

AUDIT GUIDELINES

Motion Picture Incentive: Audit Guidelines

General:

- The following guidelines set forth minimum standards for acceptability of the expenditure verification report to be performed.
- The CPA must be a Certified Public Accountant licensed in the state of Louisiana and must be appointed to the production by LED.
- The auditor's opinion must be addressed to the party that has engaged the auditor (e.g LED).
- The auditor's name, address, and telephone number must be evident on the report.
- The auditor's opinion must be dated as at the completion of the audit fieldwork.
- The audit must be performed in accordance with auditing standards generally accepted in the United States of America, as set forth in Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS). The auditor must have sufficient knowledge of accounting principles and practices generally recognized in the film and television industry.

Identification of the Production:

- The LED assigned production number and title of the production.
- The period during which the costs were incurred must be disclosed.

Cost Report of Direct Production Expenditures:

- The cost report must be in US dollars.
- Only expenditures that were actually expended for the production can be recorded as production costs. These costs must be charged to the proper budgetary item. Examples of production costs that may qualify for the motion picture tax credit include: (1) set construction and operation, (2) wardrobes, makeup accessories, and related services, (3) payroll (salary, wages and other compensation, fringe benefits taxed, sourced or apportioned to Louisiana, and federal payroll taxes such as the employer's portion of FICA/FUTA), (4) payroll company's handling or processing fee provided that the payroll company has an office in Louisiana with posted/publicized business hours that is staffed by a full-time employee overseeing payroll administration for Louisiana productions, (5) workers' compensation insurance costs to the extent purchased from a source within the state, (6) costs associated with photography and sound synchronization, lighting and related services and materials, (7) editing and related services, (8) rental of facilities and equipment, including production worker "box rentals" provided they are included in the employee's gross compensation, or payable as a vendor expense and reported on the federal form 1099 and the "box rental" must be utilized on a state-certified production, (9) leasing of vehicles, (10) costs of food and lodging, and (11) if the service is performed in Louisiana, digital or tape editing, film processing, transfer of film to tape or digital format, sound mixing, special and visual effects; and other allowable expenditures as determined by rule.
- Refunds and credit notes received for discounts, rebates, invoicing errors, purchase returns and refundable deposits must be credited to the production costs; similarly, proceeds from the sale of

props and other production assets must be deducted from the costs presented in the cost report. In cases where props and other productions assets are kept in inventory for future productions, they must also be deducted, at fair market value, from the costs presented in the cost report.

- Completion bond expenditures must reflect any "no-claims rebate" received (the amount reported must be net after rebate).
- Amortization of series costs must be allocated to specific cost categories.

Notes to the Cost Report of Production:

Sources of funds

- All sources of funds that were used to finance the production must be disclosed, including any non-monetary transactions that were included in the cost of the production.
- Non-monetary transactions must be disclosed at fair market value. The nature of the services provided and the consideration given in exchange for the services must be disclosed.
- If there were no non-cash transactions, the cost report must include a note to that effect.

Louisiana Yearly Expenditures & Louisiana Employee Payroll

- The notes to the Cost Report of Production Expenditures must provide a breakdown of the amounts spent in each calendar year for both the overall expenditures and the Louisiana employee payroll. Expenditures and Louisiana employee payroll expended in 2015 must be broken down as follows:

- Expenditures 1.1.15-6.30.15
- Expenditures 7.1.15-12.31.15
- LA Resident payroll 1.1.15-6.30.15
- LA Resident payroll 7.1.15-12.31.15

Non-Louisiana Costs

- The notes to the Cost Report of Production Expenditures must provide a breakdown of all non-Louisiana costs and must include the budget item and the amount of the transaction.
- If there are no non-Louisiana costs, the cost report must include a note to that effect.

Accounts Payable, Accrued Charges, and Deferrals

- The amount of accounts payable, accrued charges and deferrals must be presented separately as of the ending date of the cost report.
- If there are no accounts payable, accrued charges or deferrals, the cost report must include a note to that effect.
- Open accounts payable, accrued charges, and deferrals are non-qualifying transactions, and should not be included in the schedule of qualifying costs.

