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Accounting, Purchasing and Supply Chain Management Interface

Rafiu Akinpelu Olaore[1,] Nafisat Toyosi Adebisi[2]

Department of Purchasing & Supply, Faculty of Management Studies, Osun State Polytechnic, Iree, P. M. B. 301 Iree, Osun State, Nigeria

Department of Accountancy, Faculty of Financial Studies, Osun State Polytechnic, Iree, P. M. B. 301 Iree, Osun State, Nigeria

Abstract: *This paper examines an interface between accounting system and purchasing/supply chain management. It explains how professional purchasing/supply management and accounting personnel contribute at least as much to the success of their organisation in areas such as supplier sourcing, or substitute materials, price determination, value analysis, outsourcing, make or buy analysis, invoice settlement and payment. At the most fundamental level, supply management concerns quick execution of work expeditiously, without fault in a cost effective manner. The paper details efficacy of goods inspection and reception procedure for the right quality and quantity through the association of purchasing and accounting department. The findings suggest that a cooperative relationship between purchasing and accounting/finance clearly can impact the development of a good supplier relations and cost reduction for the benefit of an organisation.*

Keywords: *Purchasing, Supply chain management, Accounting, Outsourcing, Value Analysis, Invoice.*

I. Introduction

Purchasing can be described as the acquisition of required materials, services, and equipment for the operation of the business and is one of the key roles in the management of all types of businesses. The function of purchasing spread across the units of the organisation by procurement of the materials required to meet the customer demand and manufacturing schedules (Olaore & Olayanju, 2013). Supply chain management is depicted by Weele, (2000) as the act of managing all activities, data, human and financial resources connected with the operation and transformation of goods and services upward from the suppliers of raw materials, parts and components, including other suppliers of the organisation in anticipation to meet the needs and demand of the customers. Purchasing and supplier management are important to managerial accounting and supply chain efficiency (Joyce, 2006) because purchasing management focused on structuring and continuously improving purchasing processes within the organisation and all activities required to manage supplier relationship (Weele, 2000). Monczka, Handfield, Giunipero, & Patterson, (2009), emphasised that it does not take a financial genius to realise the impact that suppliers can have on a firm's total cost as many features that make their way into final products originate with suppliers. Hence, the supply base is an important part of the supply chain.

The purchasing function is of great importance and has become highly specialised because such a large proportions of a firm's cost are represented by bought in materials and services. The responsibility of the purchasing function includes price, quality and delivery all of which are crucial factors. Late or non-delivery, poor and substandard materials, and incorrect specifications are all likely to have a strong influence on profitability due to payment of an unnecessarily high price (Lucey, 2002). Economic activities and transactions form part of the functions of accounting systems, comprising sales and materials purchases, and processing of the information in such a way that will be useful to managers, sales representatives, purchasing officers, store keepers, production supervisors, and other personnel involving in the operation of the business (Horngren, Datar & Foster, 2006). Millichamp, (1992) delineates accounting as the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.

Managerial accounting as related to the purchasing function in business organizations is becoming increasingly important due to outsourcing, supply chain management, and continuing efforts to reduce costs and increase quality (Joyce, 2006). Purchasing forwards a copy of the purchase order (either electronically or manually) to accounting (accounts payable), the requesting department, receiving, and traffic. The accounting unit gains visibility to future accounts payable obligation and also has an order against which to correspond a receipt for payment when the material arrives the company (Monczka et al. 2009). Joyce, (2006), suggests that managerial accounting can not only assist purchasing on price, quality of goods, reliability and speedy time of delivery but can also participates in value analysis, make-or-buy analysis, and supplier audits and certification. Managerial accounting may also assist with the sharing of planning and information and may assist in maintaining ethical standards. It is very obvious and not hard to see why purchasing is distinctly a major field for cost savings, however, cost savings come in different forms like the traditional approach to negotiate hard for price reductions and other approach is to build good relations with suppliers (before sales services and after sales services) to jointly pull costs out of the product or service (Monczka et al. 2009). This study explains the most significant areas where accounting and supply chain management professions affect each other and how mutual understanding and integration of the functions perform can benefit the organisation.

II. Purchasing

The responsibility of the purchasing department comprises a sort of activities related to the goods and services engage by or utilised within an organization. Based on the organisation structure, the purchasing activities might include materials sourcing and availability, determining the right suppliers, vendor certification, vendor rating, conducting location, site visits, and background checks. Purchasing is usually a significant actor in searching for qualifying suppliers for required goods and services, and usually undertakes price quotes, and negotiations, continually conducting research on price inflationary trends and makes necessary strategic recommendations in respect of any suitable aspect or combination of the above activities to the organisation. It is the duty of the purchasing department to conducts final contract negotiations, furthers mutual agreement, and supervises the successful approval process. The purchasing objective is sometimes defined as buying materials of the right quality, in the right quantity, at the right time, at the right price, from the right source (Heinritz, Farrell, Giunipero & Kolchin, 1991).

