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NATIONAL ASSOCIATION
of
COST ACCOUNTANTS



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Purchase Records

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233 BROADWAY NEW YORK CITY

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Purchase Records and Purchase Orders

Adapted from a paper presented before the Boston Chapter

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PURCHASE ORDERS AND PURCHASE RECORDS

A paper on the subject of purchasing should not be confined to the technical details of orders and records. A cost accountant who undertakes to construct the cost methods of a manufacturing plant should understand the administrative requirements of an industrial organization as well as the technique of accounting procedure. A discussion of purchasing as related to cost accounting should not, therefore, ignore the organization features and, as will be shown later, there are also legal phases that should receive intelligent consideration.

The writer has recently collected information concerning the purchasing policies and methods of seven industrial corporations. Four of these companies would rank among the largest and best organized in this country and the others are representative concerns in their respective fields. It is well to look to the methods of the largest corporations for examples of efficient practice, for such companies have been more successful generally in developing the simplest and most effectual means of organization. Despite the fact that the requirements of large corporations are necessarily far more varied, their methods are usually applicable in principle to smaller concerns.

Viewing the general subject then in its broadest aspects and drawing upon the practices of large and well-organized corporations for illustrations, the author will discuss purchasing under six subdivisions, as follows:

1. General functions of purchasing.
2. Organization of purchasing department in relation to other divisions of the business.
3. Purchase requisition.
4. Purchase order form.
5. Other purchase forms.
6. Relation of purchasing to cost accounting.

GENERAL FUNCTIONS OF PURCHASING

The main functions of purchasing may be defined in logical order as follows:

1. Obtaining and recording information as to prices and

sources of supply of materials required for fabrication or other use at the plant and for resale.

2. Reviewing requisitions issued by heads of departments authorized to initiate proposals for purchase of materials required.
3. Preparing and issuing to vendors purchase orders and supplementary orders, if necessary, to cancel or modify original orders.
4. Corresponding with vendors to insure delivery on or before scheduled dates of shipment.
5. Verifying purchase invoices as to agreement with purchase orders and with reports of materials received and as to correctness of prices, terms and calculations.
6. Preparing and issuing debit and credit invoices to vendors to adjust claims and any errors in purchase invoices.

The above functions are, in practice, assigned to the purchasing department. Other functions which may be delegated to the purchasing department in smaller concerns but do not usually come under the jurisdiction of the purchasing department in larger corporations are the following:

7. Receiving—having to do with the verifying of quantities of goods received by actual count or measurement and reporting of the quantities received.
8. Inspection—having to do with the examination and testing of materials received to determine whether they correspond with the specifications in the purchase order, especially as to quality.
9. Traffic—having to do with the classification of shipments, determination and verification of freight rates, expediting transportation and adjusting claims with transportation companies.
10. Storage—having to do with the receiving of materials into the stockroom, care of and accountability for materials on hand, and delivery of materials to the shop on factory requisitions.

ORGANIZATION OF PURCHASING DEPARTMENT IN RELATION TO OTHER DIVISIONS OF THE BUSINESS

In the corporations investigated, the purchasing agent, or head of the purchasing department, reports directly to the president. He co-operates with the production, engineering, traffic (if a distinct department), credit, accounting and sales departments. He does not, as a rule, determine when orders should be placed for purchase of materials. The origination of requests for purchase is normally a function of departments outside of the purchasing department. The purchasing agent acts, as the name implies, as an agent for

other departments of the plant. The purchasing agent, nevertheless, should advise other departments of favorable quotations and opportunities to contract for large supplies of material for which there is considerable demand within the plant. The purchasing agent should be in constant communication with other departments to the end that the corporation may buy its materials on the most favorable terms and insure delivery of materials as needed.

Every corporation has to decide for itself to what extent it shall centralize its purchases. The object of centralization is to avoid competition between two or more factories which might enter the market for large quantities of identical materials.

Of the corporations investigated, the majority have succeeded in centralizing the bulk of their purchases under the general purchasing agent. One of the largest corporations, with factories in different parts of the country, now makes 90 per cent of its purchases from the central purchasing department.

A policy of centralization does not contemplate the total elimination of purchasing by local factories or branches. It is recognized that special circumstances may warrant the placing of orders with vendors by local managers. In case of breakdown, for example, it is important that the local organization should be able to secure repair materials without delay, and the local manager should have authority to issue purchase orders in any emergency without waiting for the approval of the central purchasing agent. Again, it may be desirable under certain conditions for a branch to make purchases in its immediate locality even though the same goods might be procured elsewhere at lower prices. These instances, however, are exceptions merely to the general policy of centralization which many large corporations are seeking to attain.