Related Party Transactions – *disclosure and identification*

- The notes must provide a breakdown of all related party transactions (as defined GAAS and GAAP), and include the following:
 - a. The name of the related party
 - b. The nature of the relationship between the related party and the motion picture production company
 - c. The nature of the transaction, and
 - d. The amount of the transaction.

- For further guidance on defining related parties and applicable procedures that should be considered by the auditor, *see* SAS No. 45 and AU Sec. 334 on related parties.
- If there are no related party transactions, the cost report must include a note to that effect.

Related Party Transactions – *verification of economic substance over form*

- GAAS and GAAP require the reporting of the economic substance of transactions regardless of their legal form. The auditor must satisfy himself or herself that any related party relationships and material transactions are properly accounted for and adequately disclosed in the notes. Mere disclosure of RPT’s without further analysis and explanation will be considered insufficient by LED.

Related Party Transactions – *project cost accounting and reporting*

- Motion Picture Production Companies that enter into transactions with related parties shall report project costs as detailed below, unless LED approves in writing an exception for reporting at market rates.
- The Motion Picture Incentive Program is “project” based; therefore, to the extent that related party motion picture production companies are seeking tax credits for qualifying expenditures, they must capture and report “project” costs and revenues, not just functional expense classifications.
- Full project costing requires the creation and reporting of Labor and Facility/Equipment “charge rates” to properly account for Production company personnel and facility/equipment resources used to create the state certified production, i.e. the “project”.

Related Party Transactions – *limitations on certain types of expenditures*

I. Services

A. Above the Line (ATL) services provided by related parties - 12% limit.

- For productions where the Louisiana expenditures are \$25 million or lower and where above the line services (such as producer, executive producer, actor, director and other ATL services) are provided by a related party, qualifying expenditures for these services are limited to 12% of the total Louisiana production expenditures.

B. Below the Line (BTL); actual compensation

- Where below the line services (such as production services) are provided by a related party, qualifying expenditures are limited to the actual compensation paid by the related party to its employee(s) actually performing the service (including employer-paid benefits), allocated to the production on an hourly basis.

II. Goods (equipment/supplies/studio rental/visual effects packages)

a. Fair Market Value (FMV)

- Where goods are provided by a related party, qualifying expenditures are limited to fair market value, as established through the related party’s historic dealings with unrelated parties, or actual transactions between other unrelated parties, for substantially similar goods. The comparable transactions must be substantially similar, considering the type of goods, the geographic market, and other pertinent variables.
For example:

- The production company has recently acquired the same type of goods in Louisiana at the same price from an unrelated third party;
- The studio-parent of the production company operates an equipment rental house that provided goods to the production company, and also recently provided the same type of goods at the same price to unrelated parties in Louisiana.

b. Internal Cost Recovery Rate (ICRR)

- If FMV cannot be established, qualifying expenditures will be limited to the internal cost recovery rate, consisting of actual acquisition cost, plus ongoing maintenance and upgrade cost, divided by anticipated utilization over the real useful life.

c. Visual effects packages; ICRR or actual compensation

- If FMV cannot be established for visual effects packages, qualifying expenditures will be limited to either (1) ICRR and/or (2) actual compensation paid by the related party employer to its employee(s) actually performing the service (including employer-paid benefits), allocated to the production on an hourly basis. LED will select the methodology it deems most appropriate under the circumstances.

III. Finance Fees / Interest

- No tax credits shall be earned for finance fees, interest, or payments of a similar nature paid to related parties and/or investors in the production (i.e., entities or parties that reap increased financial rewards based on sales, exploitation of the product, or the success in lining up distribution agreements)

IV. Documentation

- Related party transactions must be supported by an audit and documentation as requested by LED, which may include (but is not limited to) third-party contracts, notarized affidavits, tax records, and cancelled checks.

**** For further guidance on related party transaction questions, see www.LouisianaEntertainment.gov accounting section with example CPA notes, ICRR calculations and answers to FAQ's.**

Other Considerations

40% ATL Restriction

For productions initially certified after July 1, 2015 no more than 40% of the eligible production expenditures can be for Above the Line Services, defined as “services such as those of a producer, executive producer, line producer, co-producer, assistant producer, actor, director, casting director, screenwriter, and other services of job positions performed by personnel of the production that are associated with the creative or financial control of a production and customarily considered as above the line services in the film and television industry.”

