California Film & Television Tax Credit Program
AGREED UPON PROCEDURES
Jan.10, 2011

I. Introduction

The California Film & Television Tax Credit Program provides tax credits for qualified expenditures incurred when producing qualified motion pictures. The tax credits can be used to offset either California personal or corporate income taxes or sales and use taxes. A production company requesting a tax credit must submit an Independent Certified Public Accountant's Report on Applying Agreed-Upon Procedures (the 'Report') to demonstrate compliance with the program's requirements.

II. Statutory References

California Revenue and Taxation Code Sections:

1. 6902.5 (sales and use tax)

2. 17053.85 (personal income tax)

3. 23685 (corporate income tax)

4. California Code of Regulations, Title 10, Chapter 7.75, Sections 5500-5507

III. General

The following Agreed Upon Procedures (AUP) are to be performed by a certified public accountant (CPA) with an active California license to perform attest services. The CPA cannot provide production accounting services and agreed upon procedures services to the same production company as per Rule 101 of the American Institute of Certified Public Accountants Code of Professional Conduct and its interpretations and rulings.

The selected CPA must have sufficient knowledge of accounting principles and practices generally recognized in the film and television production industry. The CPA shall read the statute, regulations, guidelines, Qualified Expenditure Charts, Tracking Tips, and all other materials posted on the California Film Commission website.

1. The Report shall be prepared for the use of the following specified parties:

   a. The production company; and
   b. The California Film Commission

2. The Report should include the California CPA license number or the practice privilege permit number for the person and/or firm practicing assurance services.

3. The name of the production and its Credit Allocation Number must also appear on the Report.

4. The Report must be dated as of the last day of the performance of all procedures.

5. The production company's cost report must be presented in U.S. dollars.

6. The production company must provide documentation of all funds expended on the production including pre-production, production and post-production periods.

7. Please include CPA name and contact information for the CPA responsible for the review and final sign off of this Report.

IV. Agreed-Upon Procedures

The CPA shall perform the following procedures. Any exceptions are to be listed as a finding in the CPA's report on applying agreed-upon procedures utilizing Appendix C.

Eligibility:

1. Obtain the detailed cost ledger (e.g. Bible) of California Qualified Expenditures and Total Production Expenditures.

2. Obtain from the California Film Commission and read the production company's tax credit application with supporting documentation, including the following: Application Form (CFC Form A) and Qualified Expenditure Budget.

3. Obtain and read the production company's Credit Allocation Letter.

4. Obtain and inspect post-production documents (e.g. facility invoices) evidencing the date the final elements (e.g., final composite answer print, air master, or digital cinema files) were created. Determine and document in the Report the Qualification Period of the production. Verify that the Qualified Production Period does not exceed 30 months after the date in which the California Film Commission issued the Credit Allocation Letter.

5. Obtain and inspect documentation (e.g. call sheets and/or production reports, shooting schedules) for all principal photography days for the production during the Qualified Production Period in order to determine if production met the 75% principal photography day test. Based upon the inspection of the documentation, state the percentage of total principal photography days which occurred wholly in California. (The total principal photography days in California ratio can be obtained by dividing the number of days of principal photography in California by the total number of principal photography days).

6. If the production does not meet the 75% principal photography day test in Section 5 above, perform the following procedures:

    a. Obtain a detailed cost ledger of Total California Expenditures (including qualified and non-qualified expenditures) and the Total Production Budget. State the ratio of Total California Expenditures to the Total Production Budget.
    b. Select a sample of expenditures from the Total California Expenditure population (including qualified and non-qualified expenditures) according to the sampling methodology noted in Appendix A.
    c. For each expenditure item selected, obtain and inspect invoices and cancelled checks or other equivalent documentation. Verify that the expenditure amount agrees to the invoice, was incurred and paid for services and goods in California. The full value of all assets may be taken when determining eligibility if assets were used in California.

7. Inspect the detailed cost ledger of Total Production Expenditures to determine that the Total Production Expenditures met the maximum and minimum thresholds for Feature Films, Movies

of the Week, Miniseries, and Television Series per the statute. For Independent films, determine if the Total Production Expenditure met the minimum threshold and the total Qualified Expenditures met the maximum threshold per the statute and regulations.

a. If applicable, determine if the completion bond fees were omitted from the Total Production Expenditures or Qualified Expenditure total (for Independent productions only) to meet maximum thresholds noted above. If so, verify that the completion bond fees were excluded from California Qualified Expenditures.
b. If applicable, determine if litigation or insurance claims are causing a production to exceed its Total Production Expenditure maximum threshold. If so, inspect any litigation or insurance documentation for appropriateness and remove these costs in determining the Total Production Expenditures.

