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Accounting Entries for Activity-Based Costing System: the Case of a Distribution Company

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Abstract

The article describes the case of the realization of the two-stage cost allocation scheme of activity-based costing in Russian accounting system used at a distribution company. In order for the activity-based accounting to be implemented in a Russian company, it is necessary to open one group of accounts for usual responsibility and resource accounting purposes and another group of accounts to record costs by activities. These two groups of accounts are linked through the special temporary reflecting account.

In order to do resource and responsibility accounting, a medium-size distribution company opened three accounts in accordance with its organizational structure: "General Administration", "Warehouse", and "Fleet of Trucks". Each account had subaccounts for the resources consumed in the cost center (personnel, equipment, building, and inventory). To record costs by activities, the following accounts were opened for main business processes: "Take and Process Customer Order", "Complete Customer Order", "Deliver Customer Orders", "Finance Accounts Receivable Balances". Driving resource expenses to activities is recorded on the account "Tracing Costs to Activities", which contains subaccounts for each activity mentioned in the Activity Dictionary. This account also allows accountants to apply standard costing approach in ABC-environment. Finally, to drive activity costs to customers of a distribution company, it is necessary to open subaccounts for major customers or distribution channels to traditional accounts "Sales" and "Income Summary". The article provides the case of preparation of accounting entries for activity-based costing and related customer profitability report at a distribution company.

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1. Main text

A new Chart of Accounts for Business Activity Accounting was enacted by the Russian Ministry of Finance. A number of accounts in this Chart of Accounts are reserved for management accounting purposes. It is now possible to implement the two-stage cost allocation scheme of activity-based costing in Russian accounting system.

In order for activity-based accounting to be implemented in a Russian company, it is necessary to open one group of accounts for responsibility centers and resource accounting purposes and another group of accounts for cost accounting based on activities. These two groups of accounts are linked through the special reflecting account.

The first group of accounts numbered from 30 through 38 corresponds to the organizational structure of a company. A separate account is kept for each division, department or other responsibility center. A department account can have subaccounts that are used for recording the information about transactions and other events related to the resources consumed in the responsibility center. A separate subaccount is used for each resource. Overall, the first group of accounts and subaccounts parallels the traditional responsibility center accounting system.

Resources are tangible and intangible assets used by the company for business operations (manufacturing goods, providing services etc.). They may include personnel, equipment, building, facilities, supplies, inventory and so on. The cost of a resource is comprised of cost elements that usually represent the general ledger accounts associated with the resource. In Russia, cost elements include materials, salaries, social security, depreciation (amortization), and others. For example, the cost of personnel consists of two cost elements: salaries and social security expenses. Most bonuses and benefits are included into the salaries element.

The second group of accounts numbered from 20 through 29 parallels the hierarchy of activities at a company. The hierarchy reflects the way work is organized or performed. In Russia, it is possible to use traditional expense accounts and open separate subaccounts for each business process or activity mentioned in the Activity Dictionary.

Information recorded and classified on activity subaccounts would help Russian companies to adopt the most promising solution to cross-functional barriers: a process management approach. The cost and other performance information on each activity or business process could be reported to business process owners. Based on this information, process owners may concentrate on getting work to move more effectively and efficiently across functions to the benefit of customers. People at all levels in the company would understand how their work fits into the process, produce the demand for resources and practical capacity, and adds value to customers. Business processes and activities would undergo continuous measurement, improvement and redesign. Overall, the information identified on activity subaccounts could secure the adoption of organizational structure based on activities and related new methods of governance. These new managerial tools will help Russian companies improve efficiency and effectiveness of business operations.

With activity and resource accounts structured, it becomes possible to assign the costs of resources to activities using double entry principle. Driving resource expenses to activities being performed is recorded on the account "Tracing Costs to Activities", which contains subaccounts for each activity mentioned in the Activity Dictionary. The debit of the latter account is used for assigning (or allocating) resource expenses to activities. The credit of that account is used for recording the final actual costs of activities (or standard costs in some cases). The account "Tracing Costs to Activities" gets periodically closed.

To determine actual costs of activities, accountants should post the accounting entries of two types. The first type of accounting entries is aimed at collecting expenses from different resource accounts and driving them to activities in accordance with the resource consumption pattern. For example, costs of the General Administration could be traced to activities by the following journal entry:

Tracing Costs to Activities/ Invoice Customers	\$ 7000
Tracing Costs to Activities/ Process Customer Orders	\$ 5000
Tracing Costs to Activities/ Manage External Relationship	\$ 3000
General Administration	\$ 15000
(to trace general administration resource expenses to activities)	

Similar entries are made for other accounts used for resource and responsibility center accounting. All these entries involve the debit of the account "Tracing Costs to Activities".

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