In the event that Above the Line Services exceed 40% of the Louisiana Expenditures included in the applicant’s cost report the CPA must recalculate the maximum allowable ATL services as follows:

(Unlimited ATL Expenditures (e.g. ATL travel and living) + BTL + Post Production + Other Charges)
/ .6 = Allowable Louisiana Expenditures

Allowable Louisiana Expenditures - Unlimited ATL Expenditures (e.g. ATL travel and living) + BTL
+ Post Production + Other Charges = Allowable ATL Services.

Local Louisiana Productions (\$50,000 to \$300,000)

For productions considered local Louisiana productions the auditor must perform testing procedures to ensure tax credit eligibility of the production.

Test should be designed to provide reasonable assurance that the following statutory requirements are met:

- 90% of payments for above the line services must be made to Louisiana Residents
- 90% of production jobs must be filled by Louisiana Residents.

Compensation for above the line services performed in Louisiana shall be paid directly to a Louisiana resident, and any payments made to a loan-out company shall not be considered Louisiana resident payroll for the purposes of above the line percentage calculations.

Production jobs, may include, but not limited to cast and crew positions customarily considered below the line in the film and television industry, such as: production manager, cinematographer, set designer, make-up artist. Extras shall not be considered a production job for purposes of production job percentage calculations.

Ineligible Expenditures

For applications received after July 1, 2016 the following expenditures are ineligible for Motion Picture Investor Tax Credits:

- Airfare
- Bond Fees
- Insurance, unless made to a Louisiana resident licensed insurance producer that has its principal place of business in the state as required by *R.S. 22:1543* . In which case, the expenditures may be allocated only on a pro rata basis, allocating the fees based on the relative percentage of production activity occurring in and out of state.
- Finance fees, loan interest, or fees of similar nature paid to investors in the production unless paid to a Louisiana financial institution as defined in R.S. 6:2(8), or a Louisiana Business and Industrial Development Company as defined in and provided for in Chapter 39-B of Title 51 of the Louisiana Revised Statutes of 1950, R.S. 51:2386 et seq., which is regulated by the office of financial institutions and which have one or more offices in the state. In which case, the expenditures may be allocated only on a pro rata basis, allocating the fees based on the relative percentage of production activity occurring in and out of state. In which case, the expenditures may be allocated only on a pro rata basis, allocating the fees based on the relative percentage of production activity occurring in and out of state.

Eligible expenditures

Marketing and promotion expenses shall be a qualifying expense category for certain expenditures made in Louisiana. In order to be eligible these expenditures must be made from the production budget, and not with monies outside of the production budget or expenditures made on behalf of the production. Media buys are ineligible by statute.

Withholding

Productions initially certified after January 1, 2016 a flat withholding fee is required for “any individual receiving any payments for the performance of services used directly in a production activity, which payments shall be claimed as a production expenditure for purposes of certification of tax credits...”. This is inclusive of wages, box rentals, and per diems paid to both resident and non-resident loan-out companies, 1099 contractors, or W-2 employees.

The auditor must perform test procedures to provide reasonable assurance that appropriate amounts were withheld. If withholding did not take place, the expenditures should be disqualified.

Reporting:

The audit of the Cost Report of Production Expenditures must be conducted in accordance with auditing standards generally accepted in the United States of America. Once the audit engagement is completed, please submit one copy of the auditor’s opinion to the motion picture production company and one copy to the Office of Entertainment Industry Development. The auditor’s opinion should be accompanied by the Cost Report of Production Expenditures and the Notes to the Cost Report (a sample auditor’s report with an unqualified opinion is included as Exhibit I and accompanying notes as Exhibit II).

Report Deadline:

The final auditor’s opinion must be received by the Office of Entertainment Industry Development prior to any certification of expenditures. For productions certified after July 1, 2015 the initial certification letter will state the date by which an expenditure verification report must be received.

EXHIBIT I (letter format)

**Independent Auditor's Report
(Independent Certified Public Accountant's Letterhead)
Motion Picture Production Company Name
Address, City, State, and Zip**

We have audited the accompanying cost report of production expenditures of *Entity Name* for the period from XXXX through XXXXXX of the State Certified Production *Name and Certification Number*.

