Advertising Agency Accounting

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Accounting systems must be designed to fit the circumstances and needs of the particular agency and be flexible enough to be altered to meet changes in the nature and volume of the agency's operations. Any agency accounting system should have two broad objectives, to be obtained at minimum cost in money and time, namely:

1. Accurate and current accounting financial information necessary for the proper guidance of management, and
2. Establishment of billing procedures and schedules to assure that the agency is not required to finance its clients' advertising.

The internal organization of the accounting system comes under two heads—General Accounting, which includes financial reports, budgets, expense controls, and client cost analysis in addition to the usual general ledger, expense and production voucher register, cash receipts and disbursements registers, billing and cost journals, and all payroll records; and Client Accounting, which includes billing and paying printed media, radio and television, media checking and production jobs records and billing.

One of the most important features of agency accounting operations is the prompt reporting of financial information. In order to control the financial operations of an agency, management must have reports which are informative, timely, and accurate, yet simple in form and easily interpreted. An agency's profit can be seriously impaired by "loss" clients, yet management may not be aware of this situation because the relative profitableness of the individual accounts has not been determined.

Cost accounting in advertising agencies involves the development of income, cost, and profit on each client's account. The segregation of income by clients is relatively simple through the use of a billings and cost journal. Invoices are entered monthly in each client's account and are distributed so that the accounts receivable, income, and accounts payable records for each client are totaled on each page. The allocation of direct expense other than payroll can also be obtained with little difficulty through the proper classification by clients of unbillable costs and travel and entertainment expenses directly allocable to specific clients.

To insure the proper allocation of direct payroll costs to the individual clients, however, it is necessary to secure accurate time reports from each person engaged in working directly on an account, including executives, artists, production men, copywriters, publicity and media directors, and their secretaries. The basic cost accounting record for such expense is the payroll distribution by accounts.

Gross profit on each account can now be determined by deducting direct expenses from gross income. This computation requires that the agency first establish the overall gross profit percentage required to cover total indirect expenses and to provide the desired net income. A comparison of the percentage of gross profit to the gross income on any individual account with this pre-determined ratio will then indicate the account's relative profitability.

Client billing falls into two categories—billings for time and space, and billings for production (art, mechanical production, radio and television production). Nearly all space and time media allow the agency a 15% commission so that clients are billed on gross invoices. It is an accepted practice in the advertising field that the client is billed for all media far enough in advance so that the agency receives its payment before payments to media are due.

Because production invoices are normally net, they must be marked up to yield a 15% commission to the agency. The client is billed monthly on all completed production jobs within that period. Any production on invoices which belong to an uncompleted production job is transferred to a monthly billables pending account to remain until its completion and billing to the client. However, all suppliers are paid monthly regardless of whether the job is complete. In the case of large jobs which would require a substantial investment of the agency funds for an extended period of time, arrangements are usually made to bill the client on a progress basis.

The accounting records must also contain data necessary for the preparation of budgets and forecasts of future operations, with periodical comparisons with planned or desired results.

Agency revenue is related to billings. Billing estimates should be broken down by media because production requirements are not uniform among advertising media and because a more accurate forecast of income will result if the media is estimated separately. The forecast of operating expenses is prepared after the billing and income forecast has been established. Payroll expense is an agency's largest single category of expense and involves estimates from department heads and account supervisors with the accountant forecasting a large group of related expenses, such as bonuses, payroll taxes, and group insurance costs. All other expenses can be estimated from the previous year's results.

The completed forecast should be in the form of a regular financial statement and should be compared to the previous year's, or several previous years', statements. Dollar amounts can be converted to percentages, which are helpful in comparing years at different levels of operations.

A cash flow forecast is important to agencies with limited working capital although most agencies do not run short of cash because of the practice of receiving payments from clients before media payments are due. However, when needed, the cash forecast should include working capital requirements and estimated expenditures for furniture, fixtures, and other non-current assets. Depreciation and other expenses not requiring cash expenditures should be eliminated, and the remaining items of income and expense should be projected in a time sequence together with the cash balance.

While the considerable costs involved would deter all but the largest agencies from installing their own computer systems, the advent of the data processing service centers has placed electronic data processing within the reach of agencies of almost any size. These organizations provide their facilities and services which vary directly with the amount of work done. Many agencies have chosen to handle part of their billing, paying and estimating operations in this way. Others have placed selected clients on this basis for a single medium or some portion of the processing, such as the preparation of estimates.

The use of computers in determining the price of individual television spot broadcasts to reflect current client discount status in relation to active rate card information is considered an important breakthrough and a key to improved buying techniques. The computer gives the agency time buyer a report which shows, for each station used by the client, the number of spots bought per week, the plan rate they have earned, and the point at which additional spots can be acquired without additional cost.

Recently considerable attention has been given to the application of mathematical and statistical techniques to improve media selection. A few large agencies have announced the use of these new approaches, and a number of other agencies are actively exploring the potential value of these methods. The work to date in this area has been largely a pioneering effort. The new techniques are complementary to, rather than replacements for, conventional methods of media selection. Future progress will be predominantly experimental in nature for a number of years until the underlying relationship becomes more clearly perceived and used as a guide to achieve greater standardization in the reporting of marketing and media data.

It must be recognized that adequate control of all phases of agency business involves the assignment of responsibility to specific individuals, and if such individuals are to properly carry out this responsibility, they should be furnished with financial data which measures their effectiveness. Such a procedure is necessary to develop in these individuals a "cost consciousness" which is essential to good management. The maximum advantages will be obtained from accounting when used in accordance with these concepts.

Compilation and Administration of CPA Examination

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Many papers are graded as many as four times before a final decision is reached. The first grading, which is described as horizontal grading, is that already mentioned. If a paper has six questions, six graders have entered into the grading. In each question the respective grader has been permitted no deviations from the scientifically developed grading basis.

After all problems or questions in a particular section on each candidate's paper have been horizontally graded and a total score computed, a reviewer performs his grading function, which is described as vertical grading. He looks for very high or very low scores on a specific problem as related to the candidate's overall performance on a particular section of the examination. He also conducts his review with a thought as to whether the individual graders are conducting their functions in a consistent and competent manner. He is always one who has had a wealth of grading experience and, in most cases, considerable accounting and auditing experience.

If it is obvious from a cursory review that the paper is well below a passing grade, or well

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