**Note 4: PURCHASING PROCEDURE**

By the introduction of proved purchasing procedures, the high cost of investment in purchases can be reduced and savings effected in such items as obsolescence, pilfering and stock shortages.

Briefly, the objectives of the purchasing department are to procure goods and services of the right quality, in the right quantity, at the right time, in the right place, and at the right price.

**Organization in the Purchasing Department**

In each industry and in different works within an industry the detailed organization will vary according to particular conditions and ideas, but the general procedure and principles outlined in this unit may be regarded as typical, although particularly suitable for an engineering or similar factory. The forms used as illustrations are based on some actually in use, but again will vary in ruling and wording to suit particular needs.

A large engineering firm will require an efficient purchasing department, while, on the other hand, a small concern may have all functions, including purchasing, carried out by the owner. However, it is essential that in any company, whether large or small, only one person or one department should be authorized to place orders with suppliers, otherwise purchase orders may be duplicated. The head of the department is usually designated as chief buyer or purchasing agent. In a large manufacturing business he has considerable responsibility, because much money can be lost or saved by his department. He requires a good technical knowledge of the industry and a large measure of administrative and organizing ability; he must keep in constant touch with market prices, reports, and market tendencies, and have a working knowledge of contract law and procedure, together with a practical understanding of the principles of economic laws.

In some large businesses buying has been decentralized; in other words, each department is responsible for its own purchasing. However, most businesses operate one buying department, which is usually a very satisfactory arrangement.

**Centralized Buying**

The advantages of centralized buying are:

(a) a firm policy can be initiated with regard to conditions of purchasing, e.g. terms of payment;

(b) standardization of articles is facilitated;

(c) expert buying staff is concentrated in one department;

(d) the number of people authorized to make purchase commitments is reduced;

(e) combined purchasing power may result in reduced prices of commodities.

The disadvantages are:

(a) the creation of a special department may lead to high administration costs;

(b) the purchasing procedure is much less flexible than that geared to special departments.

**Procedure in the Purchasing Department**

The buyer should be provided with a schedule of technical specifications of the materials usually required, each item having a code number which will be quoted by those issuing purchase requisitions.

The department should keep files suitably indexed, both under the names of suppliers and materials. Records of prices and quantities for all materials should be kept in schedule form, arranged to show the seasonal and other movements of prices.

No purchase should be permitted except of duly authorized purchase requisitions, but in the case of materials largely and regularly used, forward contracts may be made after consultation with management. Where purchase contracts are placed, a record of orders issued against them and deliveries made should be kept.

**The Purchase of Materials**

The buyer acts upon requisitions received from the storekeeper for all stores materials and, in some instances, other requisitions may come from the engineer, drawing office, or other responsible sources for new kinds of material not previously stocked, e.g. special materials for a particular order or new design. Consideration must be given to factors other than price, viz. to specifications, conditions of delivery, various charges, times of delivery, terms of payment, and discount.

The purchase requisition (Fig.1) may be routed as follows:

(a) to the purchasing department

(b) to the production control department;

(c) retained in the issuing department.

After the buyer has decided which quotation is most acceptable, a purchase order (fig. 2) is prepared, which is evidence of the contract between the buyer and the supplier. The number of copies of the purchase order which is prepared depends on the organization of the business: a large concern may use five copies while a small concern may

use only three copies. These may be routed as follows:

(a) to the supplier;

(b) to the receiving department;

(c) to the accounting department;

(d) to the department which initiated the purchase requisition;

(e) retained in the purchasing department.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **PURCHASE REQUISITION**  Date: 23rd Feb.20… No: 3208  Date Required: 1st March, 20… Department: central stores | | | | |
| **Quantity** | **Description** | **Stock Code Number** | **Purchase Order Number** | **Supplier** |
| 3000 | 50mm x 10mm  Steel Carriage Bolts | S.B.23 | 9790 | Universal Supply |
| Requisitioned by: **T. Y Tonia** | | | Approved by: **Jubilee** | |

**Figure 1: Purchase Requisition**

Requisitions for materials regularly kept in stock might be initiated by the storekeeper, for other types of materials by the department requiring them.

