Implications of Accounting for Subcontracting in v.13

This document is written with the purpose of demonstrating the general subcontracting workflow and its behavior in relation to accounting. An example will be used for illustration.

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Example Background Information

My Company purchases Wood Planks, from Vendor Inc., to manufacture a Wooden Chair in-house. My Company also purchases Seat Cushions and Cushion Fabric from Vendor Inc. Finally, My Company ships the Wooden Chair, Seat Cushion, and Cushion Fabric to Subcontractor Inc. to assemble the finished good: Perfect Chair. My Company uses automated accounting.

My Company Summary:

Sell: Perfect Chair (Customer Inc.)

Purchase: Wood Planks, Seat Cushions, Cushion Fabric (from Vendor Inc.)

Manufacture: Wooden Chair (My Company WH)

Subcontract (purchase): Perfect Chair (from Subcontractor)

Accounting: Automated

Product Template Configuration

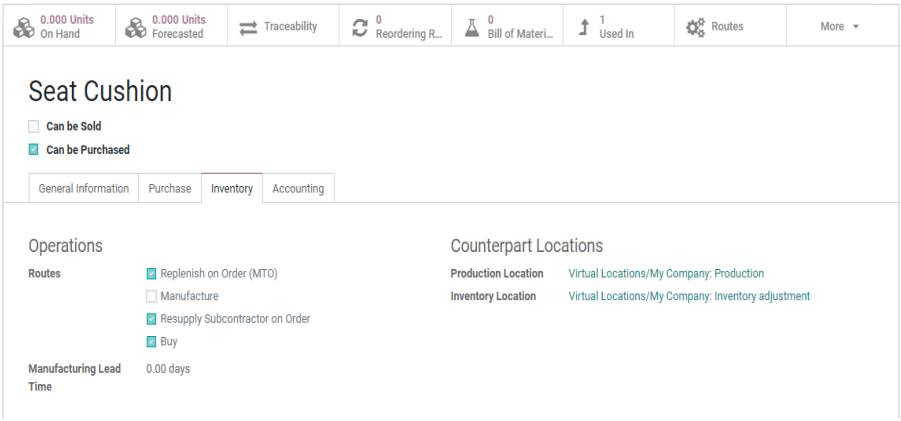
Raw Materials

Product Name: Wood Plank

Product Type: Storable Product

Unit Cost: $5

Route: Buy



Product Name: Seat Cushion

Product Type: Storable Product

Unit Cost: $20

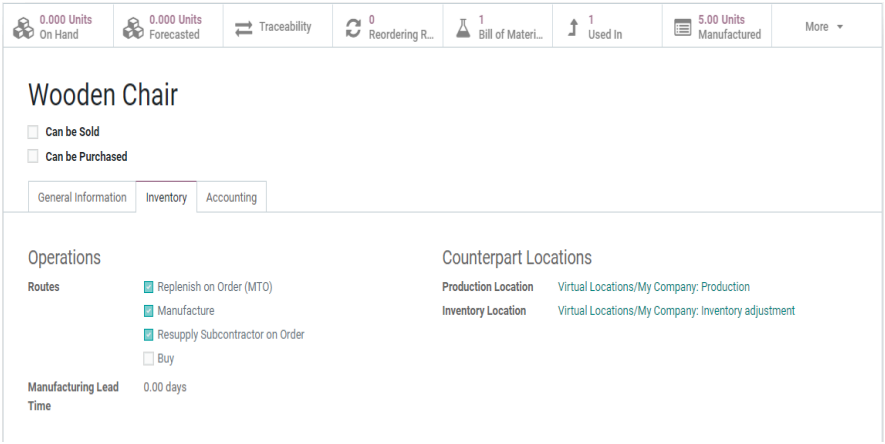
Route: Buy, Resupply to Contractor

Product Name: Cushion Fabric

Product Type: Storable Product

Unit Cost: $5

Route: Buy, Resupply to Contractor



Subassembly

Product Name: Wooden Chair

Product Type: Storable Product

Unit Cost: $25

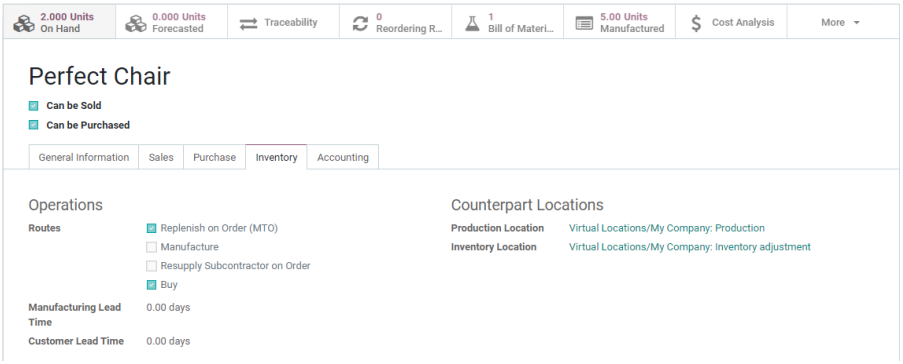
Route: Manufacture, Make to Order (MTO), Resupply to Contractor

