FINANCIAL ACCOUNTING

SECOND –TERM

S.S 3

SCHEME OF WORK

WEEKS

1. Contract Accounts
   - Meaning, terminologies – National profit, retention fee, work certified.
   - Work-in-progress, calculation of percentage of work completed.
   - Preparation of contract Account.
2. Interpretation of Financial statement – calculation of ratios e.g liquidity ratio, acid test ratio, working capital etc.
3. Departmental Account - Meaning
   - Reason for departmental Account
   - Inter Departmental transfer.
   - Lost Apportionment.
   - Preparation of departmental Account.
   - Differences between branch and departmental Account.
4. Branch Account
   - Meaning, types of branches – Local, foreign.
   - Reasons for the branch Account.
   - Branch memorandum Account.
   - Branch returns Account
   - Branch debtors Account.

- Branch Profit and loss Account.
- Branch mark-up and margin.

5. Public Sector Accounting.
   - Meaning, basis for preparation of Account, sources of government revenue.
   - Capital/Re-current expenditure.
   - Heads and sub-heads.
   - Types of fund.
   - Capital and revenue Account.
   - Income and expenditure Account.
   - Differences between government Accounting and public sector Accounting – Term in government Accounting.
6. Preparation of personnel cost Budget.
7. Revision
8. Mock Examination.

CONTRACT ACCOUNT

WEEK 1

INTRODUCTION

The contract account is a system of cost accounting used by contractors engaged in construction and building works, where it is common for a firm to be engaged in execution of many separate contracts at the same time, and which can continue over a long period (many years). The contract accounts make it possible to allocate most of the expenditure incurred directly to the individual contracts, thus making it very easy to prepare, within the framework of financial accounts, a separate account which will disclose the profit or loss on each contract.

The contract accounts take care of such businesses whose nature of work does not conform to a financial year's calculation of profits, based on the duration of period required to complete the job. Assume that a firm of contractors has only one contract in progress, which is construction of a large stadium complex which might take three years to complete. In this instance, the actual profit or loss on this type of contract can only be correctly calculated on the completion of the contract.

However, if the company has been formed especially for this contract, the owners may not want to wait for three years before profit could be calculated and dividend paid. Therefore, an attempt is made to calculate yearly profits.

In contract accounts, it is important that a firm should keep a close check on the costs incurred on each contract, and eventually on the profit actually realized. This is more so important where the contract will extend more than one accounting period its imperative that annual account be prepared to determine the yearly profit or loss on the contract.

Definitions

The Nigeria Accounting Standards Board defines construction contract as the execution of building and civil engineering projects, mechanical and electrical engineering installations and other fabrications normally evidenced by an agreement between two or more parties.

The standard classifies the construction contract as:

a) Short-term construction contract
b) Long-term construction contract

The short-term construction contract are those contracts that are expected to be completed within 12 months, while the long-term construction contracts are those contracts that are expected to take more than 12 months to complete.

Methods of Revenue Recognition

Revenue recognition means the process of accounting for and inclusion of revenue from a contract in financial statement. In contract account, revenue is deemed realized at the point where the portion of the work responsible for generating the revenue has been performed.

There are two main methods of recognizing revenue under contract account as follows:

a) Completed contract method
b) Percentage of completion method

Completed Contract Method

This is a method used for… long-term contracts (i.e. a contract that will take more than 12 months to complete), particularly in situations where there are no dependable estimates or where there are uncertainties which make accurate forecast impossible. Under this method, revenue from a contract is recognized only when the contract is completed. Thus, all costs incurred on a contract and billing there from are accumulated until the contract is completed. No interim charges and credits are made to the profit and loss account.

This method has a major problem of subjecting the periodic revenue from long-term contract to distortion. Revenue earned before the completion of the contract is not reflected in the accounts of a business, even if operations on a contract are uniform throughout the contract period.

On 1 July 2005, the Consortium builders were engaged to construct a stretch of 2km road at a contract price of N100,000. The contract was tagged contract No. 6 by the company. During the year, the company incurred the following expenditure on the contract:

	₦
Material issued from store	25,000
Materials purchased	24,000
Wages	24,750
Sub-contracting work on contract	6,000
Purchase of special equipment	45,000
On 30 June material on site amounted to	2,500

The equipment purchased has an estimated useful life of four years and the company adopts straight line method of depreciation in providing for depreciation on all its assets.

You are required to prepare a contract account for contract No. 6 for the year ended June 2006.

Consortium of Builders

Contract No. 6

	₦		₦
June 2006		June 2006	
Materials issued from		Contract price	100,000
Store	25,000	Material issued	2,500
Purchases	24,000		
Wages	24,750		
Subcontracting fees	6000		
*Depreciation of equipment	11,250		
Profit on contract	11,500		
	102,500		102,500

Depreciation calculation

Cost of equipment = ₦45,000

Estimated useful life = 4 years

Scrap value = NIL

Depreciation = $\frac{(45,000-0)}{4}$

= ₦11,250

Percentage of Completion Method

This method apportions revenue from a contract to each accounting period involved in the execution of a contract on the basis of…