**Note**: The last two columns are completed by the buyer.

The important work of following up deliveries by due date is the duty of the buyer. For this purpose, the copy purchase order, which is retained in the department, may be filed in delivery date order as stated on each copy by the buyer, so that probable daily deliveries may be checked.

Any delays must be followed up by writing to the supplier.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **PURCHASE ORDER**  No: 9790  From:  **M. Jubilee**  **Kaduna**  **To:** Universal Supply **Our Ref:** 3208  Zaira Date: 24th Feb. 20…  **Please supply, in accordance with the instruction herein, the**  **following.** | | | | |
| Q**uantity**  3,000 | **Description**  50mm x 10mm  Steel Carriage Bolts | **Price**  N 0.10 | **Unit**  each | **Delivery**  28th Feb. 20….. |
| **Delivery**  Free  Buyer | **Ship to:**  Central Stores | **Terms:**  5% Monthly  Account | **Account**  No: 57 | **Signed by:**  D. Destiny |

Figure 2: Purchase Order

Care should be taken to ensure that the purchase order specifies the date and terms of delivery, and the cash discount available if payment is made within the stipulated period.

**Use of Code Numbers for Materials**

The use of code numbers for identifying each item carried in the stores is an advantage, not only to the purchasing department and production control department but also to the stores ledger clerk, in that ambiguity in description of articles is eliminated and much time and writing is saved. The code may consist of symbols and numbers, or numbers only. For example, the symbols B and S could be given to represent brass and steel; the number following the symbol to identify the size, quality, etc.: thus, B.0640 for brass screws of the same size.

All standard articles will have identifying symbols and numbers, so the system will require careful compilation. In practice, storemen, clerks and draughtsmen find these codes easy to work with, since the code numbers of the more frequently used materials are readily memorized.

In the cost department the pricing of issued material is facilitated, and uncertainty as to size and kind of material is avoided.

**Procedure on Receipt of Materials**

Delivery notes or advices of dispatch usually accompany deliveries from suppliers, so these should be directed to the receiving clerk or storekeeper. Invoices received are passed direct to the accounts department to be checked for payment.

Materials entering the factory should be unloaded at special receiving centres. These should be situated as near to the road, railway siding, canal, or wharf as possible, yet at the same time be accessible from any part of the factory, so as to minimize handling charges.

The receiving department should receive a copy of the purchase order, so that, if necessary, arrangement can be made to unload the materials special apparatus may be necessary to handle heavy or bulky materials.

However, it is often advisable that this copy should not show quantities ordered, but only indicate that a shipment of certain materials is expected; these results in the receiving clerk being obliged to check the goods physically rather than to rely on data shown on the purchase order as a guide to quantities received.

Goods should be inspected for quality to ensure that they comply with any specification which may have been stated on the purchase order. In may large firms an inspection department is attached to the receiving department, while in small firms the storekeeper is responsible for inspection. If any goods are rejected the inspector will enter the reason for rejection on a special rejection report, so that the buyer is immediately informed and can contact the supplier.

**The Goods Received Note**

Full particulars of goods received are entered on a goods received note (Fig. 3). Routing of the goods received note will depend on the organization.

A suggested routing is:

a) to the purchasing department;

b) to the accounts department;

c) to the department which initiated the purchase requisition;

d) to the stores;

e) Retained in the receiving department.

The completed goods received note is then passed to the official responsible for approving the goods, who signs the notes and sends them, with the goods, to the storekeeper. Where the storekeeper is responsible for receiving and approving goods, he will prepare the goods received note. When the purchasing department receives a copy of the goods received note, together with the receiving clerk’s copy of the purchasing order, the order can be marked off in the order book.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **GOODS RECEIVED NOTE**  **From:** S. Garwa & Co. G.R. No. 59  Kaduna **Date:** 5th March 2000 | | | | | | | |
| Goods | Quantity | Packages | | Order No | For Office Use Only | | |
| Rate |  | N |
|  |  |  | | 4721 |  |  |  |
| Carrier  BR | Received  by  P.Maman | Goods Inspection  Report  Correct. J. G | | |  |  | |
| **Purchase**  **Requisition**  **No.**  284 | **Noted on**  **Progress**  **Chart**  5/621 | **Bin**  **No.**  72 | **Stores**  **Ledger**  212 | | **Invoice**  **No.**  360 | **A/cs. Ref**  P.J.84 | |

**Figure 3** Goods received note

This note is made out by the receiving department when goods are received, and is priced by the cost department from copy orders. It forms the basis of entries in the stores ledger made in advance of receipt of invoices, with which they are later agreed.