Finished Good

Product Name: Perfect Chair

Product Type: Storable Product

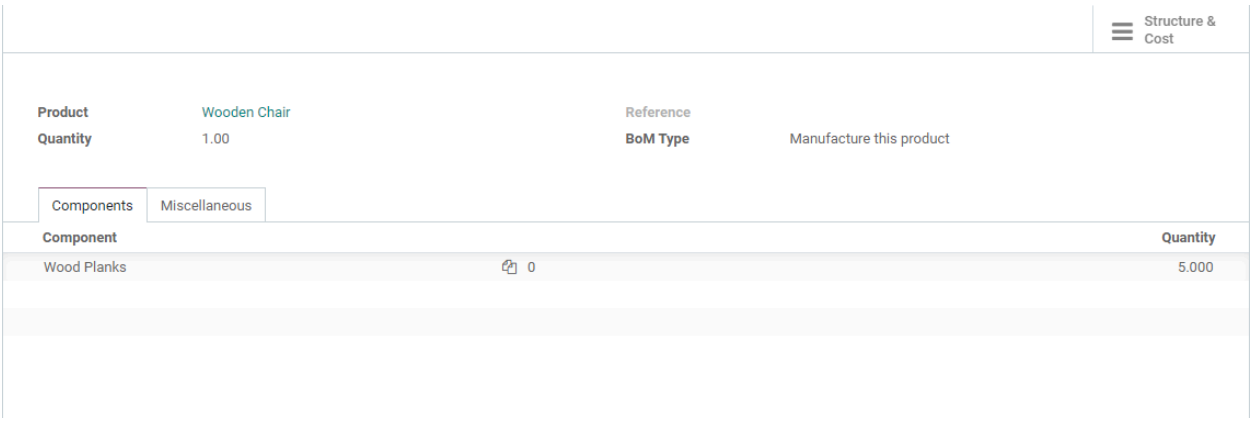
Unit Cost: $100



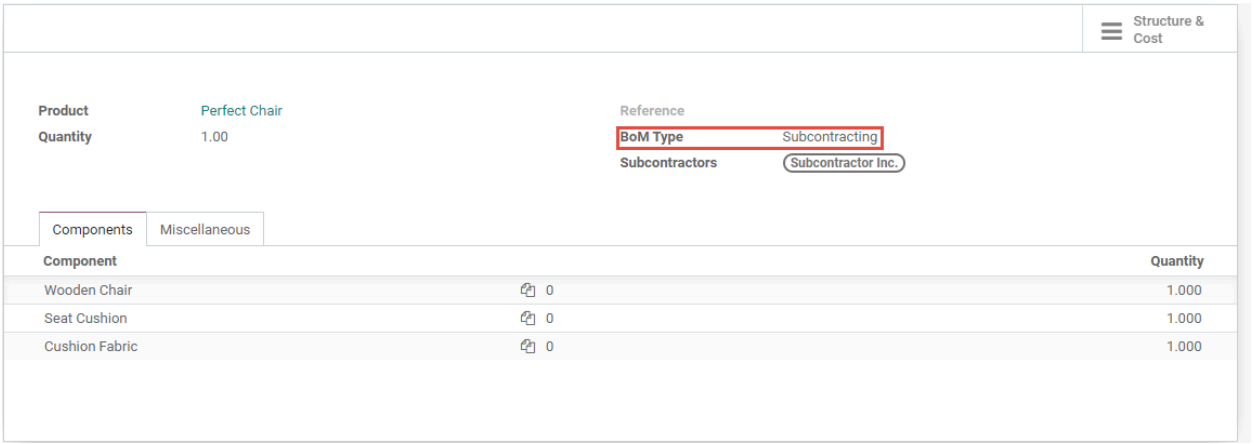
Route: Buy, Make to Order (MTO)