Management's Responsibility for the Cost Report of Production Expenditures

Management is responsible for the preparation and fair presentation of the cost report of production expenditures in accordance with the accounting and reporting requirements of Louisiana Revised Statue 47:6007. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the cost report of production expenditures that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the cost report of production expenditures based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the cost report of production expenditures is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the cost report of production expenditures. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the cost report of production expenditures, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the cost report of production expenditures in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the cost report of production expenditures.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the cost report of production expenditures referred to above presents fairly, in all material respects, the Louisiana production expenditures of Jump 21 Productions LLC for the period from *Date* through *Date* of the State Certified Production *Production name and number* in conformity with the accounting and reporting requirements of Louisiana Revised Statue 47:6007 as described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the cost report of production expenditures, which describes the basis of accounting. As described in Note 1 of the notes to the cost report of production expenditures, the cost report of production expenditures was prepared on the basis of the accounting practices prescribed by Louisiana Revised Statute 47:6007, which is a basis of accounting other than accounting principles generally accepted in the United States of America. This report was prepared for the purpose of complying with the rules and regulations of the Louisiana Department of Economic Development's Office of Entertainment Industry Development and is not intended to be a complete presentation of the production expenditures for this project. Our opinion is not modified with respect to this matter.

Restriction on Use

This report is intended solely for the information and use of the management of *Entity Name* and for filing with the Office of Entertainment Industry Development and should not be used by anyone other than these specified parties. We acknowledge that the state is relying on this report in the issuance of tax credits under the provision of Louisiana Revised Statute 47:6007.

EXHIBIT II (supporting)

Cost Report of Production Expenditures1:

Attach the audited Cost Report of Production Expenditures detailing the motion picture production company name, State Certified Production (Unique ID#), and the period reviewed.

Notes to the Cost Report of Production Expenditures:

1. General

This cost report of production expenditures represents the production costs attributable to the production entitled "XYZ" produced by the Motion Picture Production Company Name during the period _____ to _____.

2. Sources of funds

As of _____ (insert the ending date of the cost report) the production entitled "XYZ" was financed from the following sources:

The following non-monetary transactions were included in the cost of the production:

Please disclose the nature of the services provided and the consideration given in exchange for the services for each non-monetary transaction.

3. Louisiana Yearly Expenditures & Employee Payroll

The production costs presented in this cost report include the following yearly Louisiana expenditures and employee payroll:

YEAR 1 Spend: \$ _____ YEAR 1 LA Employee Payroll: \$ _____
YEAR 2 Spend: \$ _____ YEAR 2 LA Employee Payroll: \$ _____

Note: 2015 Expenditures (inclusive of Louisiana Resident Payroll) and 2015 Louisiana Resident Payroll must be further broken down between expenditures incurred 1/1/2015 – 6/30/2015 and 7/1/2015 – 12/31/2015

4. Non-Louisiana Costs

The production costs presented in this cost report include the following non-Louisiana costs:

Budget item: \$ _____
Budget item: \$ _____

5. Accounts Payable, Accrued Charges, and Deferrals

As of _____ (insert the ending date of the cost report), the production costs presented in this cost report include no accounts payable. The following expenses are outstanding, but are not included in the cost report of production expenditures:

Accounts payable: \$ _____

Accrued charges: \$ _____

Deferrals: \$ _____

Total: \$ _____

6. Related Party Transactions

Related Party Transactions – disclosure and identification

The production costs presented in this cost report include the following related party transactions (as defined by the accounting standards):

Disclose the following for each transaction:

- The name of the related party
- The nature of the relationship between the related party and the motion picture production company
- The nature of the transaction, and
- The amount of the transaction.

Related Party Transactions – verification of economic substance over form

- CPA notes on methods used, documents reviewed etc.

Related Party Transactions – project cost accounting and reporting and possible limitations on qualifying expenditures

- CPA notes on methods used, documents reviewed, calculations made, if any.

7. Louisiana Resident Employment

While in Louisiana the production employed a total of XXXX employees. Of this number XX were Louisiana residents. This represents X percentage of the total production employees.