**Checking Inward Invoices**

Invoices received are numbered consecutively on entry into the invoice register. The purchasing department clerk enters on it the order number, goods received note number, and signs for the accuracy of the particulars ascertained from the copy order and the goods received note.

The copy order retained should be marked with the invoice number and goods received note number, to preclude the passing of a possible duplicate invoice. If the invoice is in order, the buyer will sign and pass it to the accounts department for payment. There, it will be checked to ensure that any calculations are correct. The invoice is entered in the purchase day book, from which the supplier’s account is credited in the creditor’s ledger. The total purchases day book is debited to purchases account in the general ledger and credited to creditors control account.

**Note 5: STORES ROUTINE**

In most manufacturing companies, a large part of money invested is represented by stocks. Serious losses may be suffered in companies with inefficient stores techniques. Insufficient stocks may result in costly production hold-ups, or rush shipments may mean increased costs of production. On the other hand, stocks which are too large result in capital being tied up unnecessarily, and increased costs of storage and obsolescence.

**Importance and Location of the Stores**

The stores in many small firms is often neglected, and it is not realized that materials represent an equivalent amount of cash. Material pilferage, deterioration of materials, and careless handling of stores lead to reduced profits, or even losses, so it is essential that to obtain the maximum advantage of a cost accounting system, an efficient, well equipped stores, be maintained.

**Location of the Stores**

The organization of the stores will depend on the type of industry, size of the firm, and policy of the management. However, in general, we can define two types of stores organization central stores and sub-stores. The location of the stores should be carefully planned so as to ensure maximum efficiency. It should be as near to the receiving department as possible, so that haulage charges are at a minimum. At the same time, there should be easy access to all departments especially to those in which heavy or bulky materials are to be delivered.

In large factories where there are many departments it is possible that the stores cannot be situated where it is convenient to deliver to all departments and at the same time be near to the receiving department, so it is often necessary to set up sub-stores to serve a particular part of the organization. The central stores will then issue to the sub-stores the materials specially required for the department or departments serviced by the sub-store. It is strongly recommended that the storekeeper of each sub-store should be responsible to the chief storekeeper. This will ensure that a uniform policy of buying, storing, and issuing is followed.

**Centralized storage**

The advantages of operating central stores as compared with sub-stores are as follows:

(a) economy in staff and concentration of experts in one department;

(b) reduced clerical costs and economy in records and stationery;

(c) better supervision is possible;

(d) staff become acquainted with different types of stores, which is very useful if anyone is absent from work;

(e) better layout to stores;

(f) inventory checks facilitated;

(g) stocks are kept to a minimum, thus reducing storage space;

(h) fewer obsolete articles;

(i) the amount of capital invested in stock is minimized.

**The disadvantages are likely to be**:

a) increased transportation costs;

b) the stores may be situated at some distance fro may departments, thus causing inconvenience and delay;

c) breakdowns in transport or hold-ups in central stores may cause production stoppages in departments.

**Layout of the stores**

Shelves, racks, bins, etc, should be situated in clearly defined lanes, so that easy access is possible. In many cases it may be necessary to allow enough room for the passage of trucks, so white lines should be painted on the floor, determining the position of storage containers.

**The Imprest System**

It is sometimes the practice of large organizations to use the imprest system of stores control, which operates in rather a similar way to a petty-cash system. For each item in stock a quantity will be determined, which represents the number of articles which should be on hand at the beginning of any period. At the end of a period the storekeeper of each sub-store will requisition from the central stores the number of articles required to bring the stock up to the predetermined quantity.

For example, let us assume that the imprest amount which has been set for a material is 1,000 units. During the week ending 28th July, issues of the material have reduced the stock to 280 units. The sub-storekeeper would issue a requisition from the central storekeeper for 720 units to ensure that at the beginning of the next week 1,000 units are in stock.

