



2006-2007 MANUAL OF
ACCOUNTING FOR
**MAGAZINE
PUBLISHERS**

CONTENTS

INTRODUCTION	4
ABOUT THE AUTHOR	5
KEY ACCOUNTING CONCEPTS	6
ACCOUNTING FOR BOOK PUBLISHING AND OTHER SIMILAR MEDIA	38
FINANCIAL STATEMENT PRESENTATION	42
CHART OF ACCOUNTS	58
KEY DATA ANALYSIS	77

INTRODUCTION

This Manual focuses on the specialized accounting requirements of the magazine industry and should prove a useful tool not only to the accountants in the industry, but also to the managers, investors and lenders who require reliable financial data about their publishing operations to make informed business decisions.

It is the MPA's goal that this Manual will also provide a greater degree of uniformity in the accounting practices of our member publications by providing standard definitions of accounting and industry terms, as well as a general outline of a magazine publishing accounting system. The widespread use of these should facilitate comparisons among publishers.

While there are a number of income tax issues that are unique to the publishing industry, this manual does not deal with federal, state or local income taxes.

The updates and revisions have been provided by the Media Consulting Group of the accounting firm of Bay Sherman & Craig, LLP with the assistance of Hal Jaffe of Bay Sherman & Craig, LLP and Jack Craven of Media CPAS.

Most of the material has been abstracted from the book, [Accounting & Finance for Publishing Companies](#) by Peter M. Craig, published by Folio:/Red 7 Media. The book contains substantially expanded material on the information included in this Manual and additional material on income taxes and buying, selling and valuing publications.

The book can be purchased directly from Folio: by visiting their bookstore at foliomag.com.

ABOUT THE AUTHOR

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Mr. Craig's services to the publishing industry include consultation, valuations, assistance in mergers and acquisitions, litigation support and strategic planning. He has also presented dozens of seminars on management, launches, mergers and acquisitions, and valuations of publishing companies and is a frequent contributor to *Folio* magazine.

In 1981, Mr. Craig spent four months as interim chief executive officer of *Venture Magazine*. He also helped develop and successfully market a proposal for a cable network and has been a director of a publicly held financial services company. He is director of Western Publications Association and was an adviser to the PMA, a national book publishers association. Mr. Craig is a graduate of the University of California at Los Angeles.

KEY ACCOUNTING CONCEPTS

Financial accounting and reporting should reflect both the performance of the company for a period of time and the financial position, or the “health,” of the company at a given point in time.

Generally Accepted Accounting Principles (GAAP) have been established to provide a standard set of guidelines for the accounting and reporting of all businesses. In addition to those basic standards, there are acceptable practices for various industries that are both specifically identified in accounting literature for that industry and established by common practice within the particular industry.

It is obvious that operating cycles do not necessarily begin or end on the last day of a month or the last day of a calendar year. It is also obvious that certain principles must be applied to all accounting and financial reporting so that all users of the resulting information have a common frame of reference. The same principles also apply to governmental and regulatory reporting purposes such as tax returns and other information reports.

In general, publications can be classified as consumer publications, trade publications and business-to-business publications. Consumer publications cater to the interests of the general public or a special interest group that is a (vertical) segment of the general public. Trade and business publications are published to meet the needs of business, professional or technical audiences. Sometimes publications—such as a number of the e-commerce magazines—serve both consumer and business audiences.

The nature of a publication, whether it is print or online, depends on its editorial content and its distribution channels; these in turn determine many of the specific characteristics of the publication. The characteristics that define the nature of a magazine include:

- Subject matter
- Geographical area covered
- Circulation size Circulation type (paid or controlled)
- Physical size/format
- Number of pages
- Subscription price/cover price
- Advertising rates

To its readers, a publication is a service that provides information and ideas. To its advertisers, a publication is a service providing access to the readers that are potential customers for their products and businesses. But to publishing managers who must measure the publication’s viability based on revenues and costs, the publication appears in a

different light; it is part service and part manufacturing operation, and each issue should be seen as a separate product. The manufacturing process for Internet sites includes the technology and software necessary to operate the site.

The following material covers the accounting principles that apply particularly to the publishing business. The references for these principles include both GAAP and accepted industry practices.

BASIC ACCOUNTING CONCEPTS

As in all businesses, basic accounting rules apply to the recording of transactions. Accounting for these transactions generally is done on an accrual basis. This means not only accounting for cash receipts and disbursements but also providing for:

- Transactions for which you receive revenue in advance of providing service (deferred income – generally subscriptions, events and sometimes advertising collected in advance)
- Transactions in which you pay for goods or services in advance of consumption (prepaid expenses or inventory, such as paper, editorial material and event expenses)
- Transactions where goods and services are received or consumed before they are paid for (accounts payable and accrual expenses)

Historically, accounting procedures and practices have been developed around manufacturing companies. While publishing a particular issue of a publication may be viewed as the production of a “product,” the basic flow of publishing differs from the manufacturing process.

The principal difference lies in the fact that the publishing “product” generally produces more than one stream of revenue (circulation, advertising and online). The effort made to produce the product does not flow like an assembly line, but rather reflects a combination of simultaneous processes (editorial, circulation, advertising/marketing, online activity and production).

The Earnings Process

GAAP requires that revenue be recognized when the earnings process is completed. For manufacturing companies, this means when the customer purchases the product, generally from inventory.

For the multiple streams of revenue in publishing companies, some of which may be collected in advance, the earnings process is completed and income is recorded as follows, for:

-
- Advertising revenue (print and online): for when the issue is distributed to the reader (through the mail, online or through single-copy outlets), not when the billings are prepared or when the issue is printed
 - Circulation: for subscription income, when the issue is delivered to the post office for mailing, when first available online; for single copies, when the issue is distributed to direct single-copy outlets or to wholesalers or sold by the retailer (depending on when title passes to the ultimate buyer)
 - Events: when the event takes place

It is not unusual for single copies to reach the retail outlets over a different period of time than when subscribers receive their copies. In reality, copies of any particular issue will arrive at retail outlets over a number of days; the same is true for mail delivered subscriber copies. It often happens that some copies will arrive on the last few days of a month while the rest reach their destination during the first few days of the subsequent month.

From an accounting perspective, it is a common industry practice to account for all the income from a particular issue in one month or reporting period and, generally, only one issue for each reporting period.

The Internet also generates multiple sources of revenue for the publisher. As with print publishing, some revenues will be collected in advance and some revenues will be collected when invoiced.

For Internet revenues the earnings process is completed as follows:

- Advertising and sponsorships: over the period displayed on the site
- Online subscriptions: over the term of the subscription (does not include print subscriptions sold online)
- Virtual trade shows: when the show is displayed on the site
- Content licensing: when the material is delivered to the user
- Transaction fees and commissions: when the sale is completed

Realization Principle

The realization principle requires that periodically (at least annually) all asset accounts be reviewed for realization. In simple terms, this means reviewing the individual items included in each asset account to determine if their value will ultimately be realized at the amount stated.

- For receivables, this means based on prior experience, writing off known bad debts and providing for reserves against the balance. Reserves include the significant non-payment of "bill-me" subscription offers and the substantial

percentage of single (newsstand) copies distributed that will be returned. Trade or barter receivables, as discussed in detail below, should be written off if it is determined that they have no future benefit or are deemed uncollectible.

- Inventory of purchased editorial, artwork and photos should be reduced by the cost of materials that will not likely be used in future issues.
- Paper inventory should be reduced to the lower of the cost of the paper or the then current market price.
- Intangible assets (such as publications, websites or other acquired assets) must be reviewed at least annually for impairment or when an event occurs that indicates impairment (see discussion below on "Intangible Assets").

Back Issues

Publishers generally maintain inventories of back issues, although few generate substantial sales income. For accounting purposes, no allocation of the production costs of the undistributed issues should be made to inventory, and correspondingly, no inventory account should be recorded on the balance sheet unless sales are reasonably assured based on historical data. Income from the sale of back issues should be recorded in the period the sales take place.

Barter/Trade

Magazines often trade pages of advertising with other publications. Also, from time to time, publications run ads in exchange for such things as hotel rooms, services, broadcast time and even furniture and equipment.

Publishing companies often keep track of these trades or "due bills" without recording the transactions in the general books of account. The reasoning behind this practice is that usually no "cash" changes hands. While cash is the principal commodity of exchange for goods and services, it is not the only form of exchange. Trades are also an exchange of goods or services and, according to GAAP, must be accounted for. Barter is considered a non-monetary transaction and is required to be reported for both accounting and income tax purposes.

"Goods or services" used (for example, pages in another publication) are considered expenses or purchases, and "goods or services" rendered (pages in your magazine) are considered income. Since the utilization of services exchanged does not always take place at the same time the services are exchanged, it is necessary to set up accounts receivable and/or accounts payable to account for both the value of the transaction and appropriate timing for recognition of the related income or expense.

The growth of the Internet increased the use of barter, especially advertising. Since many Internet operations initially had operating losses and valuation of Internet companies were based on a multiple of revenues, the emphasis on reporting barter transactions has shifted

from the non-reporting issues to the issue of the economic substance of the barter transactions being recorded.

The concern of the accounting principles organizations (American Institute of Certified Public Accountants, state boards of accounting, etc.) and the regulatory agencies (such as the Securities and Exchange Commission) is that much of these barter revenues will never be realized in cash. While equal amounts of income and expense would be reported with no net effect on net income, valuations based on revenues would be artificially inflated. The accounting industry task force that is currently studying this issue has concluded that revenue and expense from Internet advertising barter transactions should only be recorded at the fair value of the advertising space given or received and only if the entity has a historical practice of receiving or paying cash for similar transactions.

If it is appropriate to record a barter transaction, the value of the barter should be determined based upon the best information available, in the following sequence:

1. Record the trade at the value of the goods or services provided (for example, rate card rate for pages run in own magazine or online), *otherwise*
2. If determinable, record the trade at the value of the goods or services received (for example, rate card rate for pages used in another publication or online, or value of broadcast time for radio or television ads, the value of prepress services used or the value of other services received such as website software or systems design), *otherwise*
3. If neither of the above is determinable, calculate the values based on the best information available.

As with other realization reviews, the barter receivable and payable should be evaluated from time to time (at least annually) to determine if the goods or services will actually be received, utilized or, conversely, delivered. Those amounts that have no future value or benefit should be written off like any other bad debt and adjusted against the account originally debited or credited when the barter revenue or expense was recorded.

For financial statement purposes, both the barter receivable and the barter payable should be separated into current and non-current classifications. The corresponding current or non-current accounts should be combined for financial statement purposes.

Subscription Lists and Other Intangibles

Subscription lists and other intangible assets that are acquired from other publications are recorded at their fair market value and are included as assets on a publishing company's balance sheet. For accounting purposes, the value of acquired lists must be amortized over their determinable life.

Other intangibles with undetermined lives are no longer amortized for accounting purposes but are subject to periodic impairment testing.

REVENUES

Advertising

Revenue from the sale of advertising space includes charges for display space (both print and online media), furnished inserts, other special units and surcharges for color, bleeds and premium positions. Classified advertising is billed at different rates, and some publishers record them under a separate account.

Advertising sales for magazines are recorded as income on an accrual basis when copies of a particular issue are put into the mail for readers (controlled or paid) and when delivered into the distributor/wholesale or direct dealer network (on the on-sale date). Online advertising is recognized over the term of the ads are displayed on the website or based on the number of unique visits. Advertising sales are usually presented as a one-line item on the income statement, net of agency commissions. Often, advertising sales are presented gross, with agency commissions shown as a deduction, to arrive at net advertising sales.

Publishers generally allow for discounts on insertion frequencies and amounts of space. Advertisers often contract in advance for a discount and then deviate from the agreed contract. If they run more space than they contracted for, they earn a rebate. If they run less space than they contracted for, they are billed for the difference between the contract rate and the rate actually earned (the "short rate"). In effect, therefore, the only firm agreement between the advertiser and the publisher is the insertion order, which must be submitted before the closing of each issue.

Publishers have been known to record net advertising revenue by different methods. Among these methods are:

- Gross billings recorded by income account with the commission and discount shown in separate accounts
- Income recorded exclusive of commission, with the discount entered when deducted
- Income recorded net of both commission and discount

For financial reporting, the appropriate accounting is to record net advertising revenue at the rate card amount, less agency commissions and cash discounts (plus or minus any other premiums or discounts).

Separate accounts and gross rather than net amounts provide the best information for better management controls. For example, some companies use separate accounts to distinguish between national and regional advertising and between four-color and black-and-white advertising.

Space used for house ads promoting the company's conferences, websites, books, directories and other products is generally not charged to the profit center benefiting from

the ad, and it generally should not be included in the advertising revenue account of the profit center running the ad.

Exceptions apply when the house ads are run for the benefit of different operations within the same publishing company, or if the company requires detailed profit center accountability. In this case, profit center accounting requires that the space be credited to the revenue of the operation running the space and charged to the promotion expense of the operation benefiting from the space. The revenue and related expenses from house ads would be eliminated for financial reporting purposes.

Other complications arise when dealing with group rates for multiple publications and dealing with combination sales of print and other media, especially online.

Publishing companies must set up a structure to equitably distribute group or combination discounts to each profit center. While there is no specific model that applies to all situations, the following alternatives should be considered:

- Allocate the total discount in proportion to gross rate card revenues.
- Allocate the total discount based upon a pre-determined formula that represents the company's marketing strategy.

Subscription Revenue

Gross subscription revenue income for magazines and online activities is the amount earned after deducting amounts for cancellation of credit orders not collected. Net subscription revenue is also reduced by deducting the commissions paid to subscription agencies used by some consumer magazines to procure subscriptions.

Orders (both cash and credit) received from subscription sales are initially considered to be deferred income because they represent the publisher's obligation to fulfill the subscriptions over their term—an obligation that is satisfied only as each issue of the magazine is delivered to the subscribers or over the term of the online subscription (unless the subscription is cancelled or suspended for nonpayment).

On the balance sheet, this obligation is usually identified as "deferred subscription revenue." It is classified in current liabilities in some publishers' balance sheets, below current liabilities on others, and divided between current and non-current in still others (see discussion on Financial Statement Presentation).

Some publications still record subscription income on a cash basis as they receive payment from the subscriber. The correct method, however, is to record the amounts received on a deferred basis and to realize a proportionate amount of income as the subscribers receive service. A two-year subscription to a monthly magazine, for example, would be recorded into income in 24 increments, one for each issue delivered.

Subscriptions can be sold by direct mail, inserts, subscription agencies, online and many other ways, all of which have related costs. Historically, publishers have either written off

these costs as incurred or deferred them to match the deferred income generated by the related subscriptions.

In December 1993, the Accounting Standards Division of the AICPA issued Statement of Position 93-7, Reporting on Advertising Costs. This pronouncement specifically identifies the costs of efforts to increase subscription circulation as a type of direct response advertising that must be deferred and amortized if certain criteria are met. Those costs relate to customers that have specifically responded to the promotion effort, where the promotional expenditure results in future rather than current benefit. The pronouncement also makes it clear that a low response rate is expected and the total of all expenditures—not merely a proportionate amount based on response—must be capitalized.