The tendency is towards greater centralization in all the companies investigated, except one. This concern has separate manufacturing plants, each operating as a unit. Each unit makes purchases of many kinds of material without reference to the central purchasing department. Units of the same organization are purposely thrown into competition with each other for price, supply and delivery. The local factories, however, are not permitted to negotiate purchases of basic materials that are used in very large quantities. Contracts for such materials are negotiated from the central executive offices, and the local factories place orders for delivery of the materials as wanted.

PURCHASE REQUISITION

The purchase requisition is the form on which is initiated the request for purchase of material. As already stated, it originates usually outside of the purchasing department. In industrial organizations the heads of the production, engineering, sales and office departments are customarily authorized to issue purchase requisitions. The stock records of direct materials and supplies and the requirements of the production schedule regulate the quantities

carried in stock and to be ordered on the purchase requisitions. Contracts for basic materials which are used in large quantities may be placed by the purchasing department, subject to the approval of the President of the corporation, in order to secure the benefit of low prices.

From an accounting standpoint, it is essential that each purchase requisition should specify the symbol of the account to be charged with the amount of the purchase invoice. Decision as to the account to be charged should not be deferred until the invoice is received but should be determined and approved before the purchase order is issued to the vendor.

PURCHASE ORDER

The procedure of the purchasing department may be said to center around the purchase order form. There are several important points in the design and use of this form, which should be understood and provided for by any cost accountant who may be called upon to develop or improve the methods of a purchasing department. These are:

1. Instructions and conditions.
2. Size and extra copies of purchase order form.
3. Account symbol.
4. Uses of purchasing department's copy of purchase order.
5. Changes in original orders.
6. Distribution of purchase invoices.

INSTRUCTIONS AND CONDITIONS

There is great variation in the printed Instructions and conditions on purchase order forms of large corporations. A composite list of typical instructions and conditions would include the following:

INSTRUCTIONS

- Ship via.....
- Invoices must be rendered in duplicate.
- Mail bill-of-lading with invoice.
- Order number must appear on all invoices.
- Acknowledge receipt of order and specify delivery date.

CONDITIONS

- Materials are subject to inspection.
- Goods in excess of quantities ordered will be returned at vendor's expense.
- Packing and carting charges will not be allowed.
- Right to cancel is reserved if order is not filled within a reasonable time.

Seller guarantees that sale or use of articles will not infringe any United States patent.

Corporations should rely on legal advice in the drawing of instructions and conditions on purchase order forms. The law of contracts varies in different States and is highly technical. The conditions printed on many purchase order forms would not be binding on the vendor because they would not be construed by the courts as a part of the contract of purchase. It is a general principle that printed matter not in the body of the contract is not a part of it unless specifically referred to in the body of the instrument itself. It is with the view of conforming with this principle that the conditions on purchase order forms are often prefaced by a sentence similar to the following:

By acceptance, seller agrees to all conditions specified on the face and back of this order.

Or

This order is placed subject to your exact compliance with the following conditions.

For those who are interested in reading actual decisions in cases which have turned on the construction of purchase orders, the following citations are submitted:

Anaconda Copper Mining Company vs. Houston, 107 Illinois Appeals, 183.

Miller vs. Hannibal & St. Joseph R. R., 24 Hun., 607.

U. S. Illuminating Co. vs. Fisk, 78 Hun., 328.

Atlas Shoe Co. vs. Bloom, 209 Massachusetts, 563.

McKinney vs. Boston & Maine R. R., 217 Massachusetts, 274.

Schaller vs. Chicago & Northwestern Ry., 97 Wisconsin, 31.

Missouri, Kansas & Texas Ry. vs. Patrick, 144 Federal Reports, 632.

French vs. Merchants & Miners' Transportation Co., 199 Massachusetts, 433.

ACCOUNT SYMBOL

The symbol of the account to be charged with the amount of the purchase invoice should be typed on the purchase order from the purchase requisition. It is customary also to type the requisition number on the purchase order to facilitate reference.

SIZE AND EXTRA COPIES OF PURCHASE ORDER FORM

The purchase order form should be of such size as to lend itself readily to convenient filing as well as to provide adequate space for the specifications of materials ordered. There is great divergence of practice among corporations in the methods of following up orders and in recording promised dates of delivery, quantities received and billed, transportation charges and the amounts of invoices. This variation in practice accounts in great measure for the difference in sizes of the forms. No two purchase order forms

of the seven corporations investigated were of the same size. The sizes of these forms (left-hand side given first) are as follows:

11x8½; 9½x6¼; 8¼x9; 11½x9¾; 7x8¾; 10½x6½; and 5x8.

Two of the companies make three copies of the purchase order form; one, four copies; and the others, five copies. All the corporations follow the practice of distributing one copy each to the vendor and to the receiving department and retaining one for record in the purchasing department. Where more than three copies are prepared, the fourth and fifth copies are used for follow-up in the purchasing department, or are distributed to the accounting department or the production department, or are forwarded to the vendor for acknowledgment.

