

# Accounting for pre-production costs

[Business](#), [Accounting](#)



This report advises Mr. Phillip Clark, a member of Livent Inc. 's audit committee, on what actions to take regarding recent criticisms the company has experienced concerning their treatment of pre-production costs.

Essentially, analysts feel that Livent's current policy of deferring pre-production costs is too aggressive. The most important users that must be considered when determining what approach to take regarding pre-production expenses are the board of directors, the management, Mr. Clark and the auditing committee, Livent's shareholders, and the C. C. R. A..

The overriding objective of these users is one of presenting the financial aspects of the company in the most economically realistic way, despite having determine that management's significant influence on the board might make profit maximization a conflicting objective. Four alternatives were presented. The first was to continue with the current policy, a policy that some analysts had actually stated was a more conservative approach than what the movie industry uses. The second alternative involved keeping with the current policy but making it more transparent in order for investors to asses how the costs were being evaluated and adjusted.

The third alternative called for adopting the policy employed by the movie industry, which forecasts revenues of a production and then amortizes pre-production costs based on a ratio of current revenues to forecasted revenues for the period. The final, and most conservative approach would involve simply expensing all pre-production costs as they are incurred. The recommendation presented to Mr. Clark was a hybrid of the proposed alternatives and would treat pre-production costs differently based on

whether the show being developed was a reproduction, restoration, origination, or a touring production.

In this case the current policy would be used for reproductions and restorations, originations would be expensed as incurred, and touring productions would employ the movie industry approach. To advise Phillip Clark, a member of the audit committee for Livent Inc. , on the best approach to take when accounting for pre-production costs. Advising Mr. Clark will involve discussing what effects each policy will have on the company and how the board will react to the policy suggestions.