The goal of managerial accounting with respect to purchasing, according to Joyce, (2006), is to develop and implement purchasing plans for products and services that support operations strategies. Partial payments, progress payments, penalties and incentive payments are finance-related terms and conditions which both purchasing and accounting are involved. In their own view, Dobler and Burt, (1996) opine that professional purchasing/procurement/supply management personnel contribute at least as much to the success of their organisations as other professionals in areas such as marketing, finance and accounting, engineering, and operations.

Furthermore, Joyce, (2006), Dobler and Burt, (1996) explain the functions of purchasing as identification of potential suppliers, market studies, negotiating contracts, analysis of proposals, issuance of purchase orders, administration of contract that meet production requirements in a cost-efficient manner, including the maintenance of a variety of purchasing records. Relatively, purchasing is taking on increased importance as management accounting places greater emphasis on supply chain management, quality improvement, lean production, and outsourcing (Porter & Millar 1985)..

III. Purchasing and Accounting Relationship

Supply management maintains linkages with the accounting and finance department. Much of the communication linkage between supply management and accounting today is electronic. For example, as supply management transmits material releases to suppliers, it also provides information concerning inbound material requirements to the accounting department. The account payable system receives the receipt information and compares the amount received to the amount ordered for payment (Monczka et al. 2009). Supply management may require data from the cost accounting system. For example, supply management must know handling and material rework costs for an item resulting from poor supplier performance. Supply management usually does not maintain data about individual activity costs that can increase the total cost. The supply management performance measurement system relies on input from cost accountants to help calculate the total cost of an item, which is also important in make-or-buy decisions. Finally, supply management must work closely with finance when making capital acquisition decisions (Monczka et al. 2009).

Every item purchased is a representation of money in kind as it constitutes an expenditure or engagement of company funds. It launches a series of accounting operations, such as charging the expense to the proper contract or department account, the confirmation of good receipt, verification of transaction records and approval of the invoice, payment of charge, and final audit (Heinritz, et al. 1991). There must be consultation with the finance department in the areas of pre-negotiation pricing, real negotiation and placement of the order to create effectiveness and sense of belonging for proper accountability and ease of invoice settlement. In the same vein, the finance department demands regular reports from the purchasing department on its outstanding commitments for proper cash flow planning. More so, there must be adequate cooperation on cash discount policy and standard costs settings (these are the costs per unit of production formulated in advance and employed as a standard for given accounting period) between both departments in order to save cost. Heinritz, et al. (1991) stress that standard costs are based on the costs of purchased materials, and they are in effect a purchase materials budget. It was observed that some companies accounting operations are ordinarily treated by invoice clerks in the purchasing department while in other companies' invoices move right away to accounting unit to be corresponded with the accounting purchase order and copies of receiving reports.

Purchasing and accounting/finance interact in the areas of accounts payable, planning and budgeting. In certain circumstances, purchasers frequently complain that accounting concentrates much more on the bottom line and not adequate on meeting the terms of the contract payment. The buying organisation is not living up to the terms of the agreement if it fails to pay invoices in a timely manner. Improved communication between purchasing and accounting/finance and greater goal congruence can help to alleviate some of the problems. Purchasing can help finance by providing funds flow forcasts, focusing on inventory minimisation and providing market information (Leeder, Fearon, Flyynn, & Johnson, 2002). Purchasing is in a position to provide the finance and accounting functions with information basic to budget development and administration and determining cash requirements. Material and transportation costs and trends in costs, need for forward buying because of possible shortages resulting from greater demand, or anticipated interruption of supply, such as happens during a major strike, as some of the kinds of information purchasing provides to aid in planning financial operations (Leeder, et al. 2002).

IV. Invoice Audit and Completion of the Order

In order to ensure that the purchaser makes payment appropriately for the materials usually received, there must be effectual accounting practices demanding some type of review procedure before payment to the supplier. Among the distinctive accounting procedure is a concurrent evaluation of the purchase order, goods receiving the report and the purchase invoice. Invoice auditing is technically an accounting function, and it is judiciously essential to separate the responsibility for authorising payment for an order from the purchasing responsibility of placing an order. With regards to the assumed facts, the purchasing department's task is accomplished when the material embraced by a purchase order has been inspected for quality and received in store for business operation or manufacturing purposes. In practice, however, many firms assign the invoice auditing responsibility to accounting and it should be carried out shortly after the receipt of the invoice to permit the accounting department to make prompt payment and obtain any applicable cash discounts **(**Dobler & Burt, 1996).

More so, once the goods or services are delivered safely in the right quantity and quality, the purchasing unit will issue an authorisation for payment to the supplier. Payment is then made through the organisation's accounts payable department. Currently, due to the technological development and in a bid to reduce paperwork and facilitate efficient services, suppliers are more frequently being paid through electronic funds transfer (EFT), which is the automatic transfer of payment from the buyer's bank account to the supplier's bank account (Monczka et al. 2009).