The pronouncement goes on to say that not only third-party costs should be capitalized, but also the costs of employees who are involved in the direct mail effort plus related overhead. Including employee costs and overhead in deferred costs has not historically been the practice in the publishing industry.

The deferral of direct mail costs should be captured on a campaign-by-campaign basis where practical. These costs should be amortized over the life of the related subscriptions, but generally not longer than one year unless there is clear evidence that the benefits have a longer life. The amount of these deferred costs is carried in an account called “deferred circulation acquisition costs,” and it is identified as such on the balance sheet in the same classification as the related deferred income, or is shown (parenthetically) as an offset to deferred subscription revenue.

Periodically, these deferred costs must also be reviewed for “realization” or future benefit. The amount carried on the balance sheet should not exceed remaining future revenues. Any write-offs of unamortized costs for realization should be expensed in the current period. Future subscription revenues were defined by ASEC (Accounting Standards Executive Committee of the AICPA) in Practice Bulletin 13 in December 1999 to include only revenues from subscription sales. Other related or ancillary revenues from advertising, list rentals, etc. should not be included in the test for realization or future benefit.

Credit Subscriptions and Bad Debts

It is appropriate to record credit subscriptions (“bill me”) just like any other receivable. At the same time a corresponding reserve for bad debts should be recorded. A bad debt in this case includes subscribers who are “bad debts” in the traditional sense (bad checks, undeliverable and so on), as well as the substantial percentage of subscribers that order but cancel after receiving one or more copies and those (“bad pay”) who simply never respond to billings are undeliverable, are suspended and existing subscribers that do not renew and receive copies during the renewal period.

To properly account for all subscriber activity, estimates must be made not only of the percentage of orders that will be uncollectible and that will cancel, but also for what portion of the related subscription order has been recognized as income and how much is to be relieved or deducted from Deferred Subscription Income. The information necessary to

determine the appropriate amounts and percentages is usually contained in the company's fulfillment reports.

Periodic summaries (generally monthly) included in fulfillment reports roll forward balances of accounts receivable and deferred subscription income.

Fulfillment reports usually include monthly summaries that reconcile the prior month's balances and current month's activity to the current month's ending balance. The ending balance should agree to the detail reports.

These reports only show actual transactions and do not include all of the information necessary to properly record for financial account purposes. These reports need to be reconciled to the internal accounting reports that reflect the correct amount of earned subscription income and the required balance sheet reserves.

A number of important concepts must be clearly understood in order to properly account for credit subscriptions:

- The majority of "bad debt" as it relates to credit subscription orders are for the most part cancellations and therefore a reduction of revenue, not an expense and should be recorded as "Uncollected Subscriptions Income" or "Subscription Bad Debt." (There may be a nominal number of returned checks that are traditional bad debts.)
- Fulfillment reports generally reflect only the actual transactions posted through the system in real time, but not necessarily in the correct period for financial accounting (GAAP) purposes.
- Fulfillment reports do not indicate actual delivery dates for subscriber copies, only the actual running of labels or tapes.
- Fulfillment reports do not match bad debt copies to the periods when income was reported as earned.
- Fulfillment reports generally report as bad debt the difference between the amounts of accounts receivable and the balance remaining in deferred income, and do not take into account the amount of earned income previously reported.
- Fulfillment reports generally do not cut-off at month-end or year-end and using those reports will not reflect activity through to the end of the financial reporting period.

While most fulfillment systems have been upgraded to allow publishers direct online access to reports and analyses, the fact is that reports are run in real time based on actual activity that may not be consistent with financial accounting. Accounting departments should request month-end reports from the fulfillment company or run the required reports online.

As the following worksheets demonstrate, the average bad debt/bad pay from all sources is 8.3% with a range of 12.85% for new direct mail subscriptions to .24% for renewals.

This results from the difference between the characteristics of new direct mail orders with a high percentage of credit orders with a low pay up percentage compared to renewal orders that have a high percentage of cash orders and a high pay up percentage.

In addition, in this example, new direct mail orders receive more copies prior to cancellation than do renewal orders.

If there was only one direct mail effort, all of the bad pay could be absorbed in the first few months. In reality, there are multiple mailings every year in addition to (monthly) renewal efforts and the actual bad debt/bad pay percentage will vary from accounting period to accounting period.

Instead of attempting to isolate each layer of mailing and renewals, it is more practical and acceptable to periodically update the Allowance for Bad Debts and the Deferred Subscription Income Offset accounts and adjust the difference to the Uncollectible Subscription Income account (an offset to Earned Subscription Income).

We suggest updating these accounts monthly as the adjustments for earned subscription income is made.

The allowance for bad debt/bad pay should reflect the total subscriptions that are expected to be cancelled and until copies are actually served (or delivered). Deferred Subscription Income should be offset (a contra account) by the amount of bad debt/bad pay copies still undelivered.

Instead of making monthly adjustments directly to a bad debt expense account based on the average bad debt/bad pay percentage(s), a computation of the appropriate monthly balances for the allowance accounts can be computed using the example in the worksheets below.

Depending on the mix and complexity of your subscription circulation, the analysis of the bad debt percentage should be periodically reviewed and updated for changes in circulation mix, pay up, average copies per order and average copy values.

Careful analysis should also be made of how the aging of subscription receivables matches billing efforts and the percentage of overall collections that are received from each billing effort.

Actual monthly subscription bad debts will vary depending on the mix of new and renewal copies delivered in that month. The higher the proportion of new subscription copies, the higher the bad debt.

While it would be acceptable to calculate and adjust subscriber bad debt every month to match the mix of copies delivered, it is more practical to determine in overall bad debt and record that percentage against earned subscription income when it is recorded.

Subscription Accounting Worksheets

Worksheet I: Accounts Receivable, Reserves and Offset Accounts

Column A: Aged accounts receivable at month end

Column B: Number of copies served – depending on how long the order is in the system before it is paid, cancelled or suspended

Column C: Estimated bad pay – information and pay up is obtained from an analysis of bill keys and payment history

Column D: Reserve against subscription accounts receivable based on aging and payment history based on average copies per order and average copies served before cancelled or suspended.

Column E: The amount of bad debt/bad pay dollars included in accounts receivable

Column F: The offset to deferred subscription income representing the value of deferred income that will be reversed as orders are paid, cancelled or suspended

Manual of Accounting for Magazine Publishers

	(A)	(B)	(C)	(D)	(E)	(F)
				(A) X (C)	(A) X (B)/c/p/o X (C)	(D) - (E)
<u>MONTH</u>	<u>A/R BALANCE</u>	<u># OF COPIES SERVED</u>	<u>EST. % BAD PAY</u>	<u>TOTAL RESERVE</u>	<u>BAD PAY</u>	<u>CONTRA DSI</u>
Current	\$4,000,000	1.000	45.485%	\$1,819,416	\$150,309	\$1,669,108
back 1 month	\$800,000	2.000	92.254%	\$738,029	\$118,215	\$619,814
back 2 months	\$300,000	2.343	96.936%	\$290,808	\$54,569	\$236,239
back 3 months	\$200,000	2.343	98.675%	\$197,351	\$37,032	\$160,318
Older	\$100,000	2.343	100.000%	\$100,000	\$18,765	\$81,235
Total A/R - Dir Mail	<u>\$5,400,000</u>			<u>\$3,145,604</u>	<u>\$378,890</u>	<u>\$2,766,715</u>
Current	\$200,000	1.000	20.317%	\$40,634	\$3,393	\$37,241
back 1. month	\$50,000	1.500	94.821%	\$47,411	\$5,939	\$41,472
back 2 months	\$25,000	1.530	100.000%	\$25,000	\$3,194	\$21,806
back 3 months	\$25,000	1.530	100.000%	\$25,000	\$3,194	\$21,806
Older	\$25,000	1.530	100.000%	\$25,000	\$3,194	\$21,806
Total A/R-Conversion	<u>\$325,000</u>			<u>\$163,045</u>	<u>\$18,914</u>	<u>\$144,131</u>
Current	\$200,000	1.000	13.452%	\$26,904	\$2,241	\$24,663
back 1. month	\$75,000	1.500	97.446%	\$73,085	\$9,131	\$63,954
back 2 months	\$25,000	1.574	100.000%	\$25,000	\$3,277	\$21,723
back 3 months	\$25,000	1.574	100.000%	\$25,000	\$3,277	\$21,723
Older	\$25,000	1.574	100.000%	\$25,000	\$3,277	\$21,723
Total A/R - Renewal	<u>\$350,000</u>			<u>\$174,989</u>	<u>\$21,203</u>	<u>\$153,786</u>
Current	\$60,000	1.000	49.532%	\$29,719	\$2,380	\$27,339
back 1. month	\$20,000	2.000	99.351%	\$19,870	\$3,183	\$16,687
back 2 months	\$10,000	2.036	100.000%	\$10,000	\$1,631	\$8,369
back 3 months	\$10,000	2.036	100.000%	\$10,000	\$1,631	\$8,369
Older	\$10,000	2.036	100.000%	\$10,000	\$1,631	\$8,369
Total A/R - Others	<u>\$110,000</u>			<u>\$79,589</u>	<u>\$10,455</u>	<u>\$69,135</u>

	<u>Total A/R</u>	<u>A/R RESERVE</u>	<u>BAD PAY</u>	<u>CONTRA DSI</u>
Direct Mail	\$5,400,000	(\$3,145,604)	\$378,890	\$2,766,715
Conversion	\$325,000	(\$163,045)	\$18,914	\$144,131
Renewal	\$350,000	(\$174,989)	\$21,203	\$153,786
Others	\$110,000	(\$79,589)	\$10,455	\$69,135
Balance - Current	\$6,185,000	(\$3,563,227)	\$429,462	\$3,133,765
Balance- Prior	\$4,000,000	\$2,100,000		\$1,800,000
Adjustment		(\$1,463,227)		\$1,333,765
Journal Entry			DR(CR)	
	AR Allowance		(\$1,333,765)	
	Def Rev Offset		\$1,333,765	
	Bad Pay Contra Adjustment		\$129462	

Worksheet II: Overall Bad Debt/Bad Pay (derived from Worksheet III)

Overall bad debt/bad pay is computed by dividing the total value of bad debt/bad pay copies by the total dollar value of those orders from all sources.

	net dollar earned <u>dollars</u>	Bad pay <u>dollars</u>	<u>total</u>	percentage <u>of total</u>
Direct Mail	\$2,560,976	\$377,608	\$2,938,584	62.469%
Conversion	\$631,486	\$4,097	\$635,582	13.511%
Renewal	\$997,847	\$2,406	\$1,000,252	21.264%
Other	<u>\$124,618</u>	<u>\$5,038</u>	<u>\$129,656</u>	<u>2.756%</u>
	<u><u>\$4,314,926</u></u>	<u><u>\$389,148 (a)</u></u>	<u><u>\$4,704,074 (b)</u></u>	<u><u>100.000%</u></u>

overall bad pay percentage = a divided by b

$$\begin{array}{l}
 \text{(a)} \\
 \text{(b)}
 \end{array}
 \frac{\$389,148}{\$4,704,074} = \boxed{8.273\%}$$

Worksheet III: Bad Debt/Bad Pay

Bad debt/bad pay by source is based on values determined in Worksheets IV for order value, copies per order and copy value from Worksheet VI for the percentages of cash verses credit orders.

		Direct Mail - new			
Average Order Price		\$27.37			
Copies per Order		12.1045			
copy value		\$2.2609			
Total Orders		<u>164,862</u>			
Cash %		0.0494			
Credit %		<u>0.9506</u>			
Total		<u>1.00</u>			
Pay Up %		<u>0.5451</u>			
		Copies Served	Orders	Copies	Dollars
Cash Orders	12.10453591	8,145	98,591	\$222,905	
Paid Credit Orders	12.10453591	85,434	1,034,134	\$2,338,071	
Bad Pay Orders	2.343	71,283	167,017	\$0	
		<u>164,862</u>	<u>1,299,743</u>	<u>\$2,560,976</u>	
Average Copy Value Collected				\$1.9704	
Subscription Copy Value				\$2.2609	
Bad Pay Percentage				12.85%	
Bad Pay Dollars		167,017	\$2.2609	\$377,608	

		Conversion			
Average Order Price		\$27.02			
Copies per Order		12.0064			
copy value		\$2.2501			
Total Orders		<u>24,565</u>			
Cash %		0.7616			
Credit %		<u>0.2384</u>			
Total		<u>1.00</u>			
Pay Up %		<u>0.7968</u>			
		Copies Served	Orders	Copies	Dollars
Cash Orders	12.0064	18,708	224,616	\$505,404	
Paid Credit Orders	12.0064	4,667	56,034	\$126,082	
Bad Pay Orders	1.53	1,190	1,821	\$0	
		<u>24,565</u>	<u>282,471</u>	<u>\$631,486</u>	
Average Copy Value Collected				\$2.2356	
Subscription Copy Value				\$2.2501	
Bad Pay Percentage				0.64%	
Bad Pay Dollars		1,821	\$2.2501	\$4,097	

Manual of Accounting for Magazine Publishers

		renewal			
Average Order Price				\$35.08	
Copies per Order				16.3928	
copy value				\$2.1400	
Total Orders				<u>29,158</u>	
Cash %				0.8179	
Credit %				<u>0.1821</u>	
Total				<u>1.00</u>	
Pay Up %				<u>0.8655</u>	
		<u>Copies Served</u>	<u>Orders</u>	<u>Copies</u>	<u>Dollars</u>
Cash Orders	16.3928	23,849	390,952	\$836,654	
Paid Credit Orders	16.3928	4,595	75,322	\$161,192	
Bad Pay Orders	1.574	714	1,124	\$0	
		<u>29,158</u>	<u>467,399</u>	<u>\$997,847</u>	
Average Copy Value Collected				\$2.1349	
Subscription Copy Value				\$2.1400	
Bad Pay Percentage				0.24%	
Bad Pay Dollars		1,124	\$2.1400	\$2,406	

		Other			
Average Order Price				\$24.34	
Copies per Order				12.4862	
copy value				\$1.9491	
Total Orders				<u>6,390</u>	
Cash %				0.5989	
Credit %				<u>0.4011</u>	
Total				<u>1.00</u>	
Pay Up %				<u>0.5047</u>	
		<u>Copies Served</u>	<u>Orders</u>	<u>Copies</u>	<u>Dollars</u>
Cash Orders	12.48622848	3,827	47,785	\$93,138	
Paid Credit Orders	12.48622848	1,293	16,151	\$31,480	
Bad Pay Orders	2.036	1,270	2,585	\$0	
		<u>6,390</u>	<u>66,520</u>	<u>\$124,618</u>	
Average Copy Value Collected				\$1.8734	
Subscription Copy Value				\$1.9491	
Bad Pay Percentage				3.89%	
Bad Pay Dollars		2,585	\$1.9491	\$5,038	

Worksheet IV: Cash vs. Credit Orders

<u>orders</u>	<u>cash</u>	<u>credit</u>	<u>total</u>	<u>% cash</u>	<u>% credit</u>
Direct Mail	8,145	156,717	164,862	4.94%	95.06%
Conversion	18,708	5,857	24,565	76.16%	23.84%
renewal	23,849	5,309	29,158	81.79%	18.21%
other*	<u>3,827</u>	<u>2,563</u>	<u>6,390</u>	59.89%	40.11%
Totals	<u>54,529</u>	<u>170,446</u>	<u>224,975</u>		

Worksheet V: Values

	<u>orders</u>	<u>order value</u>		
		<u>net dollars</u>	<u>order value</u>	<u>% of orders</u>
Direct Mail	164,862	\$4,511,795	\$ 27.37	71.01%
Conversion	24,565	\$663,633	\$ 27.02	10.44%
Renewal	29,158	\$1,022,901	\$ 35.08	16.10%
Other*	<u>6,390</u>	<u>\$155,514</u>	\$ 24.34	<u>2.45%</u>
Total	<u>224,975</u>	<u>\$6,353,843</u>		<u>100%</u>

	<u>copy value</u>				
	<u>copy liability</u>	<u>copies per order</u>	<u>value per copy</u>	<u>cash dollars</u>	<u>credit dollars</u>
Direct Mail	\$1,995,578	12.10	\$ 2.2609	\$222,905	\$4,288,890
Conversion	\$294,938	12.01	\$ 2.2501	\$505,404	\$158,229
Renewal	\$477,982	16.39	\$ 2.1400	\$836,654	\$186,247
Other*	<u>\$79,787</u>	12.49	\$ 1.9491	<u>\$93,138</u>	<u>\$62,376</u>
Total	<u>\$2,848,285</u>			<u>\$1,658,101</u>	<u>\$4,695,742</u>

*Other includes Gifts, Internet, Agency, Customer Service, and Misc.

