The Concept of "Work in Progress" in the Creative Industry - Part 1 of 2

By Volker Bendel

Costs incurred to buy raw materials in manufacturing or to purchase goods for retail in trading businesses are historically kept in a "Stock" account on the balance sheet rather than recognising them as costs to the business straight away.

The idea behind this practise is that those bought-ins have not yet been used for the purpose of the business, the sale of a higher-value-end-product in the case of manufacturing or the value-added-sale-to-an-end-user in the case of a retail company. Only when the finished goods or the retail wares are physically taken out of stock and sold, generating an income to the business, their acquisition costs (together with the added costs of production if any) are taken into account thus producing the true profit for the business. Applying this accounting technique ensures 2 purposes:

- neither are costs overvalued at the time of incurring them with no income
- nor are profits overvalued at the time of sales with no costs

Whilst that principle is straight forward, when "things" are concerned, it is a much more theoretical issue, when applied to services or non-material goods that are traded in the creative industry or indeed in all other service industries. And whereas the character of the traded value as either a service or a non material good can ideally be defined by the underlying contract, e.g. "to creating, hosting and maintaining a website" as a service or "to delivering a website as specified in the brief" as a good*, their treatment from an accounting point of view raises a completely new, separate question:

If the website in the example is required by an advertising agency as a "bought in" in order to complete a campaign for their client, how and when should its costs be accounted for in the profit and loss accounts? Ideally and to report the true profit of the campaign, the cost should only be recognised at the same time when the campaign generates an income to the agency. This is where the vehicle of "Work in Progress" or "WIP" comes in.

Work in progress is used as a temporary vessel to collect costs, without those costs being recognised as costs to the business yet. It is usually treated as an asset to the business (similar to the stock account, where materials are concerned) and the cost items held in this asset are transferred into the cost of sales accounts at the time of reselling the completed - possibly marked-up - service costs. This way work in progress in service environments enables accounting for unused costs to the business in the same way that a stock or warehouse account would in companies dealing-in or manufacturing material items. Work in progress serves as the "theoretical warehouse" for non material goods to achieve the same purpose a stock account would for physical raw materials: Calculate and report profits or losses at the time when they affect the business.

* see with more explanations about the regulatory background in the UK, Roger Zair "TACKLING ACCOUNTING FOR WORK IN PROGRESS" - Finance Week 22-Jun-2005

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