VI. Costs Associated with goods for sale

Horngren, et al, (2006) state that managing inventories to increase net income requires companies to effectively manage costs that fall into the following five categories;

* Purchasing costs **-** the cost of goods acquired from suppliers, including incoming freight costs. These costs usually make up the largest cost category of goods for sale. Discounts for various purchase-order sizes and supplier credit terms affect purchasing costs.
* Ordering costs**-** the costs of preparing and issuing purchase orders, receiving and inspecting the items included in orders, and matching invoices received, purchase orders, and delivery records to make payments. Ordering costs include the cost of obtaining purchase approvals, as well as other special processing costs.
* Carrying costs**-** the cost that arise while holding an inventory of goods for sale. Carrying costs include the opportunity cost of the investment tied up in inventory and the cost associated with storage, such as space rentals, insurance, obsolescence, spoilage, and shrinkage (resulting from theft).
* Stockout costs**-** the cost that ensues when materials for which there is high customer demands are exhausted from the firm's store and which there must be quick action for replenishment to meet that demand or suffer the costs of not meeting it. A company may respond to a stockout by expediting an order from a supplier, which can be expensive because of additional ordering cost plus any associated transportation costs.
* Quality costs**-** the costs that result when features and characteristics of a product or service are not in conformance with customer specifications. Horngren, et al, (2006) lists four categories of quality costs as prevention costs, appraisal costs, internal failure costs and external failure costs.

VI. Outsourcing

Outsourcing is purchasing goods and services from outside vendors rather than insourcing, which is producing the same goods or providing the same services within the organisation. for example, Kodak prefers to manufacture its own film (insourcing), but it has IBM do its data processing (outsourcing). Toyota relies on outside vendors to supply some parts but chooses to manufacture other parts internally. As outsourcing matures, it is taking its place as a business practice that supply managers use to improve cost, talent and responsibility and it is often associated with reducing cost (Siegfried, 2012). Supply management has always had a role in outsourcing, and as the business practice evolves, so has the organisation's role and responsibilities. Supply management plays a key role in the early stages, developing sourcing, selecting suppliers and drawing up the contract.

Jacobs & Chase (2008) state that outsourcing allows a firm to focus on activities that represent its core competencies, thus; the company can create a competitive advantage when reducing cost. Accordingly, Dobler & Burt (1996) suggest that purchasing and supply management play a key role in the make-or-buy process by providing information on the cost, quality, and availability of items.

Decisions about whether a producer of goods or services will insource or outsource are also called make or buy decisions. For example, Dell computer buys the Pentium chip for its personal computers from Intel because Dell does not have the know-how and technology to make the chip itself. To maintain the secrecy of its formula, Coca-Cola does not outsource the manufacture of its concentrate. Considering the studies of some companies, there was an indication that they consider the most crucial factors in the make-or-buy decision to be quality, delivery time, dependability of suppliers, services and the cost (Horngen et al, 2006).

VII. Value Analysis

Value analysis/engineering is a systematic rating of all distinctive features of the value chain and elimination of unnecessary cost associated with an item with the objective of promoting the quality and satisfaction of customer needs in a cost effective manner. This encompasses improvements in product designs, and changes in material specifications in process methods (Horngren, et al, 2006). Jacob and Chase, (2008), underscore "value chain" as mapping the process steps across the supply chain by discovering those measures that add value and striving to wipe out those that contribute waste. The techniques of value analysis represent a potentially powerful set of tools which can be used by management in controlling material costs (Dobler & Burt, 1996).

Monczka et al. (2009) argues that the principal objective of value analysis is to enhance the value of an item or service at the lowest cost without sacrificing quality. It is part of the responsibility of accounting and purchasing personnel in association with other professionals to work together in achieving maximum success of value analysis in the organisation. Joyce, (2006) posits that accounting and purchasing can offer a different perspective to the analysis, because of their association with suppliers and possession of information not known to others within the organization. If a fair amount of technical knowledge is required to review a part or service, value analysis team can be formed with representatives from design/engineering, marketing, production and operations to work with accounting and purchasing to conduct the analysis.

VIII. Conclusion

As companies struggle to reduce cost and increase customer value, many businesses are focusing their attention to accounting and purchasing/supply chain management. It is not difficult to see why accounting and purchasing are clearly a major area for cost savings because savings come in through the traditional approach to bargain hard for price reductions by buyers and building better relations with suppliers to jointly extract costs out of the product or service. The superior management of supplier relationships brings a cost advantage, quality goods and service (before sales service and after sales service), and prompt delivery to meet production schedules.

Purchasing and supply management have a major impact on goods and service quality and in many cases, companies are seeking to increase the proportion of materials, parts, components, sub-assemblies and services they outsource in order to focus on their own areas of specialisation and competence. This further increases the importance of the relationships between purchasing, accounting, external suppliers, and quality (Monczka et al. 2009). The purchasing/supply management performance measurement system relies on input from cost accountants to help calculate the total cost of an item, which is also important in make-or-buy decisions. Therefore, to achieve maximum success in the organisation, cordial relationship in the integration of accounting and purchasing/supply management functions are very crucial.

The study suggests better performance through the fruitful interaction between departments and effective communication to aid organisation sustainability, proper accountability and profitability. While accountant deals with money in cash, purchasing deals with money in kind as the material represents the substantial amount of dollars belonging to the organisation. Therefore, failure to integrate the functions of each department may result in misappropriation of funds, supplier disappointment and breach of contract, supply of substandard materials, delay in payment and other sort of ineffectiveness.

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