USES OF PURCHASING DEPARTMENT'S COPY OF PURCHASE ORDER

The reverse side of the carbon copy of the purchase order form that is retained in the purchasing department usually provides for the accumulation of data. Many companies insist that all the data pertaining to the progress of an order should be recorded, including:

- Promises and follow-up.
- Quantity and date billed.
- Quantity and date received.
- Balance due.
- Amount of invoice.
- Transportation charges.
- Patterns and samples shipped and returned.

It is advantageous to collect all of the above information in one record. An individual whose duty it is to correspond with a vendor about delayed shipments or shortages in quantities received or patterns not returned can accomplish the task much more quickly and effectively if he is able to obtain from one file a form or folder containing all the facts pertaining to a given order. Aside from the element of convenience of such a method to the employees of the purchasing department, the centralization of data is desirable from administrative and accounting standpoints. To cite one example only, the internal verification of transportation charges and amounts of invoices is most effectually handled if these items are brought together on one record.

CHANGES IN ORIGINAL ORDERS

The efficiency with which records are kept in the purchasing department can often be tested by an examination of the procedure for handling cancellations and changes in original orders. Many purchasing departments do not give this matter the attention which it deserves. The report of the Special Committee to the New England Purchasing Agents' Association on Standardized Purchase Records and Forms, for example, does not contain any recommen-

dations for suitable methods of handling changes and cancellations.

Every purchasing department should establish a definite procedure for the originating, approving and recording of changes and cancellations in original orders. One large corporation has special forms of distinctive colors for advising vendors of changes in original orders. The carbon copies of these change orders are filed with the copies of the original orders. Corporations that do not have special forms for this purpose should, at least, attach copies of the correspondence relating to changes to the copies of the original orders or file them in the same folder therewith. The size of the purchase order form should be adaptable to filing with copies of change orders or correspondence.

DISTRIBUTION OF PURCHASE INVOICES

Purchase invoices should pass from the incoming mail clerk's desk directly to the purchasing department. Each invoice should then be stamped with an imprint designating, in order of sequence, every approval to be required and check to be applied in verification of the invoice. One of the functions of the purchasing department, as previously stated, is the verification of purchase invoices. The routine should include the following steps:

Verifying date of invoice.

Checking invoice with purchase order.

Checking invoice with receiving report.

Verifying price and terms.

Verifying transportation charges or allowances.

Verifying calculations on invoice.

Posting invoice to purchase record.

Approval of invoice by purchasing agent.

Designating by symbol the account to be charged.

The symbol of the account to be charged should be transcribed from the copy of the purchase order. Each purchase invoice, when forwarded to the accounting department, should contain on its face a definite record of the account to be charged.

OTHER PURCHASE FORMS

Forms used by the purchasing department other than the purchase requisition and the purchase order are the following:

Request for quotation.

Quotation record.

Debit and credit invoices for adjusting errors or claims with vendors.

Purchase record (card or sheet for each article).

Catalogue index.

Index of vendors (according to kinds of business to indicate sources of supplies).

These forms will not be described in this paper because they do not bear a direct and close relation to cost accounting. For those

who are interested in making a complete study of the purchasing department forms, the following list of references is given:

Twyford: Purchasing—Its Economic Aspects and Proper Methods, published by D. Van Nostrand Company, New York, 1920.

Rindsfoos: Purchasing, published by McGraw-Hill Book Company, Inc., New York, 1915.

Gerstenberg: Principles of Business, Chapter 17 on Purchasing, published by Prentice-Hall, Inc., New York, 1919.

New England Purchasing Agents' Association: Purchase Records and Forms, published by the Association, George A. Rust, Secretary, Boston, 1919.

Bennett: Constructive Accounting (Vol. 2 of Business Accounting), published by The Ronald Press Co., New York, 1920.

Nicholson and Rohrbach: Cost Accounting, Chapter VI, published by The Ronald Press Co., New York, 1919.

RELATION OF PURCHASING TO COST ACCOUNTING

The normal organization of purchasing methods as described in this paper accommodates the requirements of accurate cost accounting. It is essential from the cost accounting standpoint:

1. That authority to initiate requests for purchase of materials should be definitely fixed.
2. That requests for purchase of materials should be written on a prescribed form of purchase requisition which shall pass to the purchasing department for review and approval.
3. That each purchase requisition should state the specific object for which the proposed purchase is to be made, as expressed in terms of the symbol of the account to be charged.
4. That orders to be placed with vendors should be issued only on a prescribed purchase order form.
5. That the procedure of the purchasing department should insure complete verification of each purchase invoice, comparison with the corresponding purchase order, and checking with an independent report of material actually received at the buyer's plant.
6. That each purchase invoice, as forwarded to the accounting department, should bear on its face evidence that all authorizations, verifications and approvals have been duly attended to, and should indicate the symbol of the account to be charged.

The above requirements sum up the relation of purchasing to cost accounting.