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PURCHASE AND PAYMENT ACCOUNTING METHODS

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Mr. Malcolm MacCoun
Executive Director
The Mary Imogene Bassett Hospital
Atwell Road
Cooperstown, New York 13326

Dear Mr. MacCoun:

At the present time the Purchase and Payment Accounting System for the Mary Imogene Bassett Hospital is being processed by The Data Processing Center.

Since an alternate method for processing may be sought, this report discusses the various alternatives.

If the recommended method is used, then this report can be used as part of the procedures manual.

Respectfully submitted,

Richard D. Altman

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PURCHASE AND PAYMENT ACCOUNTING

Mechanized purchase and payment plans normally fall into one of the following two categories:

1. Direct Payment
2. Voucher Buildup

Both accounts payable plans follow the same general pattern through the purchasing and invoice checking procedures. These procedures will be outlined before the two systems are explained.

PURCHASING PROCEDURES

1. Requisition

All purchases begin with a requisition. It may be a formal document, a verbal request to the Purchasing Department or a decision made by a person with authority to buy.

2. Purchase Order

A purchase order is normally a formal document, prepared in several copies, one of which authorizes the vendor to supply items or services. Normally, it is similar to an invoice in appearance. It shows the vendor name and address, the date the material or service is required, the terms of the purchase, the quantities and prices and other information pertinent to the transaction.

A purchase order is desirable, although not a necessary document, in a mechanized accounting system.

3. Receiving Report

Receiving reports are normally prepared by the Receiving Department. The report shows the type, quantity and condition of items received from suppliers.

Three types are commonly used:

1. A copy of the purchase order, with prices and terms obscured, is matched against receipts.

2. A document is originated by the Receiving Department for each shipment received.

3. A daily journal of receipts is maintained by the Receiving Department.

I would recommend number 1, above, as the best workable type.

INVOICE CHECKING

When an invoice is received, it should be checked against the documents (requisition, purchase order, receiving report) that support it, in order to verify:

1. The items billed are in agreement with the items ordered and received.
2. The prices and terms are correct.

If supporting documents are not used, or not available, approval for payment should be obtained from whomever ordered the items or services.

When the invoice is approved for payment, it is attached to its supporting documents, and is now ready for the accounting routine. The following operations are performed:

1. Extensions and additions are verified.
2. Discount, freight, allowances, etc, are verified.
3. The due date, or payment date, is noted on the face of the invoice.
4. The debit and credit distributions are written on the face of the invoice.
5. The total of the distribution amounts is proved against the invoice total. (In some mechanized accounting systems this step is ignored, since the machine can detect distribution amount errors.)

DEBIT DISTRIBUTION

Debits arising from incoming invoices can be classified as follows:

1. Inventory
2. Expenses
3. Freight
4. Sundry

1. Inventory

Basic types of inventory

A. Raw material
B. Parts
C. Supplies

Often, several sub-classifications of inventory, particularly of raw material inventory are maintained.

Since inventory debits represent from 50% to 85% of all distributions from invoices, these charges are often entered in columns on a purchase journal. The accumulated totals are posted to the distribution ledgers after the run.

2. Expense

Most Controllers prefer to have expenses posted in detail to unit distribution

ledgers. For this reason, I would not recommend batching these entries in columns.

Year-to-date balances are normally extended only at the close of an accounting period. From day to day, the balances on these ledgers reflect current period activity. In effect, a distribution ledger serves the same purpose as a column on a spread journal but contains more reference information on the detail transactions for review and analysis.

3. Freight

Generally, all freight on incoming items will be charged to one account (incoming freight). However, some hospitals allocate freight to specific inventory accounts. These freight charges are debited to an incoming freight "suspense" account when the freight bill is paid. When the material invoice is entered, the freight will be credited to this "suspense" account and charged to the material account.

4. Sundry

Sundry or miscellaneous debits are items such as asset purchases, capital improvements, etc. These sundry ledgers should be filed separately, behind a sundry index and preferably be a different color to distinguish them from distribution ledger cards.

Sundry accounts are normally considered general ledger accounts. At the close of an accounting period these balances are ruled and entered to the general ledger. From day to day, sundry account balances reflect only current period activity.

BASIC SYSTEM REQUIREMENTS

Before the machine procedure can begin, the following requirements should be met:

1. The invoices must clearly indicate the name and address of the payee.
2. The invoices must have been checked and approved for payment.
3. The due date, or payment date, should be clearly indicated.
4. The gross, discount and net should be shown.
5. The distribution account numbers and amounts should be coded on the invoices.
6. The invoice filing system should lend itself to an efficient accounting machine routine.

DIRECT PAYMENT MENTHOD

DIRECT PAYMENT

Approved invoices are NOT entered currently in the accounting records upon receipt, but are merely filed away by due date or by vendor until time for payment.