Manual of Accounting for Magazine Publishers

Worksheet VI: Orders

<u>orders</u>	<u>cash</u>	<u>credit</u>	<u>total</u>	<u>% cash</u>	<u>% credit</u>
Direct Mail	8,145	156,717	164,862	4.94%	95.06%
Conversion	18,708	5,857	24,565	76.16%	23.84%
renewal	23,849	5,309	29,158	81.79%	18.21%
other*	<u>3,827</u>	<u>2,563</u>	<u>6,390</u>	59.89%	40.11%
Totals	<u>54,529</u>	<u>170,446</u>	<u>224,975</u>		

Accounting for Credit Subscriptions and Bad Debt

Assumptions (10,000 new orders)

Average subscription price – 12 issues for \$24

95% credit orders, 5% cash with order

Cancellation or claims paid – 5% (assume an average of two issues delivered without receipt of payment)

Suspended service – 40% of credit orders

Assume an average of 3 issues delivered without receipt of payment.

Credit subscription order received:

	<u>Debit</u>	<u>Credit</u>
Accounts receivable – subscriptions	\$228,000	
Deferred subscription income (9,500 subscriptions @\$24)		\$228,000
Deferred subscription income offset account	102,600	
Allowance for bad debts – subscriptions (claims paid and suspended)		102,600
Monthly as subscription copies are served: (realization of earned income and offset for bad debts)		
Deferred subscription income	20,000	
Subscription income (10,000 copies served @ \$2.00)		20,000
Bad debt expenses – subscriptions	1,655	
Deferred subscription income offset account (8.273% - see Worksheet II)		1,655

Subscription orders suspended, canceled, etc.:

Allowance for bad debts – subscriptions	228,000	
Accounts receivable (reverse original reserve)		228,000
Deferred subscription income offset account	81,225	
Deferred subscription income (4,275 subscription orders cancelled @ 9.5 copies each @ \$2.00)		81,255

Single-Copy Revenue

Typically, single copies of consumer magazines distributed to newsstands, convenience stores, supermarkets, bookstores, discount retailers and similar outlets have full right of return. Copies distributed directly to outlets that also sell the products that are the principal subject of the magazine (“direct dealers” such as tennis shops and music stores) are often sold on a non-return basis.

Magazines distributed to single-copy outlets are usually serviced by national distributors through wholesalers that deliver to retailers. The retailer has the right to return unsold copies for full credit, generally for a contractual period of time. Distribution is based on estimates of ultimate copy sales, which for many reasons take into account significant numbers of copies that will remain unsold. It generally takes months to account for all of the copies of each particular issue that are actually returned and to make final settlement for that issue with the publisher. In the interim, for accounting purposes, returns are estimated by issue (based on the historical performance of past issues), and such estimates are recorded on the general ledger to determine the profitability of each issue.

When an issue is shipped, the distributor is billed the full amount of the sale: number of copies shipped (the draw) multiplied by the per copy price to the distributor. This amount is debited to “accounts receivable – distributor and credited to “single-copy sales”.

Returns are inevitable; therefore, a reserve titled “reserve for single-copy returns” should be recorded. The reserve is determined by multiplying the estimated number of copies that will be returned by the distributor’s price per copy. Later, as actual returns are reported, corresponding amounts are deducted from the “reserve for returns” and from the “accounts receivable – distributor.” When the issue is closed out (returned copies cease to be accepted for the particular issue), the “returns account” for that particular issue is also closed out. It should be emphasized that the details on an issue by issue basis should be maintained separately in support of the general ledger accounts. (See Schedules B, C & D.)

Another form of distribution is referred to as Scan Based Trading (SBT). This method may still use the distributor network however in many instances, the copies are not sold to the distributor but rather remain the property of the publisher until the copy is sold by the retailer.

For accounting purposes, the copies in the SBT system are considered consigned inventory. At the end of each reporting period, the consigned copy inventory will have to be valued based upon the expected net sale similar to the process described above for traditionally distributed single copies.

Retail Display Allowance

In addition to other costs and expenses paid by publishers to insure delivery of their magazines to the retail outlets, many publishers also pay an additional allowance known as Retail Display Allowance (RDA). The charge for RDA appears on the billing from the wholesaler as it is paid by the wholesaler and is generally between 10% and 20% of the cover price of the issue.

For accounting purposes, RDA should be accrued (Allowance for RDA) for each issue and accounted for like any other liability. RDA charges should be recorded as a reduction in income, not as an operating expense.

Schedule A presents an example of the accounting necessary to clearly reflect the single-copy sales of one issue. The schedules that follow (Schedules A, B and C) represent worksheets for tracking single copy Accounts Receivable, Allowance for Returns and Allowance for RDA.

Schedule A

Assumptions

Accounting month	Jan	Feb	Mar	Apr	May
Cover date	Feb	Mar	Apr	May	Jun
On-sale date	1/20	2/20	3/20	4/20	5/20
Draw	100,000	105,000	105,000	110,000	110,000
Estimated net sales %	45.00%	45.00%	45.00%	45.00%	45.00%
Estimated copies sold	45,000	47,250	47,250	49,500	49,500
Cover Price	\$3.95	\$3.95	\$3.95	\$3.95	\$3.95
Net to Publisher/Copy	\$2.17	\$2.17	\$2.17	\$2.17	\$2.17
Estimated net income	\$97,650	\$102,533	\$102,533	\$107,415	\$107,415

Initial distribution of February issue (January 20XX):

	<u>Debit</u>	<u>Credit</u>
Accounts receivable – distributor	\$217,000	
Newsstand sales (100,000 copies draw @2.17)		\$217,000
Newsstand returns	119,350	
Allowance for returns (55,000 copies estimated to be returned @ \$2.17)		119,350

Manual of Accounting for Magazine Publishers

Receipt of first payment (January 20XX):

Cash	48,825	
Accounts receivable – distributor		48,825

Periodic returns and RDA changes (February 20XX):

Allowance for returns	71,610	
Accounts receivable		71,610
Allowance for RDA's	3,022	
Accounts receivable		3,022

Financial settlement and issue closeout (April 20XX):

Cash	40,893	
Allowance for returns	11,935	
Allowance for RDA	2,266	
Accounts Receivable		55,094

If in fact the estimated net sale changes, there should be an adjustment (up or down) as that information becomes available. There may also be other settlement terms with the wholesaler and the entry process should be modified accordingly.

Certain costs related to single-copy sales such as racks, audits, promotion expenses, etc., are paid for by the distributor and deducted from payments to the publisher. Some of the expenses are deducted from revenues and which are charged as operating expenses.

The following schedules are examples of the detail analysis that should be maintained for single copy sales and RDA on an issue by issue basis. The totals should agree with the amounts on the balance sheet and operating statements for Accounts Receivable, Allowance for Returns, Allowance for RDA, Single Copy Sales Revenue and Single Copy Returns.

SCHEDULE B

ACCOUNTS RECEIVABLE

ACCOUNTING MONTH	DESCRIPTION / ISSUE	TOTAL	PRIOR	FEB	MAR	APR	JUN	JUL04
1/31	1 ON-SALE	217,000		217,000				
	2 RETURNS	0	0	0	0	0	0	0
	3 PAYMENT-CURRENT	(48,825)		(48,825)				
	4 PAYMENT-FINAL	0						
	5 RDA	<u>0</u>		<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	SUB-TOTAL	168,175	0	168,175				
2/29	1 ON-SALE	227,850			227,850			
	2 RETURNS	(71,610)	0	(71,610)	0	0	0	0
	3 PAYMENT-CURRENT	(51,266)			(51,266)			
	4 PAYMENT-FINAL	0						
	5 RDA DEDUCTION	<u>(3,022)</u>		<u>(3,022)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
	SUB-TOTAL	270,127	0	93,543	176,584			
3/31	1 ON-SALE	227,850				227,850		
	2 RETURNS	(110,996)	0	(35,805)	(75,191)	0	0	0
	3 PAYMENT-CURRENT	(51,266)				(51,266)		
	4 PAYMENT-FINAL	0						
	5 RDA DEDUCTION	<u>(5,817)</u>		<u>(2,644)</u>	<u>(3,173)</u>	<u>0</u>	<u>0</u>	<u>0</u>
	SUB-TOTAL	329,898	0	55,094	98,220	176,584		
4/30	1 ON-SALE	238,700					238,700	
	2 RETURNS	(124,721)	0	(11,935)	(37,595)	(75,191)	0	0
	3 PAYMENT-CURRENT	(53,708)					(53,708)	
	4 PAYMENT-FINAL	(40,893)		(40,893)				
	5 RDA DEDUCTION	<u>(8,215)</u>	<u>0</u>	<u>(2,266)</u>	<u>(2,776)</u>	<u>(3,173)</u>	<u>0</u>	<u>0</u>
	SUB-TOTAL	341,062	0	0	57,849	98,220	184,993	0
5/31	1 ON-SALE	238,700						
	2 RETURNS	(128,898)	0	0	(12,532)	(37,595)	(78,771)	0
	3 PAYMENT-CURRENT	(53,708)						(53,708)
	4 PAYMENT-FINAL	(41,427)			(41,427)			
	5 RDA DEDUCTION	<u>(9,991)</u>	<u>0</u>	<u>0</u>	<u>(3,891)</u>	<u>(2,776)</u>	<u>(3,324)</u>	<u>0</u>
	SUB-TOTAL	345,739	0	0	0	57,849	102,898	184,993

NOTES

1. DRAW TIMES NET TO PUBLISHER/COPY.
2. RETURNS - SEE SCHEDULE C – ALLOWANCE FOR RETURNS.
3. PAYMENT - CURRENT=50% OF ESTIMATED NET INCOME PAID AT ON-SALE DATE.
4. PAYMENT - FINAL-50% OF ESTIMATED NET INCOME LESS RDA (AND OTHER ITEMS DEDUCTED BY DISTRIBUTOR). PAID IN 3RD MONTH AFTER OFF-SALE DATE.
5. RDA - SEE SCHEDULE D – RDA ALLOWANCE.

Manual of Accounting for Magazine Publishers

SCHEDULE C

ALLOWANCE FOR RETURNS

<u>ACCOUNTING MONTH</u>	<u>DESCRIPTION / ISSUE</u>	<u>TOTAL</u>	<u>PRIOR</u>	<u>FEB</u>	<u>MAR</u>	<u>APR</u>	<u>JUN</u>	<u>JUL04</u>
1/31	1 ON-SALE	(119,350)		(119,350)				
	2 RETURNS	0	0	0				
	SUB-TOTAL	(119,350)	0	(119,350)	0	0	0	0
2/29	1 ON-SALE	(125,318)			(125,318)			
	2 RETURNS	71,610	0	71,610	0			
	SUB-TOTAL	(173,058)	0	(47,740)	(125,318)	0	0	0
3/31	1 ON-SALE	(125,318)				(125,318)		
	2 RETURNS	110,996		35,805	75,191			
	SUB-TOTAL	(187,380)	0	(11,935)	(50,127)	(125,318)		
4/30	1 ON-SALE	(131,285)					(131,285)	
	2 RETURNS	124,721	0	11,935	37,595	75,191		
	SUB-TOTAL	(193,944)	0	0	(12,532)	(50,127)	(131,285)	0
5/31	1 ON-SALE	(131,285)						(131,285)
	2 RETURNS	128,898		0	12,532	37,595	78,771	
	SUB-TOTAL	(196,331)	0	0	0	(12,532)	(52,514)	(131,285)

NOTES

1. RETURNS ALLOWANCE (ON-SALE DATE) = ESTIMATED COPIES RETURNED TIMES NET TO PUBLISHER/COPY.
2. RETURNS PATTERN = 60% RETURNED MONTH AFTER ON SALE, 30% FOLLOWING MONTH, 10% FOLLOWING MONTH.

SCHEDULE D

ALLOWANCE FOR RDA

ACCOUNTING MONTH	DESCRIPTION / ISSUE	TOTAL	PRIOR	FEB	MAR	APR	JUN	JUL04
1/31	1 ACCRUAL	(15,109)		(15,109)				
	2 RDA CLAIMS	0	0	0				
	SUB-TOTAL	(15,109)	0	(15,109)	0	0	0	0
2/29	1 ACCRUAL	(15,864)			(15,864)			
	2 RDA CLAIMS	3,022	0	3,022	0			
	SUB-TOTAL	(27,951)	0	(12,087)	(15,864)	0	0	0
3/31	1 ON-SALE	(15,864)				(15,864)		
	2 RDA CLAIMS	5,817		2,644	3,173			
	SUB-TOTAL	(37,999)	0	(9,443)	(12,691)	(15,864)		
4/30	1 ACCRUAL	(16,620)					(16,620)	
	2 RDA CLAIMS	8,215		2,266	2,776	3,173		
	SUB-TOTAL	(46,403)	0	(7,177)	(9,915)	(12,691)	(16,620)	0
5/31	1 ACCRUAL	(16,620)						(16,620)
	2 RDA CLAIMS	9,991		1,511	2,380	2,776	3,324	
	SUB-TOTAL	(53,032)	0	(5,666)	(7,535)	(9,915)	(13,296)	(16,620)

NOTES

1. RDA ACCRUAL = ESTIMATED NET SALE COPIES TIMES COVER PRICE TIMES % SUBJECT TO RDA PER CONTRACT TIMES RDA%.
2. RDA CLAIMS ARE DEDUCTED FROM DISTRIBUTORS PAYMENT TO PUBLISHER – IF SYSTEM ALLOWS, RDA CLAIMS SHOULD BE DEDUCTED FROM THE ISSUE THEY CORRESPOND TO. IF NOT, THEY SHOULD BE DEDUCTED FROM THE OLDEST OPEN ISSUE

Other Operating Income

A publisher generally has many sources of income in addition to advertising and circulation. If these other revenues are not significant, they may be recorded net of the direct third-party costs incurred in producing the income. If the income from any source becomes significant, the gross revenues and the related direct expenses should be recorded separately.