8. For all independent motion pictures with a total production budget over $10,000,000 and qualified expenditures over $9,000,000, perform all expenditure and payroll procedures as specified in section labeled "Non-Qualified Testing for Independent Motion Picture".

9. If the production has not met eligibility standards as noted above, there is no need to continue with the agreed upon procedures. Notify production company management to inform the CFC that they are ineligible for the tax credit program.

Expenditures (other than payroll):

1. Select a sample of qualified expenditures (other than payroll) from the detailed cost ledger according to the sampling methodology noted in Appendix A.

2. For each expenditure item selected in the sample perform the following procedures:

   a. Inspect invoices and cancelled checks or other equivalent documentation. Verify that expenditure amount is correct, incurred and paid for services and goods in California.

   b. Verify that the expenditure was not associated with activities specifically excluded by the statute.

   c. Verify that the expenditure was allowable as defined by sections 17053.85(b)(16) and (b)(18)(B)(i)-(iv) and sections 23685(b)(16)and (b)(18)(B)(i)-(iv) of the statute. In particular, inspect travel costs, living allowances and per diems.

   d. Verify that the expenditure was not for in-kind services.

   e. Verify that the expenditure was recorded net of any refunds (not applicable to insurance claims), credit notes received for discounts, rebates, invoicing errors, and purchase returns, as recorded in the cost report and that completion bond expenditures are reported net after rebate.

   f. Verify that the expenditure was recorded net of proceeds from any sale of the production assets.

   g. Verify that the expenditure was not incurred prior to the date in which the Credit Allocation Letter (CAL) was issued. For qualified items which required full or partial payment, such as insurance premiums or office rent, made prior to the issuance of the CAL, confirm that these costs are pro-rated by the number of pre-production, production and post-production weeks and that only the pro-rated costs after the CAL date are included in California Qualified Expenditures.

h. Verify that expenditure was not incurred more than 30 days after creation of the final elements.

i. Verify that the expenditure is pro-rated to reflect any usage out of the state.

j. Verify that insurance deductible(s), if any, was not included in qualified expenditures.

3. Obtain fixed asset listings from the production company of all assets used in the production as follows: (1) all office, post-production, digital and effects equipment; and (2) all other assets not considered office, post-production and effects equipment with an original purchase price over $10,000. The listings should indicate the status of the assets (e.g. destroyed, sold, donated, being held for future productions, given to cast or crew, etc.). A copy of both listings should be attached to the Report. For all assets on the listings perform the following procedures:

   a. For all office, post-production or effects equipment (including but not limited to computers, hardware and relevant components, printers, copiers, etc.), verify that the California Qualified Expenditure is the lesser of the net costs of the asset after sales proceeds (if assets sold) or 20% of the original cost.

   b. For all assets over $10,000 not including office, post production and effects equipment, verify the following: (1) If the asset is sold, verify that the California Qualified Expenditure is the lesser of the net costs of the asset after sales proceeds or 50% of the original cost of such asset; (2) If the asset is retained, verify that the California Qualified Expenditure is 50% of the original cost of such asset; (3) If the asset is destroyed during the process of production, verify that the production company maintains documentation to support the destruction of the asset (e.g. call sheets, production reports, still photographs, video footage, etc.) and allow 100% of that asset; and (4) If the asset is given to a non-qualifying above-the-line (ATL) cast or crew member or sold to a non-qualifying ATL cast or crew member for less than 50% of original purchase price, verify that the cost of such asset is not included in the California Qualified Expenditures.

   c. For exceptions noted in procedures (a) and (b) above, adjust the Qualified California Production Expenditures for known errors noted.

4. Obtain a listing of customized leased or rented items which are manufactured, assembled, or fabricated to specification with lease payments aggregating $10,000 or more. Verify that these items are included on the asset listing noted above (expenditure, procedure 3) if they meet any one of the following four conditions:

   a. If the term of the lease exceeds 75% of the life of the asset*;
   b. If there is a transfer of ownership to the lessee at the end of the lease term;
   c. If there is an option to purchase the asset for substantially less than fair market value (“bargain price”) at the end of the lease term*;
   d. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset.

