The Internal Magic of Creating Purchase Orders from OE Orders

As referenced in the first installment – "Creation of POs directly from OE orders" in T&T #50, these features are described in both the Order Entry Users Guide (search for "Purchase Order Automation") found in the "Orders" chapter under the "Two-step Orders/Order Line Items" section and in the Purchase Order User Guide (search for "Automated Purchase Orders") found in the "Purchase Orders" chapter. We recommend reviewing T & T # 50 and # 51 prior to reading this one since this installment is entirely dependent on these discussions (https://www.passport-training.com - selecting Tips and Tricks from the title bar.)

Recap

We left the discussion of the auto-create of POs from OE orders with the following snapshot of the bottom of the OE screen showing the results of having created a line item in OE that generated a line item in a PO.

Having saved the OE line item, the program has also created the PO line item and here displays the PO number and line number of that PO line item. Although the unit cost in this example as dictated by average cost is 14.01, the operator has decided to use 14.20 as the unit cost to be used in that PO line and this will automatically be inserted into field 10 (Unit Cost) for that PO line. The operator can alter the price, later, just like an ordinary PO.

Data Flow

Leaving the processing flow perspective, let's turn to the flow of data by the various automated processes here, and that will lead to a discussion of Costing. Let's start with a "normal" OE order/invoice and a "normal" Purchase Order i.e. when these documents are produced separately and there is no direct connection between the selling steps and the purchasing steps. In this case, there are three main points that are important:

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a) Orders are, by definition, non-accounting entries and that means that the entry of the order does not affect the accounting system in any permanent financial fashion. The quantities and dollars in an order are not really accounting/financial values so much as process indicators/statistics. This is also the reason why you are able to go in and change virtually everything in the order.

b) The second important point is that financial information is only, definitively, calculated at the moment that each line item is posted. To be clear costing and profitability numbers are available during the course of processing the order through entry, edit and printing the invoice but these are effectively just estimates. Only when the order is posted as an invoice will the pricing and costing become fixed.

c) The posting process for an order involves the OE program "sub-contracting" to the AR Misc. Charges function for the Sales side of the operation and to the IC Inventory Transaction function for the Costing side of the transaction. Each of these two operations normally generates a two-sided balanced set of GL transactions (although it can be more complicated). For OE and, in addition to the obvious functions of updating AR Open items and Sales History, the GL transactions generated are a Debit to the AR account and an offsetting Credit to a Sales/Revenue account. Assuming that this is a sale that ships stock, for the IC side of the transaction, besides updating inventory counts and purchase history, GL transactions are normally a Debit to a Cost of Sales account and a credit that typically goes against Inventory (reduction to stock) and records the reduction in stock.

For the Purchase Order the relationships are similar with some important differences. Both differences result from the fact that the vendor controls both when they ship the goods and when they send their invoice for the goods. Recall that a Purchase order goes through two steps, first the creation of the PO itself (including the printing of the PO document) and then second, the Receiving step where delivered stock is booked into inventory.

The first difference is seen in the Receiving step. This is analogous to the OE Select-for-Billing/Invoice print/Posting step except that the printing of the Purchase Order itself is done in the first step and in OE it is in the second step. This difference occurs because in PO there are two posting steps – one for the PO and one for the Receiving. And this, in turn, is primarily due to the fact that in OE your business controls when the invoice is issued and when the shipment is made i.e. when costing calculations are done; whereas in a PO the vendor controls when the product is shipped and therefore when the Receiving is done which determines the time when costs can be (finally) calculated.

Like OE, the PO application calls/sub-contracts its work to the IC Inventory transaction programs during the Receiving posting to update quantities and to do the GL distributions.

The fundamental similarity between PO and OE is that the Purchase Costs (PO) and Sales Costs (OE) are both determined at posting time in the second step and in both cases the IC Inventory Transactions function is invoked to determine the costing calculations recorded.

Accruals

The second difference between the OE and PO data flow is that the Purchase Order system must accrue the cost of the received inventory because as mentioned above, between when you receive

the goods whose costs will update inventory and when you receive the vendors invoice with what should be the confirmed costs for those goods, there is a period of time when the receiving cost must be held as a non accounts payable "pre-liability" – i.e. the costs haven't been formally invoiced to you by the vendor and therefore it has not been vouchered by you to create the accounts payable liability. In PBS terms this "pre-liability" is referred to as the "Balance Sheet Liability" account and the account is setup in the IC control file. A better name for this account might be the Uninvoiced Receivings (UIR) account i.e. the value of received inventory that has not yet been invoiced to you and therefore cannot, yet, be considered an acknowledged liability (i.e. vouchered into Account Payable).

The bottom line for items that are being received into inventory, the GL distributions generated out of a Receiving posting are a Debit to Inventory and a Credit to the UIR account. Note this makes sense in that the debit increases the asset value of inventory and the credit increases the "pre-liability" liability and therefore acknowledges a future indebtedness to the vendor. Note also that when the vendor invoice is received and vouchered the posting will credit the AP account acknowledging the now "real" liability and must debit the UIR account (instead of the normal expense account) to clear the "pre-liability" value in it. In this way the vouchering actually acts like a reclass of the UIR to the AP which is actually the accounting equivalent of acknowledging the conversion of an anticipated liability into an actual one.

In the next and last installment of this series we will finish our deep dive into the costing considerations that come from separate Order Entry and PO postings, versus the autogenerated ones.