Items often recorded under "other operating income" are websites and online services, conferences and trade shows, sale of books and directories, the sale of reprints, rights and permissions and the sale or rental of mailing lists. No item should be recorded as "other operating income" to a publication unless it is related to the publishing of that magazine or website. Management should consider whether or not to allocate income from operations that depend on more than one magazine in a multi-magazine company and if so, how to allocate them equitably among those magazines.

Below is a brief discussion of the items shown in other income:

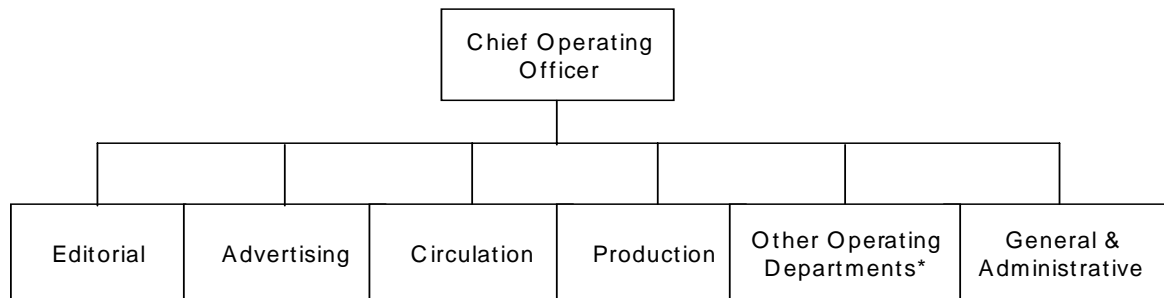
- **Internet and online services:** may either be treated as generating additional revenues for a particular magazine or a separate profit center providing support to any number of publications.
- **Conferences and tradeshow:** also includes sale of exhibit space, seminars, training programs and symposia, but only if they are directly related to the publication's market.
- **Books and directories:** generally to be accounted for as part of a publishing operation and not as an independent profit center, books have the same general subject matter and appeal to the same readership as the publication; directories generally list either the customers or the suppliers of the publication's readers, or the readers themselves.
- **Reprints:** the sale of articles reprinted from the magazine or website.
- **Rights and permissions:** the sale or lease of licenses to use material copyrighted by the publication or the publication's authors. If the authors own the copyright, they are usually paid a percentage of the permission income, and the company reports the income net of the author's portion.
- **Mailing lists:** the sale or rental of lists of the publication's subscribers. This amount should always be reported in "other operating income" not credited to the circulation department.

Costs and Expenses

As discussed above, the publication of a magazine is considered to be the "product" of a publishing company. The publishing industry has developed a chart of accounts to show operations in a way that allows management to get a clear view of each operating

department. A chart of accounts and the related financial reports should be organized to reflect both the relationships between the various (major) operating departments and the lines of management reporting.

To that end, the chart of accounts should basically follow the organization of the particular company. This means that instead of the most commonly used “manufacturing” oriented chart of accounts that reflects the cost of sales and gross profit, a magazine’s chart of accounts would be more useful if it is organized to compliment the following structure:



** Separate Operating Departments, such as Internet, Events.*

All costs that can be specifically identified with a particular issue should be accounted for as an expense in the same accounting period as the period in which the revenue from that issue is reported as income. Magazines published more frequently than once a month usually account for their operations on a monthly, rather than an issue-by-issue basis. Their operating statements include the expenses for all the issues published during that month. The monthly financial statements for a weekly publication, for example, will generally include four-issue months, five-issue months, and thirteen-issue quarterly financial statements. On the other hand, the financial statements for a bimonthly magazine will reflect some months with no income.

Expenses that can be directly attributed to issues that have not yet been published should be treated as prepaid expenses and charged to operations only when the issue is actually published.

Departmental costs of an ongoing nature, such as salaries and related benefits, should be recorded in the period in which they are incurred, even though in theory they may contribute to the publication of an issue a month or more in the future.

If a company publishes more than one magazine, each magazine should be accounted for separately for management reporting purposes. Expenses incurred on behalf of more than one publication should be allocated among them as accurately as possible, and on a consistent basis. Similarly, expenses incurred on behalf of more than one department should be allocated among those departments. Expenses for operations not connected with publishing should be kept separate so that the results of each operating unit will be as accurate and useful as possible.

Editorial and Art

Editorial costs include all the expenses, direct and indirect, of preparing the editorial and graphic content of the publication. Costs include fees for articles and other editorial material submitted by non-staff contributors, as well as fees paid to non-employees for editorial services, contributions and consultation on editorial matters.

Publications that make a significant number of purchases of manuscripts and other materials for future issues should inventory them and charge them to the issue in which they are published. The inventory of purchased editorial material should be periodically reviewed, and material with no future value should be written off and charged to "kill fee" expense.

Advertising

- **Advertising sales:** Advertising sales encompass all costs associated with selling ad space, including the expenses of the sales staff and all other costs of the department. This also includes the work involved in handling contracts and the commissions paid to publishers' representatives. Commission paid to advertising agencies are charged directly against advertising income.
- **Promotion:** Promotion includes costs for all activity involved in selling space to advertisers and ad agencies: producing and mailing promotional pieces to advertisers and agencies, promoting the publication as an advertising medium in other publications and websites, producing special sales presentations to advertisers and potential advertisers, and developing sales manuals, fact sheets and other presentation aids used by the sales staff.
- **Research:** All costs involved with preparing statistical data for market and readership surveys conducted by the advertising department, including outside studies to support advertising sales efforts, should be recorded under research.
- **Reader-service processing costs:** This account includes staff salaries, data processing and other costs for printing, processing and tabulating reader-service cards or inquiries.
- **Other:** Different accounts may be used for staff commissions and bonuses, for salaries, and for branch office expenses. Other departmental costs accounts may include travel and entertainment, telephone, payroll taxes and fringe benefits, incentive programs, postage and freight, computer modeling, research and development.

Circulation/Distribution

Circulation costs include the costs of distributing the magazine to readers, whether free or controlled, by subscription or through single-copy outlets. They also include postage, labor and the material required to prepare the copies for mailing. The costs of inserting the magazines into envelopes or wrappers, bundling, bagging, loading, and shipping to postal entry points are also circulation costs.

Subscription Fulfillment

All the costs of processing subscription orders and payments fall under subscription fulfillment. This process includes maintaining subscriber lists; addressing invoices, renewal notices, and promotion; maintaining records for circulation audits (ABC, BPA); and answering subscriber complaints. The costs of compiling statistical reports for the accounting and circulation departments are also included.

Many publishers retain outside firms to handle subscription fulfillment, with charges based on the number of subscriber names maintained and other services provided. Some publishers contract with outside firms to handle all circulation functions. All of these costs are charged to circulation. In-house fulfillment includes the cost of rental, depreciation and upkeep for all software and equipment used in fulfillment. For larger magazines, this account may be broken down into accounts for equipment leases, depreciation (on company-owned equipment), maintenance and repairs.

Circulation Acquisition Costs

For paid circulation, costs include fees for securing new and renewal orders by mail promotion and the costs of obtaining orders through field staff or agencies. For controlled circulation publications, costs include fees for developing readership lists and verifying the job titles and functions of readers. Circulation costs also include the amortization of subscriber or readership lists purchased and the amortization of deferred circulation costs.

Subscription Promotion

All costs of acquiring subscriptions, both new and renewal, broken out by source, and the costs of billing and collecting charge subscriptions fall under subscription promotion. For controlled circulation magazines, costs also include the development of lists. The amount of detail needed for these accounts depends on the method of circulation and the requirements of management. For paid circulation publications, a distinction should be made between the costs associated with direct mail, costs attributed to subscription agency efforts and costs related to other major subscription sources. The portion of the subscription payment retained by subscription agencies should be offset against subscription income.

Single-Copy Distribution

Except for postage, many of the costs for distributing single-copies are the same as for subscriptions.

Single-Copy Promotion

The costs for single-copy promotion include all costs of planning and maintaining single-copy sales; coordinating the marketing activities of national distributors, wholesalers and retailers; and other related promotional costs. Also included are brochures, racks, incentive programs, and other sales tools for promoting single-copy sales.

Retail and Display Allowance

Additional allowances paid to certain retailers fall under this heading. The cost of and the unpaid liability for retail display allowances should be carefully tracked and accrued for each issue.

Production/Manufacturing

Manufacturing costs represent the charges incurred in the physical production of the magazine and the related costs of supplies. Paper can be purchased through a printer, broker or directly from a mill. Transportation to the printer is included in the cost of the paper. Paper costs also include charges for storage, handling, and shipping for returnable cores and skids, local hauling and insurance.

Printing costs are a function of the number of copies in the press run, the number of pages in each copy, and the type of press used.

In general, the manufacturing process includes the cost printing, paper, ink and binding. In addition, production costs include electronic prepress (page make-up) costs, digital edition costs, scanning and the cost of alterations, shipping and handling.

Overtime is an important variable in printing costs and requires careful monitoring. Larger magazines usually have at least two accounts in which they monitor overtime: prepress and presswork.

Production department salaries include the salaries for all employees who are involved in the manufacture and physical qualities of the magazine, supervise technical and production matters with the printer, handle all material going to the printer, maintain production control at the printing plant and purchase paper.

Conferences and Trade Shows

The revenues and expenses of conferences and trade shows should be deferred until the event actually takes place.

Most companies defer all revenues and only third-party costs related to future events. Some companies track employee costs related to each future event and defer those costs along with an application of overhead.

While the first method is most common and conservative, the second method is also acceptable.

Website Development Costs

Early in 2000, the Emerging Issues Task Force (EITF 00-2) of the FASB issued a position paper that outlined the accounting for various costs associated with website development. The following costs should be expensed as incurred:

- Planning, budgeting and marketing analysis
- Research on technology, hardware, software and systems
- Identification of vendors, vendor demonstrations and related costs
- Legal costs for rights, trademarks and compliance
- Costs to enter initial content (both text and graphics) into the website
- Costs to train employees involved in website activities

Website hosting services should be expensed over the term of the engagement.

Other costs, including the following, should be capitalized:

- Internet domain names
- Costs to acquire or develop software for sites and related systems
- Costs to acquire or develop code or custom applications
- Costs to acquire, develop or customize database software
- Costs to create initial graphics

The costs of internally developed software should be capitalized once the preliminary development and application testing process has been completed. Capitalized software costs should be amortized ratably over their estimated useful life.

General and Administrative

All expenses of a general nature directly related to the operation of the company, but not directly related to advertising, editorial, circulation, manufacturing or Internet activities, and that have not been accounted for elsewhere, are included under this category. These administrative costs may be accounted for under two general headings: "publication administration" and "general administrative" costs.

Publication Administration

Costs that fall under this heading are primarily the salaries of the publisher or chief operating officer (COO) and others involved in overall management of the publications, as well as their support staff.

For companies that publish more than one magazine and maintain websites, each operation's senior manager may be separated from general company executives. The salary and expenses of these people and those working directly for them are not considered overhead but are expenses of a particular operation. This also applies to certain other administrative expenses, and it requires the allocation of certain significant costs to a particular operation.

General Administrative Costs

Overhead costs not accounted for under "publication administration" are general administrative costs. For companies with more than one operation, this category also includes the cost of joint service departments and those serving more than one operation.

General administrative costs cover employee salaries not charged to a particular publication or operating department, including those for general company executives or for employees in the general accounting and payroll departments, controller's office, human resources, credit, insurance, tax and internal audit departments. Also included are salaries not accounted for under any other category, such as those for office managers, purchasing department employees, technical/IT support, central mail and file department employees, telephone operators, receptionists and messengers.

Other Administrative Costs

Included in this category are legal and accounting fees, insurance, fringe benefits, travel expenses of administrative employees, technical support/IT, office furniture and equipment depreciation, amortization of leasehold improvements, maintenance, rent and other occupancy costs, electricity, repairs, and all taxes other than income and payroll taxes for non-administrative employees.

ACCOUNTING FOR BOOK PUBLISHING AND OTHER SIMILAR MEDIA

Many magazine publishers also produce and publish books, videos, CDs and other similar media.

There are numerous types of books, including trade and consumer, mass-market paperbacks, religious books, elementary and college textbooks, technical and professional books, reference books, mail order books and book club books. Publishers also publish single or serial CDs and videos and other forms of media.

The accounting process for these products generally covers a longer time frame than for periodicals. These products usually require accounting for inventory and certain revenue recognition concepts that are different from those for periodical publishing.

Book Accounting Concepts

Author's Advances

Author's advances against royalties are treated as deferred costs. Advances are paid to authors when a manuscript or proposal is accepted. Provided that a final manuscript is delivered on schedule, the advance is generally not refundable to the publisher, even if the product is never published or its sales are insufficient to cover the advance.

Advances are usually classified as noncurrent assets. Some publishers, however, classify the portion of the advance they expect to earn in the subsequent year as current assets. Regardless of their classification, advances must be evaluated like other assets to determine whether they are likely to be realized—that is, a publisher must determine periodically whether the product's sales will be sufficient to generate the royalties necessary to earn the advance. If sales are not sufficient, the unrecoverable amounts should be written off against current earnings.

Liabilities

The only unusual characteristic of liabilities for these products is the accrued royalties to the author. Royalties usually are accrued when earned.

Accrued royalties are treated as a current liability unless payment to the author is contractually deferred for a period in excess of one year.

Subsidiary Rights

Some publishers can generate additional income from their literary properties by selling the rights for their use to mass-market paperback publishers, film companies, television producers, foreign publishers or other such buyers.

Editorial Expense

For accounting purposes editorial expenses are generally not included in inventory (see definitions of Inventory and Plant Costs), but they may be capitalized by a publisher if its editorial staff contributes significantly to a particular product.

Inventory

Even though most publishers engage third parties to manufacture their book products, publishers must still inventory the materials required in the manufacturing process.