Bill of Material

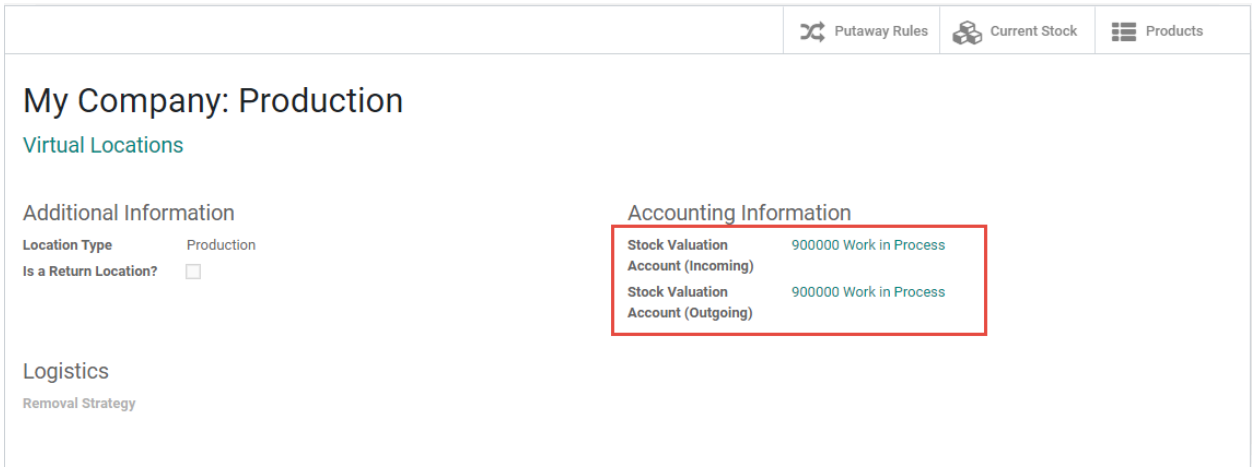
Subassembly: Wooden Chair



Finished Goods: Perfect Chair



Production Location Stock Valuation Accounts



* Access Inventory >> Configuration >> Locations and remove all filters to locate “Virtual Locations/My Company: Production” and set the stock valuation accounts.

Step 1: Sale Order (for Perfect Chair)

Records Triggered

Upon Confirmation:

- Delivery Order
- Purchase Order
    - For Perfect Chair via MTO route on product template

Resulting Journal Entry(s)

- None

Step 2: Purchase Order (for Perfect Chair)

Records Triggered

Upon Confirmation:

- Receipt Order
- Purchase Order
    - For Seat Cushion and Cushion Fabric via MTO route on product template
    - Fulfills subcontractor's need for raw materials to produce finished good
- Manufacturing Order (My Company Manufacturing Operation Type)
    - For Wooden Chair via MTO route on product template
    - Fulfills subcontractor's need for raw materials to produce finished good
- Delivery Order
    - To deliver Seat Cushion, Cushion Fabric, and Wooden Chair from My Company WH to Subcontractor Inc.
- Manufacturing Order (My Company Subcontracting Operation Type)
    - For Perfect Chair to fulfill My Company's need
    - To access the view of these subcontractor MO's
        - Inventory app
        - Overview
        - Active the "Archived" filter
        - Locate the "Subcontracting" operation type for My Company
        - Click into the operation type to view the manufacturing orders

Resulting Journal Entry(s)

- None

Step 3: Manufacturing Order (for Wooden Chair)

Records Triggered

- None

Resulting Journal Entry(s)

Consumption of Raw Materials (Wood Planks)

Account	Debit	Credit
Work in Process (WIP)	$25	
Inventory Valuation (Raw)		$25

* **5** Wood Planks x **$5** per Plank = **$25**

Production of Finished Goods (Wooden Chair)

Account	Debit	Credit
Inventory Valuation (Sub)	$25	
Work in Process (WIP)		$25

Step 4: Delivery Order (for Perfect Chair Components)

Records Triggered

- None

Resulting Journal Entry(s)

- None

* Unlike delivery orders to customers and vendors, delivery orders to subcontractors do not generate journal entries because the subcontracting location is an internal one.

Step 5: Receipt Order (for Perfect Chair)

Records Triggered

Upon validation of receipt:

- Automatically marks the subcontracting MO as “done”

Resulting Journal Entry(s)

The journal entries that are generated upon validation of the receipt are actually triggered by the subcontracting MO, not the receipt itself.

Consumption of Raw Materials and Subassembly (Wooden Chair, Seat Cushion, and Cushion Fabric)

Account	Debit	Credit
Work in Process (WIP)	$50	
Inventory Valuation (Raw)		$25
Inventory Valuation (Sub)		$25

* **$25** Wooden Chair (Sub) + **$20** Seat Cushion (Raw) + **$5** Cushion Fabric (Raw) = **$50**

Production of Finished Goods (Perfect Chair)

Account	Debit	Credit
Inventory Valuation (FG)	$100	
Work in Process (WIP)		$100

* **$50** Consumed Material + **$50** Service Cost (for Subcontractor Inc. to provide the Perfect Chair) = **$100**

** Note that the amount that is credited from the WIP ($100) is greater than the amount debited to the WIP ($50). The difference is equivalent to the cost of purchasing the Perfect Chair from Subcontractor Inc. ($50).