**The Storekeeper**

The stores should be under the control of one person, who may be known as the storekeeper, chief storekeeper, or stores superintendent. He should be a man of wide experience in stores routine, able to organize the operation of the stores, of undoubted integrity, and capable of controlling men under his authority.

His duties and responsibilities may be as follows:

a) maintaining the stores in a tidy manner;

b) accepting materials into the stores, after having ascertained that the delivery complies with specifications detailed on the purchase order, goods received note, or stores debit note;

c) correct positioning of all materials in store;

d) checking the bin card balance with the physical quantities in the bins;

e) requisitioning further supplies from the purchasing department

when the recorder level is reached on any materials;

f) preventing unauthorized persons entering the stores;

g) issuing materials against authorized stores requisition notes;

h) advising management of obsolete or slow moving stocks.

**Requisitioning for stores**

The storekeeper is guided when requisitioning for stores, by the maximum and minimum quantity which he is authorized to store in respect of each kind of material, and the recorder level.

The maximum stock is fixed by taking into account such aspects as:

a) rate of consumption of the materials;

b) time necessary to obtain new supplies;

c) finance-if stocks are unnecessarily high, capital is locked up which could probably be otherwise employed;

d) storage space-the provision of, and cost of, maintaining the necessary storage room must be considered;

e) possibility of loss by evaporation, deterioration, etc.;

f) extent to which price fluctuation may be important;

g) risks of changing specifications and obsolescence;

h) Seasonal considerations as to both price and availability of supplies, e.g. market shortages;

i) Economic ordering quantities

**The minimum stock is fixed by taking into account:**

a) rate of consumption of the material;

b) time necessary to obtain delivery of supplies.

The reordering level is the quantity fixed between the maximum and minimum stock figures, at which time it is essential to initiate purchase requisitions for new supplies of the material. This level will usually be slightly higher than the minimum stock figure, so as to cover such emergencies as abnormal usage of the materials or unexpected delay in delivery of new supplies.

It is fixed by taking into account:

a) rate of consumption of the material;

b) time necessary to obtain new supplies.

**Example of the Calculation of Stock Levels**

The materials analyst has forecast the following data in respect of material MS6:

Maximum consumption of material per week: 400 units

Normal consumption of material per week: 300 units

Minimum consumption of material per week: 200 units

Reorder quantity: 2,000 units

Reorder period: 4-6 weeks

**Reorder level**

Maximum consumption x Max. Reorder period=

400 units x 6 weeks = 2,400 units

This level is calculated first, because the maximum and minimum stock levels both include the reorder level in their formulae. It considers the longest period of time and the maximum usage of materials which could be expected.

**Minimum stock level**

Reorder Level – (Normal Consumption x Normal Reorder Level)

RL – (NC x NRP)

2,400 – (300 units x 5 weeks) = 900 units

This level considers the average or normal consumption expected.

Stocks should not normally fall below this level, but the buffer stock is maintained in case of emergencies.

**Maximum stock level**

RL – (Min. C x Min. RP) + RQ =

2,400 – (200 units x 4 weeks) + 2,000= 3,600 units

This level considers the lowest rate of consumption which could be expected if delivery was received in the shortest possible time. The addition of the reorder quantity shows the highest point in inventory which would be allowed. Stocks should never be allowed to rise above this point without special authority.

**Average Stock Level**

This measure the average level of stock held during an accounting period. One simple formula which may be used for calculating this level is as follows:

Maximum stock level + Minimum stock level

2

If we use the figures given in the previous example, it is found that the average stock level is:

3,600 + 900

2

= 2 2,250 units

The average stock level is a useful measurement when considering stores turnover.

**Turnover of Stores Materials**

It is useful to compare the turnover of different grades and kinds of materials as a means of detecting stock which does not move regularly, thus enabling management to avoid keeping capital locked up in undesirable stocks. It is not an infrequent occurrence for a particular item of stock to be overlooked for long periods unless means are taken to prevent such accumulations. The balance of stores, compared with the total withdrawals, indicates how many times a year the stock is renewed.

The formula is:

Consumption of materials

Average stock of materials