These costs are typically accumulated, product by product, during the manufacturing process in a "work-in-process inventory account." Upon completion of the process, the costs are totaled and transferred to the "finished goods inventory account." The cumulative cost is then divided by the number of units completed and delivered, which represents the cost per unit. As units are sold or disposed of, the cost value of those units are removed from the "finished goods inventory" and charged to "cost of sales" in the statement of operations.

In book publishing, if plant costs (defined below) are allocated over one printing of a book, they should be included in inventory. But if plant costs are amortized on a percentage basis or a sales forecast method, they are generally excluded from inventory and included in fixed assets or other assets, classified as either current or noncurrent inventory, and appropriately captioned.

In evaluating inventories, a publisher must consider the following factors on a product-by-product basis: returns, obsolescence and salability.

New print-on-demand technology will likely reduce inventory and obsolescence considerations.

Returns

Of the various valuations required in the accounting process for publishers of books and similar media, the reserve for returns is probably the most subjective. In calculating this reserve, there is more than one correct method. Industry and company statistics on past returns are compiled, and percentages are determined based on the type of product. The percentage is then applied to gross sales.

To evaluate return statistics properly, two factors must be considered: (1) the return period (the average length of time over which retailers typically return the product), and (2) the effect that a bestseller has on the overall pattern of returns. Generally, a bestseller should be evaluated separately because the period during which it is actively sold is likely to be longer, its return pattern different, and the percentage of returns smaller than the average.

Obsolescence

Books and similar media are rarely considered obsolete in the normal context of a manufacturing operation because they always will have some level of sales.

Plant Costs for Books

These nonrecurring manufacturing costs are the component costs of producing a book before the actual printing and are the only unusual characteristic of a publisher's tangible assets. These costs generally do not include the salaries of in-house staff members, such as editors, designers, illustrators and proofreaders.

Plant costs include the following:

- Manuscript development
- Permissions paid by the publisher for copyrighted art, photos or text
- Outside editorial services
- New art, photos and design
- Preparation, including author's alterations, which in some contracts are charged to the author if they are over a certain percentage of the original composition
- Prepress and process camerawork

Book publishers may account for plant costs in one of the following ways:

- Write them off as incurred
- Write them off on publication
- Write them off in the year of publication
- Record them as inventory and write them off as each unit is sold
- Amortize them over two to seven years on a straight-line, accelerated or sales forecast method

No particular method of accounting for plant costs is used by a majority of publishers, and some use more than one method. The type of book being published usually dictates the method adopted. For a book whose life is relatively short, such as a popular novel, plant costs could be expensed as incurred or within the month or fiscal year of publication. Some publishers amortize these costs over the life of the first printing, along with their associated manufacturing costs.

For a book with a longer expected life, such as a textbook, plant costs could be amortized over a fixed period of time or the expected life of the book, generally from two to seven years. Some textbook publishers charge plant costs to inventory, along with related manufacturing costs. Most publishers of professional books, for example, charge plant costs to inventory.

Production Expense

Production expense represents the labor and material costs incurred by the publisher in manufacturing.

Manufacturing Costs

These costs represent the expenses for the physical components of the product sold and are generally accumulated by category and by title and/or unit. Manufacturing expenses are separate from both editorial and production expenses.

Gross Sales

This account consists of actual billings to customers. It includes sales at standard trade discount or net prices of current products.

The following items are included in gross sales:

- Net sales from consignment stocks
- Any commissions, fees or other service charges allowed
- Sales to jobbers and dealers at the net amount charged

The following items are not included in gross sales:

- Transportation charges billed to and paid by the customer
- Cash discounts allowed to customers
- Charges to customers for returns
- Subsidiary rights income
- Agency commissions or fees for handling books for the account of others

FINANCIAL STATEMENT PRESENTATION

Financial statements offer a source of information for getting a better understanding about a publisher's financial condition. Properly prepared, financial statements clearly describe what happened over a period of time, give a snapshot of where a company is, and are a good indication of where the company may be headed in the future.

In the previous section, we discussed how the accounting process for publishing operations differs from that of a manufacturing company. This chapter will show how the publisher's unique operations result in financial statements that differ from those of the typical manufacturing-oriented financial statements.

As a reader of financial statements, you should be aware of the differences that can be found in the statements of various publishers. The publishing industry is noted for its lack of uniformity in accounting for revenues and expenses. That lack of uniformity is due not only to the diverse nature of the industry, but also to its large number of small, privately owned and thus tax-oriented publishers. In addition, the financial statements of these privately owned companies may not always conform with GAAP. A broad range of accounting policies fall under the umbrella of GAAP, including those that have become acceptable practices by publishing industry custom. This range of practices results in a variety of acceptable financial statement presentations.

The financial statements of all companies should contain the same basic schedules and general footnote disclosures spelled out under GAAP requirements. Every company should include, at a minimum, the following in its financial statements:

- **Balance sheet:** The balance sheet presents a snapshot of the financial condition of the company at a point in time, which is generally the end of the period covered by the income statement.
- **Income statement:** Also referred to as the statement of earnings or statement of operations, it gives a picture of the operating results for the period covered.
- **Statement of cash flows:** This statement gives a different perspective on what has happened to a company during the period covered by the financial statements. It presents sources of cash from operations, investments and financing activities and shows how the company used that cash to reinvest in the business, acquire new businesses or other assets, or pay dividends and distributions.
- **Statement of equity:** This statement summarizes the changes in components of owners' equity.
- **Footnotes:** Footnotes expand on items in the basic statements and, where appropriate, provide additional disclosures required by GAAP. Footnotes give information on accounting policies, acquisitions, equity and other stock options,

benefit plans, short- and long-term debt and financing, leases, long-term commitments, income taxes, contingent liabilities, and so forth.

Financial statements may also include schedules following the footnotes that provide additional detail to information presented in summary form in the basic financial statements.

Every industry generates financial statements that are tailored to reflect a clear picture of how that industry operates. Because publishing involves multiple revenue streams and promises of future services to subscribers, it is necessary for the publishing industry to have financial statements that will differ from service businesses and manufacturing companies that produce goods for sale.

Even within the industry itself, presentations will vary. Footnotes are a key source for clarifying and understanding financial statements. They should be reviewed carefully because they set forth the varying accounting policies selected by the particular publisher and allow the reader to determine the impact those choices make on the financial statements. Understanding these policies will also allow for better comparisons to similar companies.

By and large, publishers' diverse accounting practices reflect the timing by which subscription revenue and related circulation acquisition costs are recognized. The method of valuing acquired subscription lists and other intangibles, and the classification of those costs—as well as the (deferred) subscription revenue and its related costs in the publishers' balance sheet—also differ and affect financial statement presentation.

Each of these matters will be discussed in this chapter with accompanying financial statement examples. In addition, there are examples of footnote disclosures that describe significant accounting policies.

THE BALANCE SHEET

Every company's balance sheet will be different since it represents a snapshot of a particular type of business, particular circumstances and a particular point in time. Broad differences can be noted, however, between the balance sheets of a publisher and those of a typical manufacturer or service company. Typically, the largest assets on a manufacturer's balance sheet are property, plant and equipment, which for publishers are generally very minor assets. The vast majority of publishers use outside printers to produce their magazines. As a result, they do not require capital for printing presses or plants to house them.

Inventory, another major asset of a manufacturer, is not significant to a publisher unless the publisher purchases paper to be held at the printer or in outside warehouses. A publisher's inventory typically includes manuscripts and other material purchased for future issues. Generally, the most significant asset on a publisher's balance sheet, other than the cost of acquisitions, is accounts receivable. Receivables from all revenue sources, including barter receivables, are usually presented together in a one-line item, although additional disclosures by revenue type are also acceptable, though generally presented in the footnotes. Receivables are shown net of estimated discounts, allowances for bad debts, advertising agency commissions and reserves for subscription cancellations, bill-me bad

debts and single-copy returns. The amounts of allowances and reserves should be noted either parenthetically on the balance sheet or in the footnotes.

A few other line items are found on the magazine publisher's balance sheet that would not appear on that of a manufacturer or service company. Deferred liabilities (such as unearned revenues from subscriptions, advertising, conferences and trade shows) and deferred assets (such as deferred circulation acquisition costs, deferred commissions, prepaid conference and trade show expenses and purchased publication rights, (goodwill) and subscription lists) are particular to the publishing industry.

It is important to keep in mind that even within the publishing industry, no "typical" balance sheet exists. Due to the diversity of accounting practices, some publishers will show assets, where others will have the same items net against liabilities.

The industry also lacks standardization as to the location of items on the balance sheet itself. For example, "deferred subscription revenue" can be found in "current liabilities" on some publishers' balance sheets and below total "current liabilities" on others. In some cases, it might be allocated between both current and noncurrent classifications.

Although Accounting Research Bulletin No. 43 would seem to require the amount of "deferred subscription revenue" (with the possible exception of the portion that represents gross margin) to be classified as a "current liability" in the financial statements, it is a common and acceptable method in the industry to treat the amount as a "deferred revenue" item below the "total current liabilities" line. Whatever method is used, it is particularly important to provide adequate disclosures in a footnote that includes the treatment of earnings from subscriptions and other relevant significant facts. In certain instances, it may be desirable to present "total current liabilities," excluding subscriptions as an undescribed subtotal, and then to add the amount of deferred subscription revenue to arrive at a total captioned "total current liabilities," including "deferred subscription revenue." In each case, a decision regarding classification and disclosure should be made after a careful review of the specific facts.

In some cases, it is common to reflect deferred subscription revenue as an amount net of the related deferred circulation acquisition costs on the balance sheet and disclose the gross amount in a footnote to the financial statements; however, presenting both deferrals gross on different sides of the balance sheet is also acceptable.

Similarly, for balance sheet purposes, the amount of deferred subscription agency commission expense is normally reflected as an offset to deferred subscription revenue. Alternatively, under some unusual circumstances, it might be appropriate to classify deferred subscription agency commissions to direct mail agencies or PDS agents as an "other" asset.

One of the most significant assets of a publication is typically not even reflected on the balance sheet: the circulation base of subscribers developed by the publisher through in-house promotional efforts or with the help of outside agents. It is this subscription base that generates advertising revenue for the publication. Thus, for the most part, the publisher has a valuable "intangible" asset not shown on the balance sheet.

Occasionally, publishing companies will have this intangible asset recorded on their books. This happens when a publisher buys a subscriber list or a consumer publication or a paid subscription website and part of the purchase price is allocated to the subscription list.

There are a number of methods commonly used for determining the value of a subscription list. One method is to project the future revenue stream from the circulation base acquired and discount the cash flows back to its present value. Another is to estimate the current cost to "reproduce" the subscription list.

Once a value has been determined, a noncurrent asset is recorded on the balance sheet as part of the purchase accounting for the publication acquired. For accounting purposes, an estimated useful life for the subscription list needs to be determined, just as it is for other intangible assets with a determinable life.

Other intangibles such as goodwill are no longer amortized for accounting purposes. Rather they are periodically evaluated (at least annually) and written down when they are considered impaired.

The rules for accounting for long-lived assets, goodwill and other intangibles and impairment testing are outlined in Statements of Financial Accounting Standards 141, 142 and 144

THE INCOME STATEMENT

Revenues

All statements of income begin with revenues. As discussed previously, a publication may have multiple revenue streams, including advertising, circulation (subscription and single-copy sales) and other operating activities (mailing list rentals and sales, reprint sales, and so on).

Revenues reflected in the income statement are those recognized by management as earned in the period covered by the financial statements. Revenues must be recorded on an accrual basis to be in accordance with GAAP; however, some judgment and selection are involved in determining the appropriate amounts and accrual policies. A publication has several important dates that affect the revenue recognition policies chosen by management for the various streams. A monthly magazine that carries an April cover date most likely will go on sale in March. It may have been shipped from the printer as early as February and it goes off sale when the next issue is distributed.

The revenue section of a publisher's income statement should appear as follows:

Revenue

Advertising sales	\$ 2,500,000	
Less – Agency commissions, cash discounts, volume and, frequently, rebates and other allowance and adjustments	<u>(480,000)</u>	
Net advertising revenues		\$2,020,000
Subscriptions sales	1,200,000	
Less – Agents' commissions	(50,000)	
Estimated cancellations and bad debts	<u>(45,000)</u>	
		1,105,000
Single-copy sales	600,000	
Less – Estimated returns	(240,000)	
Distributors' discounts	<u>(50,000)</u>	
		310,000
Conferences		500,000
Internet		400,000
Other income (subscription list rentals, reprints, etc.)		<u>50,000</u>
Total net revenues		<u>\$4,385,000</u>

Financial statements produced for external purposes with this level of detail are rare. In most instances the amounts of the individual items are not material enough to warrant detailed disclosure in the overall context of the financial statements. In some cases, captions may be summarized into the major basic (net) revenue streams. The condensed statement would appear as follows:

Revenue

Advertising	\$2,020,000
Circulation	1,415,000
Conferences	500,000
Internet	400,000
Other	<u>50,000</u>
Total net revenues	<u>\$4,385,000</u>

For the many publishers that report only “revenue,” or some other limited breakdown on their income statement, other information will determine the relative importance of the different revenue streams. A look at the amount of deferred subscription revenues on the balance sheet, for example, will give some idea of the significance of subscriptions to the publication. Many publishers, both public and privately held, present the single line “revenue” on their income statements. Other publishers break down revenues and identify the chief revenue streams on the face of the income statement.

Generally, the operations of the larger publishing companies include significant revenue streams other than publications. The financial statements of these companies usually include schedules that provide detailed information on revenues and other operating results by segment.

Expenses

Following the matching principle of GAAP, unrecorded expenses should be accrued to match revenues to arrive at the appropriate periodic net income for the period and/or issue. The classification of costs incurred and recorded for publishing, which differs from manufacturing and service businesses, should be a direct reflection of the following major operating functions:

- Editorial (and art)
- Advertising
- Fulfillment/distribution *
- Circulation acquisition *
- Production
- Internet
- General and administrative

*(*Often combined under Circulation)*

Some companies do tailor the expense portion of their income statement to describe their publishing operations more accurately. They use some or all of the publishing operation's

cost categories listed above. Many large publishing companies also are involved in books, conferences, trade shows, newspapers, radio, TV, cable, database operations and many other activities. Since all of their activities are combined with their publishing operations, expense line items appear that may not necessarily apply only to publishing.

To understand just what these categories of expense actually represent, it is necessary to refer back to GAAP and the accounting policies selected by the publisher. It should also be noted that some publishers capitalize certain costs, while others expense them as they are incurred. It is important, therefore, to understand the policies selected by the publisher, as described in footnotes to the financial statements, to determine their impact on the financial statements.

Editorial Expenses

The term *editorial expense* encompasses a wide range of activities from the creation or purchase of articles through completion of final drafts and preparation of related artwork for production. Editorial expenses may include freelance writers, readers, indexers, proofreaders, illustrators, photographers, translators, designers and reprint rights. They also include travel and entertainment costs and other departmental expenses.