As the due date on a batch of invoices matures, they are removed from the files, vouchered, checks written and debit distribution made for the entire batch.

Most hospitals using Direct Payment procedure write checks only two or three times a month. These check writing days are commonly referred to as "payment days" or due dates.

UNPAID INVOICE FILING

After the invoices have been checked and approved for payment, they are sorted into batches by payment dates. Some hospitals will run an adding machine tape of these batches and maintain a control total by payment date. This assists in balancing the payment run and permits management to know the case requirement in advance for each due date.

Normally, the invoices are filed alphabetically by payment dates. Some hospitals prefer to file alphabetically without regard to date. At the time of payment, the invoice file is searched for items due. This permits a re-examination of the invoices to avoid missing a discount, or to defer payment, if desired.

ACCOUNTING MACHINE PROCEDURE

Approved invoices are held in an unpaid file until the payment date and all accounting records are updated with one handling of the invoices. The invoice amounts are credited to the voucher and the corresponding debits are distributed. If credits and debits balance, the check is written.

The check and voucher set used for direct payment normally consist of:

1. Check and remittance advice for the vendor.
2. Alphabetic file copy. This copy is filed by vendor, with the supporting documents attached.
3. Numerical file copy. Filed by check number - voucher number (same) for reference and in some instances used for check reconciliation purposes. The paid invoices may be filed with the numeric copy instead of the alphabetic copy of the voucher because of audit requirements desired in the general system by fiscal management or accountant.

EXCEPTIONS TO NORMAL ROUTINE

1. Immediate Payment Items

It is occasionally necessary to issue a check for immediate payment when the accounting machine is not free. A definite procedure should be established

for these occasions. A commonly used procedure is:

A. A regular voucher check is prepared with a typewriter. The next consecutive check number is assigned. The purpose for the check is typed on the voucher portion of the voucher check.
B. The check is issued to the payee.
C. The supporting documents are stapled to the remaining copy and these are filed in a special folder for later processing.
D. At the next payment date these items are processed through the system in the order of payment. These transactions are processed in the same manner as unpaid invoices. The machine entries are made directly below the typewritten figures.

2. Payment Prior to Charge Distribution

This situation arises when it is necessary to pay for an item prior to its receipt, in order to take advantage of a discount or special price; when the specific accounts to be charged cannot be determined; or in order to suspend a debit for a period of time.

A commonly used procedure is:

A. Write the check in the normal manner
B. Post an offsetting debit to an accrued expense (suspense) ledger.
C. When the charges against specific accounts are to be made, post an offsetting credit to this "Suspense Ledger". Post these entries to the ledger cards in a normal payment run before the regular run. The vendor name is used for reference.

3. Payment Withheld

Periodically, it is necessary to enter the charges and credits to distribution accounts, prior to payment to the vendor. This situation arises almost every accounting period in hospitals who want to charge all available items into the current accounting period, yet delay payment until a succeeding period.

A common procedure is:

A. These items are processed in a regular payment run.
B. The debit entries are made in the normal manner to columns or distribution ledgers.
C. An offsetting credit is posted to an accounts payable "Suspense Account". This can be one account for all vendors or a separate account for each vendor.
D. The vendor name is used for reference.
E. When the suspense items are to be paid, they are processed in a normal check-writing routine. An offsetting debit is posted to the accounts payable "Suspense Account".

4. Period End Accruals

At the end of an accounting period, there may be invoices that have been approved for payment but not processed. Some hospitals accrue these items.

One of two procedures is used:

A. These items are processed as outlined above in point three.
B. These items are listed on a work sheet and the totals are posted as follows:

DR. Inventory
DR. Accrued Expenses
CR. Accounts Payable "Suspense Account".

At the beginning of the next accounting period, these entries are reversed, so that the items can be processed in the normal routine.

ADVANTAGES OF THE "DIRECT PAY" METHOD

1. Less Forms Handling

The voucher check is handled only once and remains in the machine until the check is written. If several invoices from one vendor affect one distribution ledger card, that ledger card need be handled only once.

2. Less Invoice Handling

Unpaid invoices are filed by due date by vendor and remain there until paid. Paid invoices are stapled to a copy of the voucher check and filed by vendor.

3. Less Figure Handling

The debit and credit entries to the Accounts Payable account are eliminated, except for month-end memo entries. No voucher old balances are handled. Distribution ledger balances are picked up only once for a vendor, regardless of the number of invoices processed for the vendor. Voucher numbers and check numbers can be identical and the voucher number need not be listed for cross reference.

VOUCHER BUILDUP METHOD

VOUCHER BUILDUP

Under this procedure, the approved vendors' invoices are entered in the accounting records at periodic intervals before time for payment. The phrase "build-up" is used because under this plan invoices are posted to the voucher and a new balance is extended each time, which of course "builds up" the voucher and the voucher balance as additional invoices are posted.

Concurrently, the debit distribution of these invoices is performed on a current basis all during the month.