Step 6: Vendor Bill (for Raw Materials)

Records Triggered

- None

Resulting Journal Entry(s)

Account	Debit	Credit
Stock Interim (Rec)	$25	
Accounts Payable		$25

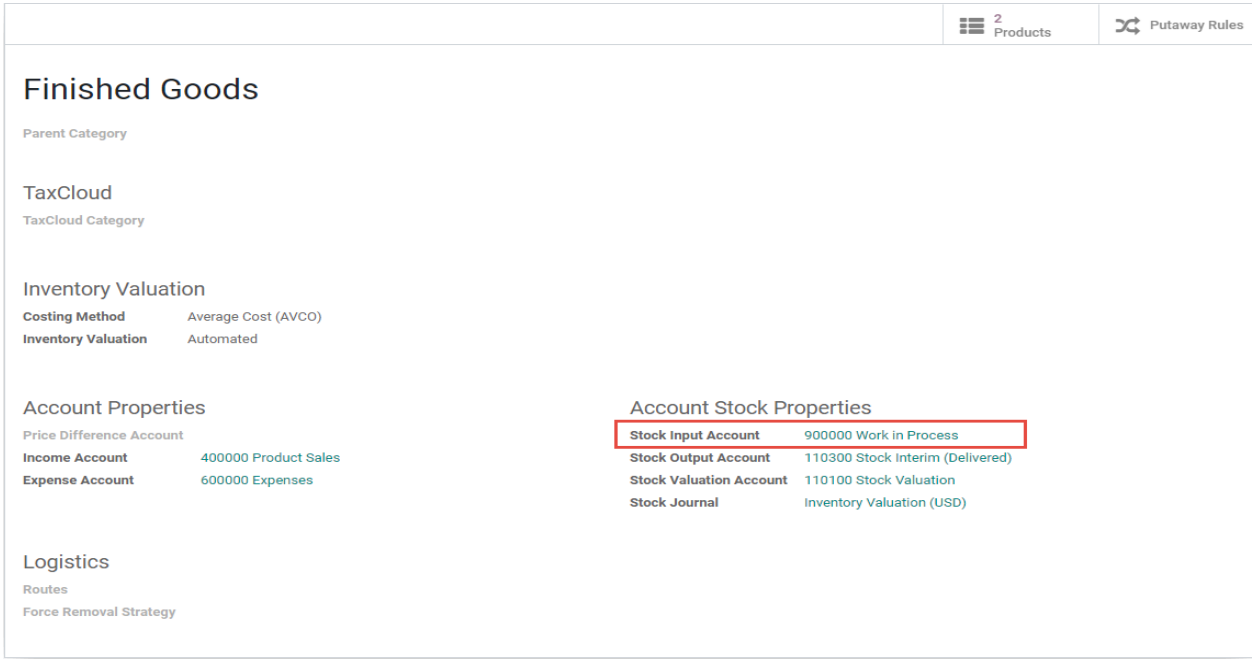
Step 7: Vendor Bill (for Perfect Chair)

Records Triggered

- None

Resulting Journal Entry(s)

Account	Debit	Credit
Work in Process (WIP)	$50	
Accounts Payable		$50



* As mentioned in Step 5, there was still a residual value left in WIP after the processing of the manufacturing order. Because the difference is directly correlated with the cost of the service done on the Perfect Chair, that is the amount that needs to be moved into Accounts Payable. Normally, when receiving a good, the Stock Interim (Rec) account is credited and then later dumped into Accounts Payable once the bill is validated. However, since there was no journal entry generated by the receipt order from the subcontractor, the cost of the good is not counted in the Stock Interim account. The value is held in the WIP account as a result of the manufacturing order.

For this reason, the “Stock Input Account” field on the subcontracted good’s product category should be set to the same WIP account set in the virtual Production location. In this case, the Perfect Chair is the

subcontracted good, which is why its parent category “Finished Goods” is configured as shown in the image above.

Extra Notes

The configurations and workflows, as demonstrated in this document, function properly from an accounting standpoint. However, it is possible that the client prefers to have separate accounts to handle WIP for in-house manufacturing and for stock currently being processed in a subcontractor location.

In this case, it is advisable to not only create two separate accounts, but also, to create a second virtual “Production” location, in which the accounts could be appropriately set as defaults. For example, the in-house Production location would have the standard WIP account set as the default stock valuation accounts, and the subcontractor Production location would have the second “WIP” account set as the default.

Make sure to set the default production location for the subcontracted product (on the product template) as the new subcontractor Production location.