Current accounting practices for editorial costs range from charging them to “expense when incurred” to “deferral of editorial costs in inventory” and the subsequent charge to “expense in the period of distribution.” Many publishers charge internally generated (in-house) editorial costs to “expense when incurred” while they defer purchased editorial and editorial material costs in inventory to match issue revenues. Editorial cost of online content should be treated in the same manner.

Publishers who charge in-house editorial costs to “expense when incurred” reason that an editorial staff is maintained to write or review articles for any number of issues at any given time. It would be burdensome to determine which issue or issues the staff is working on at any one moment during a particular month. Since in-house editorial costs are relatively constant in amount and generally do not vary significantly from issue to issue, there is usually no material distortion in the results of operations for a particular accounting period if these costs are expensed as incurred.

In addition, publishers may also reason that no objective standard for the time required to write an article has been established. An article or piece of artwork can be reworked several times before it is finished. Accordingly, it is difficult to assess the utility or future recoverability of these editorial costs.

Many of these same publishers follow the practice of capitalizing outside purchased editorial costs in inventory. The costs are charged to expense in the period they are actually used. Financial statements can differ depending on management’s decision as to whether in-house or freelance editorial efforts will be expended on a particular manuscript or editorial project. A large publisher may be able to perform all editorial work in-house, while a small publisher often has many editorial functions performed outside. Even publishers with large staffs occasionally buy freelance editorial services during periods of peak activity for the in-house editorial staff.

There is no theoretical justification for having a different cost accounting practice for in-house versus outside editorial expenses. Both methods are used in practice and are generally acceptable. It should be noted that if editorial costs are inventoried, they must be reviewed periodically for future use. As soon as it is determined that articles, artwork or photographs are dated or will not be used, they should be charged to that period's expense as "kill fees."

Circulation Acquisition Costs

Publishers obtain new subscribers by using their own promotional efforts and/or outside agents. The publisher's own efforts include the costs of developing and producing promotional packages and, in some cases, purchasing premiums. The outside agents receive a large percentage of the initial subscription price as commission. This commission should be considered a discount in the subscription price and not an operating expense.

When publishers turn to outside agents to help build up their circulation base, they generally use direct mail agencies and telemarketing through other types of direct marketing agents. Direct mail agencies design, produce and distribute promotional mailings to sell magazines for many publishers in a single mailing. The agencies normally sell subscriptions at a reduced rate and for a shorter subscription period. In addition, direct mail agencies often extend credit to the subscribers and collect payments from them. The cost of these services is an extremely large percentage of the initial subscription price. The publisher may receive only 5 percent to 10 percent of the sales price, in some cases, nothing at all (zero remit) or even have to pay the agency for the subscription obtained (negative remit).

To a much lesser extent, publishers may use "paid during service" (PDS) agencies that in turn use independent contractors to sell multiple subscriptions on a long-term basis. The customer normally makes monthly payments over a period of several years. As payments are made to the PDS agent, the agent withholds a commission and remits the balance, usually only 5 percent to 10 percent of the sale price, to the publisher.

For accounting purposes, agents' commissions should be deferred when incurred and amortized over the life of the related subscription. The amortization of these costs should be shown in the income statement as a reduction in the related subscription revenues, rather than below the revenues line as an operating expense. A gross presentation with the appropriate detail is also acceptable. Some publishers parenthetically note the amount of amortized commission expense currently recognized on the income statement.

Magazine publishers may also use their own in-house promotional and direct mail departments. Those departments prepare and implement direct mail campaigns using lists rented from other magazines and websites or other sources or compiled in-house. Other promotional tools include insert cards, print and broadcast advertising, and online and telephone solicitation. The costs incurred by the publisher in these efforts are both internal (salaries, for example) and external (printing and postage, for example). Total costs of a promotional campaign can be very high. They may even exceed the revenues derived from the subscriptions acquired. In this case, the publisher is relying on subsequent conversions

and renewals along with advertising revenues to recoup the investment in building its circulation base.

Promotional costs incurred by the publisher ultimately end up as an operating expense on the income statement. The timing of expense recognition, however, will vary based on the facts and circumstances of the promotion and the accounting policy the publisher selects. Moreover, a variety of terms are used to describe these costs. Subscription and circulation are terms often used synonymously, as are the terms acquisition costs, promotion costs and procurement costs.

In December 1993, the AICPA published Statement of Position 93-7 titled "Reporting on Advertising Costs." This pronouncement, which is effective for all financial statements after June 15, 1994, states that if subscription acquisition costs meet the criteria described in the Statement, those costs must be capitalized as incurred and subsequently amortized over the same period as the related revenue generated by the particular promotion is taken into income.

Even in situations where promotion costs are normally being deferred, it still may be appropriate to expense the costs of test mailings. Since many test mailings, especially for new publications, are unsuccessful, they are more characteristic of research and development costs and, therefore, may be expensed currently. Individual mailings should be reviewed to determine if they represent ongoing business (deferred and amortized) or testing of new production (expensed as incurred).

It is also important to periodically review amounts recorded on the balance sheet for realization. It is not appropriate to show deferred costs as assets or as an offset to deferred revenue if they are not realizable through the profitable future operations of the particular periodical. In making that decision, total estimated revenues (advertising, subscription and newsstand) should be compared with total estimated costs (promotion, fulfillment and distribution) to deliver the copies represented by the deferred costs. Deferred costs should be written down to the extent that they exceed the related estimated future revenues.

The publisher needs to make this "big picture" evaluation because, as we have said, the costs of obtaining a subscription often can exceed the revenue from that subscription. It will then become a matter of determining whether the revenue streams generate enough revenue over a reasonable period of time to more than offset future production and fulfillment costs.

Production Costs

Recurring production costs include all types of manufacturing costs (for example, paper, printing, binding and prepress) incurred in printing each issue. Current industry practices are uniform; recurring manufacturing costs are accumulated as prepaid expenses. When the revenues for the related issue are recorded as income, these costs are charged to expense. Once an issue has passed its delivery and/or on-sale date, there is rarely any further need to inventory the costs of that issue.

Internet Costs

Internet costs include all the activities related to websites, online activities and e-commerce. These costs include access costs, web hosting, design, development and maintenance of the site and salaries, benefits and related costs of personnel involved in Internet activities.

Fulfillment/Distribution, Advertising Sales and General and Administrative Costs

Generally, these costs are considered period costs and are expensed as incurred. Any deviation from this practice would be unusual and would depend on the specific facts and circumstances of the publisher.

The Statement of Cash Flows

The cash flow statement is another valuable source of information about the activities of the publisher for the period being reported. It reports the amount of cash generated from operations and details how cash was used in the business. In separate sections, the statement also reports on the amounts of cash provided by, or used in, financing and investing activities. These activities include acquisitions or dispositions of businesses, the addition or payment of debt, and the payment of dividends and distributions, among other activities. Thus, while the balance sheet will give an idea as to the current strength of the company, the cash flow statement tells how the company got there. To some extent, the statement becomes the bridge between the "balance sheet" and the "income statement." By looking at its trends, you can get an indication of the direction the company will be taking in the future.

The cash flow statement can be presented using a direct or indirect method of reporting cash flow from operations.

FASB (Financial Accounting Standards Board) encourages companies to use the direct method presentation, but the indirect method is more widely used. Under the direct method, operating cash receipts and disbursements are shown. Those that choose the indirect method and do not show operating receipts and disbursements must present a reconciliation of net income to cash flow from operating activities.

The Footnotes

A close reading of the footnotes that follow the basic financial statement provides additional information about a publisher's financial statements. By first reviewing the footnotes that indicate specific accounting policies, the reader will be able to anticipate how various revenue and expense recognition policies affect the financial statements. In addition to the information on selected accounting policies, other footnotes will offer information that is helpful in understanding the particular company.

Accounting Principles Board Opinion No. 22 requires all companies to disclose significant accounting policies selected from acceptable alternatives, and as such, publishing operations should disclose, if applicable, the following significant accounting policies:

-
- **Subscription revenue**
 - description of the accounting treatment used to record subscription revenue, including how revenue is reflected in income
 - explanation of the balance sheet and income statement account classification criteria used for subscription-related amounts, including deferred revenue and related deferred expenses
 - **Return policy for magazines** – description of the company's magazine return policy: the method for calculating and classifying the reserve for returns or a statement that returns are not material and, consequently, are recorded in the account when received, if appropriate
 - **Circulation acquisition costs** – description of the accounting treatment for agents' commissions and subscription promotion costs (for example, the amortization procedure used) and the balance sheet classification or location (for example, are circulation acquisition costs netted against deferred subscription revenue). The disclosures should include the amount indicated in the balance sheet, the amortization period for subscription promotion costs, current period charges to operations, and any write-downs for realization for the period.
 - **Barter** – description of the method used to value barter transactions (for example, based on the value of what is received or what is delivered)
 - **Sponsorship revenue** – description of the accounting treatment to record the revenue from long-term agreements including the related obligations and deferred revenue, if any
 - **Fees** – description of the accounting treatment for revenues from the delivery of content, design and site production

The following are some examples of footnotes relevant to publishing company financial statements.

THINKER MEDIA, LLC
NOTES TO THE FINANCIAL STATEMENTS *(In part)*

DECEMBER 31, 20XX

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Description of Operations

Thinker Media, LLC (the Company) a limited liability corporation, was formed in December 1996. In 1997, the Company acquired various magazine publication and trade show entities.

The Company is engaged in the consumer and business-to-business publishing and produces events with revenues generated primarily from the sale of advertising in its various magazine properties websites and from conferences and tradeshows sponsored by the Company.

(2) Revenue and Related Expense Recognition

Magazine advertising revenue is recorded net of discounts and is recognized when the magazines are mailed to customers. Receipts from magazine subscriptions, less estimated cancellations, are deferred and recognized over the term of the subscriptions (generally one year). Subscription acquisition costs are capitalized and charged to expense as the related revenues are recognized. Newsstand sales are recognized at the on-sale date, net of provision for estimated returns. List rental revenue is recognized as customer lists are delivered. Newsletter revenue is recognized when the newsletters are distributed. Banner advertising revenue is recognized in the month the advertising appears on the website. Membership revenue is recognized evenly over the membership period.

The Company incurs certain costs in connection with conferences and tradeshows it operates. The revenues and related costs are deferred and recognized in the period the conferences and tradeshows are held.

(3) Impairment of Long-Lived Assets (e.g. Goodwill)

Statement of Financial Accounting Standards 144 (SFAS 144), "Accounting for Impairment or Disposal of Long-Lived Assets", requires the grouping of long-lived assets and liabilities that are largely independent of other groups of net assets and the testing of those groups of assets for impairment. Impairment exists where the carrying amount of those assets are not recoverable and exceeds their fair market values. Intangible assets and other long-lived assets with determinable lives are amortized over their remaining useful lives. In

reviewing for impairment, undiscounted cash flows of the group of assets is compared to their carrying amount and if the total of cash flows is less than the carrying amount, the carrying amount is compared to the net discounted cash flow expected for that group of assets and the difference is recognized as an impairment.

(4) Goodwill

Effective January 1, 2002, the Company adopted SFAS 142, "Goodwill and Other Intangible Assets." Goodwill and certain other intangible assets with indefinite lives, which were previously amortized, are no longer being amortized to earnings. Under SFAS 142, these assets are being tested for impairment by reporting units on an annual basis or at such time as events or circumstances occur that might indicate a reduction in the fair market value of those assets below their carrying amount.

(5) Advertising Expenses

The Company expenses costs of advertising as incurred. Advertising expenses for the year ended December 31, 20XX was approximately \$700,000.

B. ACCOUNTS RECEIVABLE

Accounts receivable at December 31, 20XX consists of the following (\$000's):

Magazine	\$5,000
List Rental	900
Conferences	300
Online	<u>200</u>
	6,400
Allowance for doubtful accounts	<u>(700)</u>
	<u>\$5,700</u>

C. GOODWILL

During 20XX, the Company completed initial impairment testing under SFAS 142 and recorded a change to earnings of \$1,500 million.

Goodwill consists of the following (\$000's):

Balance, January 1, 20XX	\$80,000
Acquisitions	<u>15,000</u>
	95,000
Write down for impairment	<u>(1,500)</u>
	93,500
Accumulated amortization	<u>(10,000)</u>
Balance, December 31, 20XX	<u>\$83,500</u>

D. INTERNAL USE SOFTWARE

Under provisions of Statement of Position ("SOP") 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, the company capitalizes costs associated with internally developed and/or purchased software systems for new products and enhancements to existing products that have reached the application stage and meet recoverability tests. Capitalized costs include external direct costs of materials and services utilized in developing or obtaining internal-use software, payroll and payroll related expenses for employees who are directly associated with and devote time to the internal-use software project. Also capitalized are interest costs incurred, if material, while developing internal-use software. Capitalization of such costs begins when the preliminary project stage is complete and ceases no later than the point at which the project is substantially ready for its intended purpose. The carrying value of the software is regularly reviewed, and a loss is recognized if the value of estimated undiscounted cash flow benefit related to the asset falls below the unamortized cost. As of December 31, 2005, capitalized costs are not yet being amortized since projects are still in process.

E. BARTER

Barter transactions are recorded at the lower of estimated fair value of the goods or services received or the estimated fair value of the advertisements given based on historical cash transactions. Barter revenue is recognized when the advertising impressions are delivered to the customer, and advertising expense is recorded when the advertising impressions or other advertising services are received from the customer. If advertising impressions are received from the customer before the company delivering the advertising impressions, a liability is recorded, and if the company delivers the advertising impressions to the customer prior to receiving the advertising impressions or other advertising, a prepaid expense is recorded. For the year ended December 31, 2005, the company recognized approximately \$3.8 million of advertising revenues and \$3.0 million of advertising expenses from barter; for the prior year, the comparable figures were \$650,000 in revenues and \$498,000 in expenses. The company has recorded approximately \$968,000 in prepaid expenses related to barter transactions as of December 31, 2005.

Editorial and operational expenses primarily consist of Internet connection charges, depreciation, purchased content, salaries and benefits of operating and editorial personnel and other related operating costs and are recorded as incurred.

Book Publishing Sample Footnotes

A. RETURNS

For financial reporting purposes, provision is made at the time of sale for the estimated effect of sales returns where right-of-return privileges exist. Returns of books from customers are accepted in accordance with standard industry practice. The full amount of the returns allowance (estimated sales to be returned net of inventory costs and reduction in royalties) is shown as a reduction of receivables in the accompanying financial statements.

B. COSTS

Depreciation and amortization (in part): The cost of prepress for educational publications and trade reference works is amortized on a straight-line basis over 36 to 60 months. The cost of prepress applicable to general trade publications is charged to income two months after the date of publication. Cost of sales includes amortization of prepress amounting to \$_____.