Most hospitals using this procedure process unpaid invoices through accounts payable several times a month. Checks are written two or three times a month in a separate check writing routine.

UNPAID INVOICE FILING

One of three procedures for filing approved invoices is commonly used:

1. File in alphabetic order in folders. This is the easiest filing procedure and provides easy reference to unpaid invoices by vendor. It also enforces a re-examination of the invoices prior to vouchering, to protect against lost discounts.

2. Invoices are filed in alphabetic order by payment date. This procedure provides a tickler of items to be paid by payment dates and lends itself to control totals for planning cash requirements.

3. Invoices are filed alphabetically with the assigned vouchers. If a voucher has not been assigned, the next voucher in numerical sequence is headed and filed with the invoice. This procedure results in maximum productivity during voucher run.

ACCOUNTING MACHINE PROCEDURE

Approved invoices are posted to vendors' vouchers by payment date at periodic intervals. Corresponding debits are distributed at this time. Checks are written at a separate operation on the payment date.

The check and voucher set used for voucher buildup normally consists of:

1. Check and remittance advice for the vendor.

2. Alphabetic file copy. (Paid invoices are filed with this copy in most cases.)

3. Numeric file copy. (This copy is filed because the numeric reference on the distribution ledgers cannot be the check number. The check number is not known at the time the debit distribution is made.)

4. Register of assigned vouchers.

This copy is separated at the time the set is headed. Since the voucher set is filed alphabetically until the payment date, numerical sequence has been lost. This copy maintains numerical sequence to provide cross reference during the interval between the date of assignment and the payment date. In some hospitals, this copy is not used, since other means of control is established.

EXCEPTIONS TO NORMAL ROUTINES

1. Immediate Payment Items

It is occasionally necessary to issue a check for immediate payment between payment dates. A definite procedure should be established for these occasions.

A commonly used procedure is:

A. A regular voucher check is prepared with a typewriter. The next check number is assigned. The purpose for the check is typed on the voucher portion of the voucher check.
B. The check is issued to the payee.
C. Supporting documents are stapled to the remaining copies and filed in a special folder for later processing.
D. During next voucher run, the required debit distributions are made and the posting of the voucher is made below the typewritten information.
E. At the next payment date, the paid voucher checks are processed through the machine disbursement procedure in check number sequence prior to preparing current checks. This is done to insure that all checks drawn maintain correct check number sequence. The machine entries are made directly below the typewritten figures.

2. Payment Prior to Charge Distribution

This situation arises when it is necessary to pay for an item prior to its receipt, in order to take advantage of a discount or special price; when the specific accounts to be charged cannot be determined; or in order to suspend a debit for a period of time.

A commonly used procedure is:

A. Process the invoice in the normal manner.
B. Post an offsetting debit to an accrued expense (suspense ledger).
C. When the charge or charges against specific accounts are to be made, post an offsetting credit to this "suspense ledger".
D. Write the check in the normal manner. In the event that immediate payment is required, handle the check as outlined above under "Immediate Payment Items".

3. Period End Accruals

At the end of the accounting period, there will normally be several approved invoices that have not been processed. If these invoices are not processed this period, the P & L and balance sheet will not reflect a true condition.

One of two procedures can be used:

A. Make a voucher run on the last day of the accounting period.
B. Summarize the invoices on a work sheet. Post the totals as follows:

DR. Inventory
DR. Accrued Expenses
CR. Accounts Payable Suspense Account

At the beginning of the next accounting period, these entries are reversed, so that the items can be processed in the normal routine.

ADVANTAGES OF THE "VOUCHER BUILDUP" METHOD

1. Peak Loads are eliminated

Even though voucher buildup requires more over-all time than direct pay, it lends itself to large volume because the work is more evenly distributed through the accounting period.

2. Accounting figures are available on a more current basis for management reports and for planning cash requirements.

3. Balancing is easier. Frequent processing of invoices keeps the batches smaller and makes balancing easier. Better control can be maintained on unpaid invoices.

4. Better machine utilization. Since vouchering and check writing are separate operations, more totals are available for distribution during the vouchering run.

5. Profit and Loss statement is available sooner after the end of the month because of eliminating the peak load of work at the end of the month.

After successfully implementing both plans in various hospitals, I would recommend the "Voucher Buildup" method as the best all around method for accurate, up to date, management information and control.

MANAGEMENT REPORTS

The final objective in keeping detailed records is to prepare a report to management. Sometimes this report takes the form of a separate report for each operating department; a listing of expense amounts and possibly a comparison with budget figures.

This report can be prepared in the following ways:

1. Manually
2. Accounting Machine
3. Data Processing
   A. In House (On Premise)
   B. Outside Service Bureau (Off Premise)

The entire accounting procedure and output reports is dependent on the type of equipment used. An evaluation of equipment will be discussed in another report.