

Automating Purchase Orders to Drive Accountability and Profits

Among the problems that arise as a contractor progresses from small to mid-sized business owner is a loss of control. Losing control of material and subcontractor costs is especially painful because it can jeopardize cash flow and profits.

Growing contractors that no longer purchase items from a single lumberyard, or hire just one subcontractor, must learn to track and manage numerous suppliers and the costs committed to each. Lacking

an accurate system to track and manage these costs, contractors risk overpaying vendors or losing track of supplies.

Fortunately, sophisticated construction accounting systems have automated the processes by which contractors efficiently track and manage their material, supply and subcontractor expenses. Construction accounting software packages with purchase order and subcontract functions allow contractors to bypass the time-

consuming tasks that otherwise would be needed to control these costs.

WHY USE PURCHASE ORDERS?

Businesses use purchase orders because these contracts determine the conditions of the sale. They spell out not just price, but also delivery specifications, payment guidelines and other terms equally important to the sale.

From an accounting and management perspective, the benefit of using purchase orders for construction supplies is twofold:

1. They create a system for tracking the physical or quantity aspect of the purchase agreement.
2. They allow contractors to track the monetary or billing aspect of the transaction.

PURCHASE ORDERS FOR QUANTITY TRACKING

As a contractor grows and its materials/supplies multiply, tracking quantities becomes exponentially more difficult.

Consider the following example. Using no purchase orders, Contractor A orders 100 widgets to complete a current job, but receives only 30. The supplies arrive at the job with a packing list, which is quickly discarded. Meanwhile, the accounting department receives an invoice for 70 widgets. Having no idea what quantity was actually delivered, the contractor issues payment to the supplier. Not only is the company's billing off balance, but no one can confirm how many widgets are at the jobsite or on backorder.

Contractor B uses a purchase order system, but without a sophisticated accounting system has no way of efficiently tracking supply quantities. When supplies arrive at the jobsite, someone verifies the order and sends the packing slip to accounting. The accounting clerk files it with the



original purchase order. When the invoice comes in, the clerk matches the invoice against the purchase order and the packing slip—a time-consuming process.

To eliminate both the guesswork and the manual work of tracking material and supply orders, Contractor C uses purchase orders, a system for verifying delivery and a construction-specific accounting system. If a supplier shorts the contractor by 70 widgets, the packing list is entered into the accounting system where it automatically ties to the original purchase order. A back-order report tells everyone in the office and on the jobsite how many widgets are currently available. If the supplier tries to bill for more than what was shipped, the system notifies the contractor that the invoice does not match the packing list.

Most contractors need to track far more than 100 items at any given time. Some contractors may have 30 jobs going on, with perhaps 15 purchase orders for each job. Depending on the materials and the vendor, each purchase order might involve multiple deliveries and invoices. A well-planned purchase order system, along

with a sophisticated construction accounting system, is the only way these contractors can realistically track and manage job materials and supplies.

PURCHASE ORDERS FOR MONETARY TRACKING

From a financial standpoint, purchase orders are critical because they help contractors track material billings and committed costs. In much the same way, subcontract management systems help monitor billings, retainage and committed costs associated with subcontractors. Using a construction-specific software package, contractors can manage these processes faster and easier while decreasing the risk of payment errors.

A drywall contractor working on a commercial building, for example, might hire a specialty subcontractor to complete \$75,000 of interior stonework. When the project is finished, the job cost report shows a total profit of \$100,000. This looks great until the contractor realizes the subcontractor has billed for only \$25,000 of its work. Suddenly, the contractor's profits have shrunk by half.

THE ADVANTAGE OF TECHNOLOGY

When a purchase order is entered into the software, it generally posts to the job-costing module as a committed cost, and nothing else. Once the contractor receives supplies and the packing slip is entered, those items are marked as "received." Finally, when the supplier's invoice is received and the data is entered in the accounts payable module, it flows to both job costing and the general ledger.

As a result, contractors can produce real-time job cost reports with details such as the total supply order, how much has been received or is on backorder, how much has been billed, and the remaining commitment.

Most sophisticated systems also have safeguards in place to guarantee contractors do not overpay their suppliers and subcontractors. For example, if a subcontractor sent a second \$40,000 invoice to a contractor that committed to \$50,000 of work, a red flag would raise immediately. The system, recognizing that the contractor has only \$10,000 left in committed cost, would prompt the user to put the invoice on hold or go to a change order.

Many construction-specific software programs also offer additional time-saving benefits related to subcontract management. With each invoice entered, not only does a contractor see a summary of the subcontract to help verify billing accuracy, but it also sees the status of certificates of insurance. Knowing that a subcontractor's workers' compensation, liability insurance or safety certification has expired gives contractors the opportunity to avoid potential problems.

Material, supply and subcontract costs are all job-related expenses typically charged directly to jobs, but that doesn't mean contractors can't lose money on them. Without the processes and the financial controls in place to manage and track these costs, contractors cannot protect themselves from losses. Construction-specific software technology is the best choice to streamline these systems while improving job cost accountability and profits.

Fred Ode is CEO of Foundation Software, Brunswick, Ohio. For more information, call (800) 246-0800, email fred@foundationsoft.com or visit www.foundationsoft.com.