All editorial costs are expensed as incurred. Prepublication artwork, composition and camerawork necessary for publication of multivolume reference works and elementary and secondary textbook series, and prepress for all books are capitalized. These costs are amortized from date of publication at rates based on estimated lives, using principally the unit-of-sale or the sum-of-the-years-digits method. All prepublication costs relating to individual books are expensed as incurred.

Prepublication costs include editing, art, composition and camerawork necessary to prepare a book for publication and are generally amortized over two to five years

from the publication date. Purchased title rights are amortized on a straight-line basis over periods ranging from 5 to 20 years.

C. PREPUBLICATION COSTS

Comprised principally of externally developed art, manuscript and editorial costs, and internally or externally developed prepress costs of the Company and advertising and premium costs associated with the Company's direct marketing operations are deferred. Such costs are amortized from the date of initial product sale, generally over a period of one year. External costs related to the Company's product catalogs are deferred and amortized over one year, the period to which the catalogs relate.

Prepublication costs of new books and audio-visual materials consist primarily of outside design, layout, art and photo services, composition, mechanicals, film and prepress charges. These costs are amortized over five years, by the straight-line method, from the date of publication or the estimated remaining life, if shorter. Costs applicable to revised editions of standard texts are included in prepublication costs, and costs applicable to reprints are expensed as incurred.

D. INVENTORY

Inventories are stated at the lower of cost (principally first-in, first-out) or market. Inventories of books and software include certain publication costs principally outside preparation and prepress costs, which are amortized from the year of copyright over their estimated useful lives utilizing either the sum-of-the-year-digits or the straight-line method.

Costs of inventory include paper, printing and binding, and prepublication costs. Principally outside creative costs are amortized over three years. Direct costs of acquiring new book titles and costs incurred in updating education testing methods are capitalized as product acquisition costs.

E. AUTHORS' ADVANCES

Advances to authors represent payments made to authors prior to publication of a book. These advances are reduced when books are sold and royalties are earned. Advances are written off when it is determined that the advances will not be earned through sale of books.

CHART OF ACCOUNTS

In designing a chart of accounts, the primary goal is to provide a logical framework for recording a company's transactions—a framework that enables those transactions to be summarized into reports that aid management in operational decision-making, communicating with interested third parties such as lenders, investors and shareholders, and compliance with tax and other regulatory agencies.

That framework includes accounts and groupings into which transactions are accumulated. To organize the accounts, departments are created and grouped by product, by location or by responsibility. In more complex organizations, departments might be grouped together into divisions or profit centers. In some cases, profit centers are grouped within departments.

The chart of accounts outlined here is intended to be general in nature. It is meant to be flexible and should be individually adapted by each company.

The structure and definitions provided here are applicable to consumer, business to business and trade publications. The chart of accounts includes operations other than magazines such as Internet activities and conferences. In addition to providing a logical system for reviewing financial and operational information, uniform industry-wide information makes it easier for publishing companies to compare their results with industry surveys and enables management to make decisions based to some extent on comparable industry data.

In adapting any general chart of accounts, or in designing a chart of accounts from scratch, the starting point is the design of an overall structure of the operation. That structure will determine the type and frequency of financial reports and analysis that should be prepared to meet the requirements of that organization. Among the considerations in designing that package, and subsequently a chart of accounts, the following variables should be taken into consideration:

- (1) The company's organizational structure,
- (2) The complexity of the company's operations, and
- (3) Management's appetite for information and analysis.

Organizational Structure

In very simple organizations, a very simple chart of accounts will suffice. When the owner is the only manager and no employees have been delegated authority to approve outside purchases, hire staff or sign contracts without the owner's permission, then generally the need for a complex chart of accounts is diminished.

When an organization grows and hires middle- and upper-level managers who are responsible for revenues, expenditures and performance versus budget, a more complex

chart is required. Managers who are held responsible for the performance of a group of employees, a group of tasks, or a product line, must be given reports that help them measure and analyze their own results. Supplying managers with the reports necessary to manage not only the overall business, but also their individual functions, generally requires more accounts and more departments to organize those accounts.

Additionally, as the number of reporting levels in the organization grows, so does the complexity of the chart of accounts.

Complexity of Operation

The complexity of an operation includes the number of different products offered, the intricacy of rate cards and other pricing structures, the number of different single-copy sales outlets used, the number of different marketing vehicles used to generate sales, the geographical spread of employees, the number of leases and other contractual obligations, the complexity of incentive, commission and bonus plans, and many others.

The more complex a company's operation, the more complex a chart of account it will require. For example, assume that two publications within one company each sell approximately 50 pages of advertising per month. Publication A sells from one simple rate card, does not discount from published rates, and pays a straight commission of 5 percent on all sales, when invoiced. Publication B offers a discount off regular display rates for direct-response advertisers in a back-of-book section, prepares special advertorial sections a few times each year, discounts off-rate card occasionally, pays commissions on a sliding scale above individual sellers' quotas, and only pays after the advertiser pays.

Managing Publication B will require a number of different revenue accounts to segregate the different rate classes, multiple expense accounts to capture the cost of the advertorial section, and a liability account for unpaid commissions.

Management's Requirement for Information and Analysis

No matter how complex the organizational structure and how complex the operational profile, if senior management asks for only basic financial data and operating statistics to run the business, then a more simple chart of accounts can be used. More important, the converse is also true—even in simple operations with relatively flat and simple organizational structures, if management demands sophisticated data, roll-ups and analysis of that data, then a more complex chart of accounts will be necessary for the accounting department to meet management's needs.

It should be noted that: (1) that there are no specific rules to determine how much information is necessary to manage a business, and (2) that different management styles require different amounts of information. A good chart of accounts allows for management's preferences, anticipates that those preferences (or management) may change, and is appropriate to the complexity of the organization.

Accounting Software

The three variables discussed above deal primarily with finding the appropriate level of detail in creating accounts and departments to house those accounts. The method in which a company's accounting software works will have a bearing on how accounts and departments are numbered. Items to be considered are:

- How many characters are allowed?
- Into how many segments can an account number be broken?
- What canned, pre-programmed reports are available?
- How easy it is to modify canned reports?
- Is there a custom report writer available?
- How do reports roll-up account data?

BASIC CONCEPTS

Natural Accounts

The term "natural account" is a useful concept in keeping a chart of accounts (no matter how complex) as simple as possible. Natural accounts refer to account descriptions that encompass a common revenue or expense type; a description that communicates simply and generally what transactions would be recorded within that account. For example, Postage would be a natural account, whereas Postage - Direct Mail would be too specific to be considered a natural account.

In assigning a numbering system to accounts, it is preferable to assign a unique account number (or root) to each natural account and to use that same number in every department or division in which that account is used. That is, if account #9891 is assigned to Postage expense, then the #9891 should be used as (the suffix for) postage in every department in that uses postage. Just as importantly, account #9891 should never be used for any other revenue or expense account.

This type of logical framework makes it much simpler for accounting and finance staff to remember account numbers and it avoids clutter in the chart of accounts by minimizing the quantity of account numbers assigned.

Gross vs. Net

While various combinations of accounts may appear as single line items in a financial or management report, the chart of accounts should indicate the gross amount of each activity and the related direct offsets.

For example, net advertising revenue is defined as the gross revenue received from the sale of advertising space, less agency commissions and volume and frequency discounts.

Practices differ in the mechanics of recording these items. Several possible methods are as follows: (1) The income account shows gross billings while the commission and discount are recorded in separate accounts; (2) the income is recorded net of agency commission, and cash discounts are recorded when deducted by the advertiser; (3) the income is recorded net of both commission and discount. Whichever method is used, *net* advertising revenue (as herein defined) should be readily determinable for comparative purposes.

For accounting control purposes, it is advantageous to use separate accounts to distinguish the original billing to advertisers from the various classes of subsequent adjustments. Some companies use separate categories of accounts for national and regional advertising, four-color and black-and-white advertising, classified advertising and any other significant category for the particular company.

Gross subscription revenue is the amount earned by the publisher after deduction of refunds and cancellations on charge orders not collected.

The commissions paid to direct mail agents and field or paid-during-service agents (PDS) should be recorded in separate accounts. They should also be recorded in an asset or contra liability account and amortized over the life of the related subscription.

Single-copy revenue is defined as the net revenue received by the publisher for single copies sold. "Copies sold" for a particular issue means the net value to the publisher (not the cover price) of the actual number of copies shipped, less estimated returns of issues not yet closed.

Allocations

Certain expenses are often not directly identified with a particular department in a single-title publishing company or with a particular operation in an integrated media company. Those expenses, where practical, should be allocated among departments and/or titles as described in the chapter on management reports.

Departments

The term "department" used in the context of a chart of accounts is meant to describe a section of the chart, not an actual department.

Initially accounts are grouped into departments to facilitate generation of financial statements, to make it easier to calculate and analyze operating statistics, and to help produce reports for the managers who are held responsible for parts of the company's operations. Beyond those needs, it frequently become desirable to create additional departments when financial managers or operating department heads desire more detailed information than natural accounts provide.

An example might be where a Circulation Director decides it is no longer sufficient to receive reports that indicate total postage has been spent in the Fulfillment department. The Circulation Director may want to see postage segregated between the mailing of renewal efforts and the mailing of invoices to subscribers.

Rather than create two accounts (6891, Renewal Postage; and 6892, Billing Postage), it would be more efficient to create new departments to separate billing activities and renewal promotion from basic file maintenance and label costs. Each department would use exactly the same account numbers as the other, unless prefixes were desired to alter the natural account root for sequencing purposes.

Staff Expenses

A number of basic expenses are incurred in compensating, training, equipping and supporting a company's employees. The accounts listed in Exhibit I include those expenses that are generally controllable directly by a department supervisor or manager. These accounts can be added to each staff department as required.

Exhibit I

9301	Salaries
9309	Commissions
9320	Temporary Help
9345	Travel
9350	Meals & Entertainment
9360	Education/Seminars
9365	Supplies – Office
9370	Dues, Subscriptions & Books
9890	Consulting
9899	Miscellaneous

Other expenses related to hiring and housing staff are not as directly controllable by individual supervisors and managers, but with effort can usually be broken out or allocated by department (see Exhibit II).

It is not uncommon to see many of these accounts (especially payroll taxes, postage, telephone, and health insurance) in each staff department in a company's chart of accounts. However, since these expenses are generally not directly controllable by department heads, rather than repeating each of these accounts in each department, they can be housed in administrative departments that describe the type of expense (for example, Employee Benefits or Occupancy expenses). In addition to reducing clutter in the chart of accounts, this method produces other benefits.

First, because all occupancy or facilities-related expenses are captured in one department, it becomes easier to monitor total spending—to compare it to budget or to prior periods, to analyze variances based on number of employees or square footage, or as a percent of revenue.

Secondly, it reduces the need to have accounting staff allocate individual expenditures to each staff department. If it is absolutely necessary to allocate a share of employee benefits and/or occupancy extensions to each staff department, allocating departmental totals periodically is much simpler.

In companies with operations in multiple states, creating a separate Occupancy department for each state, city, or location may be desirable. This helps analyze and manage expenses by location and aids in generating state required apportionment information when filing state income tax returns.

Allocations

A single title or website publishing company requires only a single set of expense accounts following the classifications in the chart. Analysis of costs by department and by type of expense is sufficient.

A company that publishes more than one title (or publishes and also operates some other business enterprise) spends money for purposes that are not specifically identifiable with one publication or enterprise but rather serve all jointly. In addition to meeting all the usual requirements of accounting by cost and departmental classification, costs of joint services must be charged to publications and/or enterprises, where practicable. It is important that costs not be allocated arbitrarily to departments.

One of the most important responsibilities of an accounting department in a multi-operation company is to develop sound methods of allocation that help determine the actual cost for each operation. If the allocation methods used do not result in an accurate representation, management will be misinformed about the financial condition of various publications and other operations.

Principles of Allocation – Basic

The accounting system attempts to separate, as precisely as possible, the income and expenses of individual operations. These principles may be summarized as follows:

- Income of each operation is recorded separately.
- All expenses incurred specifically for one operation are charged to that publication.
- Single-item or occasional expenses applicable to two or more operations are divided equitably among them.
- Expenses of departments that service more than one operation should be accumulated under the heading Joint Service Departments.

The basic principles of allocating expenses are simply that:

- They must be as objective as possible.
- They must be logical.
- They must be consistently applied from one accounting period to the next.

Allocation of Costs

Two types of expenses require allocation:

- Expenses of operating departments serving two or more publications jointly. Services such as subscription fulfillment, production, traffic, and circulation are joint-service departments in most companies. Virtually every operating function is a joint service in some companies;
- General administrative expenses of the entire company (often called overhead) that are present in every multi-operation company.

Allocations Using the Activity-Based Costing System (ABC)

A more detailed approach to allocating costs can be developed using the Activity-Based Costing (ABC) system.

The ABC system is based on the premise that the product or services provided by a company requires not only operating activities, but also management and administrative activities. All costs of operating a business are linked to the product or service that it provides.

Costs are either assigned directly to the product or service or an activity performed by the organization.

For publishing companies, as with most operations, implementing this system is easy for some costs and difficult for others. For example, it is clear where to allocate the printing cost of a particular issue. It is more difficult to allocate production staff salaries and even more difficult to allocate a share of corporate staff or other management costs to a particular issue.

The larger the publishing operation, the more likely there will be departments that provide production and circulation services to multiple operations and general management services provided to all of the company's operations.

Implementing a fully integrated ABC system is not likely except in the largest of companies. However, the fundamental concepts of ABC could be applied to the service departments of multi-title and multi-dimensional publishing companies.

More detailed information on the theory and mechanics of the ABC are available in books written specifically on this subject.

Joint Service Departments

Subscription fulfillment cost varies according to the volume of work performed for each publication. The volume of work depends on a number of factors, the most important of which are (1) frequency of publication, (2) number of subscribers, (3) copies served, (4) changes in the subscription list, and (5) volume of charge business.

Ordinarily, it is not practical to allocate fulfillment costs on the basis of each of these factors. Among publications of the same frequency, it is usually adequate to apportion total fulfillment cost on the basis of the number of readers or subscribers.

If there are significant differences among publications in the average subscription term, renewal rate or volume of charge subscriptions, the effect of the differences can be estimated and brought into the allocation formula by weighing the particular factors in question.

Distribution expenses (other than freight and postage) must often be allocated among publications and also between subscription copies and single-copies of the same publication; the natural basis in both cases is the number of copies distributed. If two publications have very different page counts, the weight per copy may have a significant impact on the relative cost of distribution.

Production department salaries and expenses can be allocated on the basis of (1) total production cost of each publication, (2) printing cost of each publication, and/or (3) total copy pages of each publication.

Advertising sales costs must be allocated when one advertising department serves two or more magazines or when space in two or more magazines is sold as a unit. Ordinarily, these costs should be allocated in proportion to the advertising revenue produced. Occasionally (for example, if one publication is well established and the other is just being started), the

revenue base may be inaccurate. In such cases, another basis for allocation should be considered.

