Profit taken} = \frac{2}{3} \times \text{Notional profit} \times \frac{\text{Cash received}}{\text{Value certified}}$$

$$= \frac{2}{3} \times 58\,350 \times \frac{490\,550}{545\,000}$$

$$= ₦35\,010.$$

Profit Not taken = (58 350 − 35 010)

= ₦23 340 //

3. Kekemeke Ltd.

Process I Account.

Narration	Qty	Rate	Amount ₦	Narration	Qty	Rate	Amount ₦
Input	6000	2	12000	Normal loss	600	3	1800
Add: Material			7000	Output	5000	6.3	31500
Labour			8000	Abnormal loss	400		2500
Expenses			3000				
Other expenses			800				
Production overhead			5000				
	6000		35800		6000		35800

Cost per unit = $\frac{\text{Cost - Scrap}}{\text{Input material unit - Normal cost unit}}$

$= \frac{₦(35800 - 1800)}{₦(6000 - 600)}$

$= ₦\frac{34000}{5400}$

$= ₦6.3$

Process II Account.

Narration	Qty	Rate	Amount ₦	Narration	Qty	Rate	Amount ₦
Process I transfer	5000	6·3	31 500	Normal loss	500	3	1500
Add: Material			8000	Output	6000	13·9	83 400
Labour			10 000				
Expenses			4 500				
Other expenses			1200				
Production overhead			4000				
Abnormal profit	1500		20 700				
	6500		84 900		6500		84 900

$$\text{Cost per unit} = \frac{\text{Cost} - \text{Scrap}}{\text{Input material} - \text{Normal cost unit}}$$

$$= \frac{₦(64\,200 - 1500)}{₦(5000 - 500)}$$

$$= \frac{62\,700}{4500}$$

$$= ₦13·9$$

Process III Account.

Narration	Qty	Rate	Amount	Narration	Qty	Rate	Amount
Process II transfer	6000		83 400	Normal loss	400	3	1200
Add! Material			5000	Output	4000	18.4	73 600
Labour			7000	Abnormal loss	1600		29600
Expenses			2500				
Other exp			500				
Production overhead			6000				
	6000		104 400		6000		104 400

Cost per unit = $\frac{\text{Cost} - \text{Scrap}}{\text{Total Input material unit} - \text{Normal Cost Unit}}$

$= \frac{₦104\,400 - ₦1200}{6000 - 400}$

$= \frac{103\,200}{5600}$

$= ₦18.4$

Abnormal Loss Account

Narration	Qty	Rate	Amount ₦	Narration	Qty	Rate	Amount ₦
Process I	400		2500	Scrap	2000	3	6000
Process III	1600		29600	P/L			26100
	2000		32100		2000		32100

Abnormal Gain Account

Narration	Qty	Rate	Amount ₦	Narration	Qty	Rate	Amount ₦
Scrap	1500	3	4500	Process II	1500		20700
P/L			16200				
	1500		20700		1500		20700