



NAHB Building Business Briefs

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Tech Talk: Managing Purchase Orders and Payment Approval

By Bill Allen

This is the eighth article in the Tech Talk series.

It's no secret that a builder doing any significant volume benefits from using purchase orders. The documents are great for controlling materials costs, and you can use them as checklists to make sure all materials have been delivered and/or trade contractors have completed work before you approve their invoices for payment.

And if you use handheld devices to send electronic purchase orders to and from the field, you can speed up the payment approval process and enhance its efficiency by putting that responsibility in the hands of the person (often the superintendent) who approves the work or material deliveries. There's no need to handle and re-handle paperwork, and there's little chance of purchase orders getting lost.

That scenario sounds good and it is. However if you don't have good purchase order management and payment approval procedures in place, you have no control over the processes or the quality that's tied to them. Chaos will sustain chaos, guaranteed.

Purchase Order Process

Most builders work with some kind of trade contractor agreement that spells out the scope of work to be done and then have their accounting departments issue payment after the work is finished. Although both processes originate in the office, there's often a disconnect between them because the actual work is done in the field. You can start integrating those processes by putting take-off information and bids into a database that produces purchase orders with information from accepted bids.

Similarly, you can produce a bill of materials for each of your plans, and then have suppliers bid on unit prices within those line items. Once you've accepted a bid that meets your budget, use the information to spit out a purchase order.

You can produce purchase orders by creating a Word or Excel template from QuickBooks or another accounting program. Alternately, you can use interactive software like that from

MasterBuilder, Timberline, or CDCI to build a file of contracts and prices you can use for each job.

Don't send purchase orders to vendors and trade contractors until you know how to use them internally. You need to determine who in your company produces purchase orders, who approves them before they leave the office, who gets copies of them, when and how they are sent to the field and the trade contractor or supplier, who approves the work done or materials delivered, and how invoices will be reconciled with completed purchase orders and then processed for payment.

You also need to figure out how frequently to issue purchase orders; will you issue them in advance for the entire project, or will you issue them for each phase of construction?

Setting up your purchase order process involves a lot of communication. Meet with everyone who will be involved (employees in sales, contract administration, estimating, production, accounting, etc.) and find out what they need from the process to make it work and to do their jobs. It's a good idea to get input from trade contractors and suppliers, too. Since they work with other contractors who use purchase order systems, they can offer good insight on what works—and what doesn't.

To get comfortable with using purchase orders, try testing the process with dummy documents (that are clearly labeled as such). Instruct your employees to treat them as "hot potatoes"—that is, to expedite them as soon as possible so that they don't sit around on anyone's desk (and delay work to be done or payment once you're using real purchase orders). Write down working procedures and be prepared to amend them.

Once you're comfortable with your purchase order system, use the process on one project at a time. Remember that there's a learning curve with all new systems and procedures; no one gets it right the first time.

Purchase Order Management

If you go the electronic route, it's best to use a single database to account for regular purchase orders, variance purchase orders (used for unplanned items and work, these typically originate from the field), and change order requisitions (those issued if the customer requests something that affects the scope of work).

Make sure variance purchase orders don't duplicate change orders. That problem occurs if someone sits on a document and the paperwork doesn't keep up with the chain of events. There should be either a variance purchase order or a change order for something unplanned or added to the scope of work; never two separate documents for the same item. If you have a substantial number of variance purchase orders, your estimating process may need a tune-up.

Payment Approval

Decide whether you will pay trades and suppliers by the task (or delivery), by the construction phase, or perhaps weekly or monthly. If you pay by the task or phase, make it clear to suppliers

and trade contractors that they won't get paid until the job is finished or all materials are delivered. Don't issue partial payments for partial jobs or deliveries.

Make one or two people on each jobsite responsible for approving work for payment. Tell trades and suppliers who those people are so they don't try to request payment approval from field personnel who don't have the authority to grant it. One benefit of using purchase orders is they often include take-off lists you can use as quality control checklists.

Reconcile invoices against purchase orders as soon as you receive them, and put them through to accounts payable pronto. Besides eliminating phone calls from people looking for their money, prompt payment provides a tremendous amount of price negotiation with trades and suppliers.

Integrated software systems like those from NewStar, Phast, and ProStar offer the advantage of document control between purchase order and accounts payable systems. Many integrated systems also offer handheld capability, which lets users zip documents back and forth from the office to the field and cut down on paperwork. If you do purchase orders and payment approval manually, you must enter prices and payment amounts separately in each system—and see to it that they match.

No matter what system you use, purchase orders can benefit your business by driving accountability for working within a planned budget to the source of the action and by enhancing communication throughout your company.

Note: Various software products are mentioned throughout the Tech Talk series. The intent is not to recommend these products as being right for you, but to identify some fairly known players and to note a few new ones. My apologies to vendors who aren't mentioned—the omission was not intentional.

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