



Revenue Recognition in Creative Agencies - Defer Income or Accrue for Costs?

By [Volker Bendel](#)

Article Word Count: 616 [[View Summary](#)] [Comments \(0\)](#)

A discussion often had, when implementing an integrated job costing and accounting system in a creative agency, relates to the way to best get accurate profitability figures at the right time. In the creative industry it is not unusual to have big time gaps between incurring costs on jobs and billing the client. These time gaps will happen either way with projects where all the costs are encountered to start with, but the project billing takes place at the end of the job's life or projects where all the billing is raised at the beginning of the job - based on the proposal - and costs are then accumulated as the project work proceeds. In the first case, where costs arise prior to the sales billing taking place, a reliable work in progress (WIP) system will ensure that the profitability calculations are real-time.

In the second case where billing is undertaken some time before costs are incurred on the project, the challenge to face is not to report a big profit in one month and then a big loss in the next. There are different possible ways conceivable to avoid that situation and to achieve an accurate monthly income statement:

- Take the revenue at the time of billing and post a cost of sales accrual based on the expected figure of costs to be necessary for the project. Where a good project budgeting procedure is in place these accruals may simply be based on the cost budget so the better the budgeting the more exact the cost accrual.
- The second option is to delay the recognition of income at the time of billing and wait til the end of the project or until all the costs for the project have materialised and only then take the sales value into revenue.

In both cases GL accounts on the balance sheet are used to store the cost accrual or deferred income values.

Both options will generate an income statement, where costs are reported against revenue during the same accounting period. However there are differences between the two techniques regarding accuracy.

Applying the cost accrual system uses estimated cost figures relating to future vendor invoices and therefore being entirely outside of the control of the enterprise. Although they can be based on budget figures, which in ideal scenarios will have considered the source the costs will be bought from, so may be relatively close to reality when costs eventually arrive, the final amounts are within the control of that supplier and thus only, when the AP invoices arrive, will the exact cost be known.

A different situation is given, if revenue deferral is used. The value of income eventually achieved is a known and final figure as it is the billing value from the A/R invoice already sent to the client. No third party has any influence on the value of that sales bill. Depending on the costs coming in and the time they arrive either the full sales invoice amount can be released into revenue or it can be taken into income in installments over several months in line with the costs being received to ensure periodicity.

Agencies using this second option have noticed that it offers a better control to get to an accurate and real-time profit and loss report whilst fulfilling both the principle of prudence as well as the convention of conservatism at the same time. Better reporting of current figures increases the confidence of shareholders in the performance of the enterprise and is the basis of better planning and forecasting for the future. This may explain why revenue deferral has

become the preferred option for many companies in the creative industry.

© 2010 Volker Bendel - Volker Bendel is manager of the training department of Agency Software Worldwide, the producers of the "Paprika/Rebus" job costing software (<http://www.paprika-software.com>) - (<http://www.rebus-software.com>). Originally from a legal background, he has several years experience in planning and implementing Job Costing and Accounting Software Systems in the Creative Industry. He has also delivered training courses in the UK, Europe, Dubai, the US, China, Japan and Australia. Prior to that he worked as a senior business consultant in Hong Kong and as a department manager of a design department in Hong Kong.



Article Source: http://EzineArticles.com/?expert=Volker_Bendel

This article has been viewed 20 time(s).
Article Submitted On: November 14, 2010