Editorial and art departments sometimes serve two or more publications. If the publications are not radically different, costs may be allocated in proportion to editorial pages.

General Administrative Expenses

Allocation of general administrative expenses should be kept simple. Many companies make only one monthly allocation of the total expenses on the basis of one general formula. A simple method is to allocate these expenses based upon a pro-rata share of gross income.

When one overall formula appears to be too simplistic, it can be refined by breaking the total general administrative expenses into two or more subtotals. Each subtotal is then allocated according to a simple formula that fairly represents the relative service of that class of expense to different publications.

Carrying the search for precision too far is not advisable. In theory, every general administrative account could be allocated separately. These allocations would reflect the calculations or estimates of the proportions incurred for each publication. In practice, however, the results are likely to be less precise than supposed, and in any case, such meticulous allocations are not practical. Most publishers, therefore, allocate overhead in total, or in two or three subtotals, in accordance with some general formula.

Allocations should be made only to the operation itself. Overhead costs should not be allocated a second time to individual departments, such as advertising, editorial and circulation. A basic rule of good cost accounting is to charge each department only with the costs under its control.

The intent of this chapter is to give an overview of effective financial and operational management. The outlines, examples and suggestions are not meant to be comprehensive. Rather, the intent is to guide management in determining the structure of its organization in collecting and organizing information efficiently and in gaining insight into sound management practices.

Staff vs. Functional Expenses

The following chart of accounts segregates staff costs from the direct, functional expenses incurred by that department. For example, Production staff is housed in a separate department from Manufacturing Costs (which are obviously managed and incurred by the Production department). The costs included in Manufacturing (paper, print, prep, binding) are all variable costs that are driven either by book size or print order or both. These costs will be used to calculate a variety of operating statistics that should not include the fixed and semi-fixed staff costs. Segregating these expenses into separate departments facilitates the analysis of operating statistics and enhances the distinction between fixed and variable costs in the accounting staff.

Allocations

It is common in companies that publish multiple titles, for magazines to share Production staff or Circulation staff. Where practical, and material, these expenses should be allocated to each title.

Exhibit II

Employee Benefits

9303	Bonuses
9305	Vacation
9310	Social Security
9311	Medicare
9312	Unemployment Insurance
9314	Disability Insurance
9315	Workers Comp Insurance
9325	Employee Med Insurance
9326	Group Life Insurance
9335	Profit Sharing Plan Contributions
9336	Profit Sharing Plan Administration/Fees

Occupancy Expenses

9365	Supplies
9801	Rent – Space
9805	Property Taxes
9810	Insurance
9820	Security Services
9830	Janitorial
9835	Maintenance/Repairs – Space
9840	Rent – Equipment
9842	Maintenance/Repairs – Equipment
9845	Telephone
9850	Depreciation
9851	Amortization – LHI
9852	Amortization – Other

THINKER PUBLICATIONS

PUBLISHING RELATED CHART OF ACCOUNTS (In Part)

ASSETS

000 - 1010	Accounts Receivable – Advertising
1011	Allowance for Bad Debts – Advertising
1015	Accounts Receivable – Newsstand
1016	Allowance for Returns – Newsstand
1020	Accounts Receivable – Subscriptions
1021	Allowance for Bad Debts – Subscriptions
1025	Accounts Receivable – List Rental
1026	Accounts Receivable – Online
1027	Allowance for Bad Debts - Online
1055	Prepaid Postage (Periodical Class)
1060	Prepaid Editorial Costs
1070	Prepaid Agents Commission
1071	Deferred Event Costs
1075	Deferred Promotion Costs
1121	Subscription List
1122	Accumulated Amortization – Subscription List
1126	Intangible Assets (Goodwill)

LIABILITIES

2174	Deferred Event Revenue
2175	Unearned Advertising Revenue
2181	Current Portion – Notes Payable
2190	Deferred Subscription Income
2199	Deferred Subscription Income – Contra

ADVERTISING REVENUE

301 - 3201	Display
3203	Direct Response
3205	Other BOB
3207	Advertorial
3208	Supplied Inserts
3209	Agency Commissions
3210	Discounts

SUBSCRIPTION REVENUE

302 - 3211	Gross Subscription Revenue
3212	Agents Commission

NEWSSTAND REVENUE

305 - 3231 Newsstand Revenue – Gross
3232 Newsstand Returns
3233 RDA

306 - 3298 List Rental Revenue

321 - 3010 Internet Advertising Revenue

326 - 3298 Internet List Rental Revenue

EVENTS

341 - 3241 Attendee Revenue
3243 Exhibitor Revenue
3245 Sponsorship Revenue

EDITORIAL COSTS

401 - 4410 Photo/Illustration
4415 Copy/Manuscript
4420 Design Fees

EDITORIAL STAFF

402 - 4301 Salaries
4320 Temporary Help
4345 Travel
4350 Meals & Entertainment
4360 Education/Seminars
4365 Supplies – Office
4370 Dues, Subs & Books
4890 Consulting
4899 Miscellaneous
9997 Allocations

EDITORIAL STAFF – INTERNET

421 - 4301 Salaries
4320 Temporary Help
4345 Travel
4350 Meals & Entertainment
4360 Education/Seminars
4365 Supplies – Office

4370 Dues, Subscriptions & Books
4890 Consulting
4899 Miscellaneous
9997 Allocations

DIRECT INTERNET COSTS

422 - 4410 Photo/Illustration
4415 Copy/Manuscript
4420 Design Fees
4440 Hosting Fees
4445 Syndicated News
4750 Research
4899 Miscellaneous

DIRECT EXPENSES – EVENTS

441 - 4345 Travel – Staff
4346 Lodging – Staff
4350 Meals – Staff
4351 Attendee Meals
4510 Speaker Fees/Expense
4520 Hand-outs
4530 Site Rental
4540 Staging & Production
4550 Security
4560 Site Maintenance
4810 Insurance
4885 Credit Card Fees
4899 Miscellaneous
4995 Capitalization
4996 Amortization

MANUFACTURING COSTS

501 - 5450 Prepress (Electronic)
5455 Paper
5460 Print
5465 Ink
5470 Binding
5475 Freight
5899 Miscellaneous

SUBSCRIPTION DISTRIBUTION

502 - 5470 Subscription Postage
5480 Mail Prep

NEWSSTAND DISTRIBUTION

505 - 5475 Newsstand Freight

506 - 5498 Internet List Rental Costs

PRODUCTION STAFF

508 - 5301 Salaries
5320 Temporary Help
5345 Travel
5350 Meals & Entertainment
5360 Education/Seminars
5365 Supplies – Office
5370 Dues, Subscriptions & Books
5890 Consulting
5899 Miscellaneous
9997 Allocations

LIST RENTAL COSTS – INTERNET

526 - 5498 List Rental Costs

CIRCULATION STAFF

601 - 6301 Salaries
6320 Temporary Help
6345 Travel
6350 Meals & Entertainment
6360 Education/Seminars
6365 Supplies – Office
6370 Dues, Subscriptions & Books
6890 Consulting
6899 Miscellaneous
9997 Allocations

FULFILLMENT COSTS

602 - 6601 File Maintenance
6610 Printing – Forms
6620 Data Processing
6630 Lettershop
6891 Postage
6892 BRE
6899 Miscellaneous

DIRECT MAIL PROMOTION

- 603 - 6610 Printing
- 6630 Lettershop
- 6640 List Rental
- 6680 Creative
- 6685 Premiums
- 6891 Postage
- 6892 BRE
- 6899 Miscellaneous
- 6995 Capitalization
- 6996 Amortization

OTHER SUBSCRIPTION PROMO

- 604 - 6465 Bindery Charges
- 6610 Printing – Inserts
- 6770 Space Ads – Outside
- 6895 House Ads – Allocated
- 6899 Miscellaneous

NEWSSTAND PROMOTION

- 605 - 6790 Other Promotion
- 6884 Foreign Exchange

EVENT PROMOTION

- 641 - 6610 Printing
- 6630 Lettershop
- 6640 List Rental
- 6680 Creative
- 6770 Outside Space Ads
- 6891 Postage
- 6892 BRE
- 6895 House Ads
- 6899 Miscellaneous
- 6995 Capitalization
- 6996 Amortization

ADVERTISING ADMINISTRATION

- 701 - 7301 Salaries
- 7308 Commissions
- 7320 Temporary Help
- 7345 Travel
- 7350 Meals & Entertainment
- 7360 Education/Seminars

Manual of Accounting for Magazine Publishers

7365 Supplies – Office
7370 Dues, Subscriptions & Books
7890 Consulting
7896 Bad Debt
7899 Miscellaneous
9997 Allocations

ADVERTISING SALES OFFICE

702 - 7301 Salaries
7308 Commissions
7320 Temporary Help
7345 Travel
7350 Meals & Entertainment
7360 Education/Seminars
7365 Supplies – Office
7370 Dues, Subscriptions & Books
7890 Consulting
7899 Miscellaneous
9997 Allocations

ADVERTISING REPS (OUTSIDE)

706 - 7308 Commissions
7320 Temporary Help
7345 Travel
7350 Meals & Entertainment
7360 Education/Seminars
7365 Supplies – Office
7370 Dues, Subscriptions & Books
7890 Consulting
7899 Miscellaneous

ADVERTISING MARKETING & PROMOTION

708 - 7370 Subscriptions
7680 Creative
7710 Surveys
7720 Media Kits/Sales Aids
7730 Trade Shows
7750 Research
7760 Public Relations
7770 Outside Space Ads
7775 Reader Service
7780 Circulation Audit Fees
7785 Merchandising
7790 Complimentary Copies
7899 Miscellaneous

ADVERTISING ADMIN – INTERNET

- 721 - 7301 Salaries
- 7308 Commissions
- 7320 Temporary Help
- 7345 Travel
- 7350 Meals & Entertainment
- 7360 Education/Seminars
- 7365 Supplies – Office
- 7370 Dues, Subscriptions & Books
- 7890 Consulting
- 7896 Bad Debt
- 7899 Miscellaneous
- 9997 Allocations

ADVERTISING MKTG & PROMO – INTERNET

- 728 - 7370 Subscriptions
- 7680 Creative
- 7710 Surveys
- 7730 Trade Shows
- 7750 Research
- 7760 Public Relations
- 7770 Outside Space Ads
- 7780 Circulation Audit Fees
- 7899 Miscellaneous

EVENT ADMINISTRATION

- 759 - 7301 Salaries
- 7308 Commissions
- 7320 Temporary Help
- 7345 Travel
- 7350 Meals & Entertainment
- 7360 Education/Seminars
- 7365 Supplies – Office
- 7370 Dues, Subscriptions & Books
- 7890 Consulting
- 7896 Bad Debt
- 7899 Miscellaneous
- 9997 Allocations

EXECUTIVE

- 901 - 9301 Salaries
- 9320 Temporary Help
- 9345 Travel

Manual of Accounting for Magazine Publishers

9350 Meals & Entertainment
9360 Education/Seminars
9365 Supplies – Office
9370 Dues, Subscriptions & Books
9890 Consulting
9899 Miscellaneous
9997 Allocations

FINANCE

902 - 9301 Salaries
9320 Temporary Help
9345 Travel
9350 Meals & Entertainment
9360 Education/Seminars
9365 Supplies – Office
9370 Dues, Subscriptions & Books
9890 Consulting
9899 Miscellaneous
9997 Allocations

GENERAL ADMINISTRATION

905 - 9301 Salaries
9320 Temporary Help
9340 Recruiting
9345 Travel
9350 Meals & Entertainment
9360 Education/Seminars
9365 Supplies – Office
9370 Dues, Subscriptions & Books
9806 Tax & Licenses
9889 Legal Fees
9890 Consulting
9891 Postage
9893 Courier Services
9899 Miscellaneous
9997 Allocations

EMPLOYEE BENEFITS

920 - 9303 Bonuses
9305 Vacation
9310 Social Security
9311 Medicare
9312 Unemployment Insurance
9314 Disability Insurance
9315 Workers Comp Ins

9325 Employee Med Insurance
9326 Group Life Insurance
9335 Profit Sharing Plan Contribution
9336 Plan Administration/Fees
9890 Consulting
9899 Miscellaneous
9997 Allocations

OCCUPANCY

930 - 9365 Supplies
9801 Rent – Space
9805 Property Taxes
9810 Insurance
9820 Security Services
9830 Janitorial
9835 Maintenance/Repairs – Space
9840 Rent – Equipment
9842 Maintenance/Repairs – Equipment
9845 Telephone
9850 Depreciation
9851 Amortization
9899 Miscellaneous

NON-OPERATING ITEMS

998 - 9000 Interest Income
9150 Interest Expense
9160 Loss/(Gain) on Sale
9899 Miscellaneous

KEY DATA ANALYSIS

Title: _____ Date: ____ / ____ / ____

	Historical			Y-T-D	
	Year 1	Year 2	Year 3	Current	Prior
I ADVERTISING					
A. No. of paid ad pages *	_____	_____	_____	_____	_____
B. Net ad revenue (\$000s)	_____	_____	_____	_____	_____
C. Net per paid page (\$)	_____	_____	_____	_____	_____
D. Market share (%)	_____	_____	_____	_____	_____
II RATIOS					
A. Total paid ad pages *	_____	_____	_____	_____	_____
B. Total nonpaid ad pages	_____	_____	_____	_____	_____
C. Editorial pages	_____	_____	_____	_____	_____
D. Total all pages	_____	_____	_____	_____	_____
E. Ad ratio	_____	_____	_____	_____	_____
* Including paid inserts					
III SUBSCRIPTION & CIRCULATION					
A. Avg. no. of direct paid subscriptions/issues	_____	_____	_____	_____	_____
B. Avg. price of direct paid subscriptions/issue	_____	_____	_____	_____	_____
C. Direct subscription revenue (\$000s)	_____	_____	_____	_____	_____
D. Avg. no. single copies shipped/issue	_____	_____	_____	_____	_____
E. Avg. no. single copies sold/issue	_____	_____	_____	_____	_____
F. Avg. sell-thru (%)	_____	_____	_____	_____	_____
G. Single copy revenue, net of returns (\$000s)	_____	_____	_____	_____	_____
H. Avg. no. of copies shipped/dealers/issue	_____	_____	_____	_____	_____
I. Avg. no. of copies sold dealers/issue	_____	_____	_____	_____	_____
J. Avg. sell-thru (%)	_____	_____	_____	_____	_____
K. Dealer revenue, net of returns (\$000s)	_____	_____	_____	_____	_____
L. Avg. no. of free subscriber copies/issue	_____	_____	_____	_____	_____
M. Avg. no. comp. & promo.					

Manual of Accounting for Magazine Publishers

Cost per copy _____

ACCOUNTS RECEIVABLE: Days Sales Outstanding (DSO)		
A/R Aging Percentages		
	% 0-30	
	% 31-61	
	% 61-90	
	% 91-120	
	% 121+	
Bad Debt Reserve Percentage		%

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