

# What is the Purpose of a Purchase Order System?



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At some point over the course of small business operations, you will definitely need to purchase goods or services from another company. Whether it's a bunch of small purchases or a few large purchases, you'll need a way to track the orders. A purchase order system allows you to create and execute the orders - from the purchase requisition all the way through to vendor payment to streamline your purchasing process.

## How a Purchase Order System Works

Once you've set up the system with all the users in your organization - from staff who can request items to the department heads that will approve purchases, to the purchasing department who will handle larger purchases, it becomes easy to automate the approval process and pass things to the accounts payable department to handle invoice payment.

## **Purchase Requisition**

When someone requires goods or services for the business, they create a purchase requisition that outlines what they need, who they need it from, when they need it by, where it will be delivered, and how much it costs.

From there, it will go to the appropriate staff member for approval. If it's not approved, the staff member can note why it was rejected, or request changes before approval.

## **Purchase Order**

Once the purchase requisition is approved, it will become an official purchase order that's sent to the supplier. Once it's accepted by the supplier, it becomes a legally binding contract and requires the vendor to send the goods or services that have been ordered.

Each PO is assigned a purchase order number for easier tracking through the system. It includes everything from the requisition, along with the billing address, and any additional terms.

## **Order Fulfilled**

At this point, the vendor has sent the goods or provided the services ordered. The vendor should supply tracking information, so your organization knows when to expect the shipment to arrive.

## **Goods Received**

Once the shipment arrives, someone in the organization acknowledges receipt of the items. Because items may arrive in multiple shipments, it's important to check the packing slip against items that were ordered each time, to ensure you received only items you ordered, and only pay for what you receive.

## **Invoice Processing**

The purchase order system should automate the process of three-way matching, comparing the purchase order to the goods received, to the supplier invoice. In the event that something doesn't match, it is flagged for manual intervention.

When everything matches, it's automatically passed on to the accounts payable department for payment. This ensures no invoices fall through the cracks, allowing you to promptly pay all your vendors, thus strengthening vendor relationships and potentially allowing you to capture early payment discounts.

*In organizations where one department handles the budget, another makes purchases, and yet another pays the bills, a purchase order system lets everyone see what's happening in real-time, whereas paper systems leave plenty of room for error.*

## **Benefits of a Purchase Order System**

### **Improve Order Accuracy**

Sending a purchase order to your supplier is a legal offer to make a purchase. If the supplier accepts the order, it forms a legal document between you and the supplier. Until the supplier accepts the order, there is no contract.

Using purchase orders provides accurate documentation of what has been ordered, in the event of a dispute. The PO lists the quantities, item descriptions, price, discounts, delivery date and instructions, so there is reduced potential for error compared to a verbal order.

Ensuring the details on the PO are correct will also make paying the associated invoice much easier.

### **Better Purchase Management**

Since the PO system outlines costs before a job begins, it's easier to see how budgets are affected. You can place an order for a single project, or multiple projects at the same time.

When you order goods or services for a project, apply the project reference to the order so you can link the goods on the order to the project. This automates allocation of stock and costs to the project at every stage of the purchase order life cycle, so you can provide accurate quotes.

If you want your POs to be accurate, you must calculate actual purchase order

quantities to determine the costs before a project begins.

## **Save Time and Money**

When suppliers send invoices that reference your PO number, employees don't have to spend time checking to make sure the bill is legitimate. Because the PO becomes a contract once the supplier accepts it, it eliminates any dispute in that regard.

Because of the PO process, the invoice should be entered into your accounting system with reference to the original PO, recording delivery and updating stock levels automatically. Faster payment times mean you save money in terms of invoice processing costs because it takes less time to process them, allowing your team to be productive with other tasks.

## **Conduct Business with Government Agencies**

The majority of government agencies will not pay invoices until they receive a valid purchase order. Without the ability to create POs, you're limited in terms of your business opportunities.

If you're producing purchase orders, you're telling others you're on top of your finances and cash flow, so you can gain more confidence over businesses that don't use a purchase order system.

## **Streamline Your Stock**

With an effective purchase order software in place, you can easily see your financial investment on inventory for better inventory management. You'll be able to see current stock levels, reorder levels, stock on hold, and free stock. This gives you a level of clarity and control that many businesses lack - which leads to stock shortages. Using purchase orders gives you visibility into all these areas, in addition to costs and sales process, so you can better see the profit margins on each of your products.

## **Discover Your Best Suppliers**

Do you know your best suppliers are? Do you know who you're ordering most of your products from? Do you know what you've been paying for past products, and

whether or not you should be receiving discounts per your contract or because of your purchase volume?

Many businesses leave these questions unanswered, and as such are doing themselves a great disservice.

Your purchase order system will allow you to more quickly and easily see which suppliers are taking care of the majority of your needs. You'll also be able to determine which suppliers are not holding up their end of the bargain - through consistent late deliveries, out of stock items, and so on.

This information allows you to see when it's time to drop a vendor in favor of another supplier, or when it's time to negotiate better payment terms with some of your suppliers.

Operating with a solid purchase order system ensures your business has access to a great deal of information to help you make data-driven decisions. With information about what you're spending, where you're spending it, and who you're spending it with will help you inform choices in the future to accelerate growth and improve profitability.

## **What's your goal today?**

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