   Any such rental or lease agreement that meets the above standards for a capital lease will be considered a purchase and subject to the 50% limitation for purposes of determining California Qualified Expenditures as per above expenditure procedures 3 (b) and (c).

   *If the asset value or asset life is not explicit, please contact the CFC to discuss.

5. Obtain a list from the production company of any and all visual effects, digital effects, post production sound and/or title companies who worked on the production. Verify that all listed

parties have provided the production company with documentation indicating the total dollar amount of work performed within the state and verify that only the amount of work performed within the state of California is included in the California Qualified Expenditures total. Adjust California Qualified Expenditures for any work which was not performed in California.

6. For exceptions noted in the expenditure test in procedure 2 above (not including payroll), for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing.

7. For exceptions noted in the expenditures test in procedure 2 above (not including payroll), for the sample identified in the Stratum 1 and Stratum 2 in Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 and Stratum 2 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:

   a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures, document the projected misstatement in the Report. Do not make any adjustment to the California Production Expenditures for a projected misstatement.

   b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures, select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1 and Stratum 2. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make an adjustment to the California Qualified Expenditures for a projected misstatement; however, do adjust the California Qualified Expenditures for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.

   c. Attach a listing of any exceptions noted in the expenditure test in procedures 2 and 7(b) above (other than payroll). The listing should include amount, vendor/person, and nature of discrepancy.

<u>Payroll:</u>

1. Obtain documentation from the payroll service verifying that there are no outstanding invoices pending for work incurred up to 30 days after the creation of the final element. Adjust California Qualified Expenditures for any non-paid invoices.

2. Select a sample of employees from the Qualified Wages account in the detailed cost ledger according to sampling methodology noted in Appendix A. For each employee selected in the sample perform the following procedures:

   a. Compare the amount of the Qualified Wages in the detailed cost ledger for the individual with the payroll report.

   b. Inspect time cards, production reports, call sheets or other equivalent documentation. Verify that wage amount is incurred for services performed in California.

c. Inspect invoices from "qualified entities". Verify the date the expenditure was incurred, and that the loan out company name and the amount of the expenditure agrees with supporting payroll records. Verify that the expenditure was incurred in California.

d. Verify that the "qualified wages" only include those expenses listed in Revenue and Taxation Code Section 17053.85(b)(18)(A)(i)-(iv) or Section 23685(b)(18)(A)(i)-(iv) and do not include any of the expenses listed in Section 17053.85(b)(18)(B)(i)-(iv) or Section 23685 (b)(18)(B) (i)-(iv).

e. Determine that only "qualified individuals" as defined in Revenue and Taxation Code Section 17053.85(b)(14) or 23685(b)(14), received "qualified wages".

f. Verify that all Qualified Wages do not include compensation for any work incurred out of the state.

g. Verify that all Qualified Wages were not incurred prior to the date of the Credit Allocation letter.

h. Determine that all Qualified Wages were not incurred more than 30 days after the creation of the final elements.

3. Inspect the detailed cost ledger and verify that no account codes for non-qualified job positions as defined in Revenue and Taxation Code Section 17053.85(b)(18)(B)(i)-)(iv) or 23685(b)(18)(B)(i)-(iv), contain wages classified as qualified as defined in 17053.85(b)(14)(B) or 23685(b)(14)(B). Adjust California Qualified Expenditures for misclassified wages.

4. Obtain the final "galley" or checker" of the main (if applicable) and end title credits for the production. For those below the line (BTL) individuals (e.g., Unit Production Managers, Production Supervisors, First Assistant Directors, Post Production Supervisors, Visual Effects Supervisors) who also are receiving an on screen producer (e.g. executive, line, co-, associate, visual effects, music, post) credit, verify that qualified wages only include: up to $100,000 in Director Guild of America (DGA) wages; industry standard wages; or wages equivalent with other crew in similar positions. For those receiving both above the line and below the line credits, please note in the Report the names and qualified compensation for each individual for each end title credit received. Adjust California Qualified Expenditures for any below the line crew also receiving a producer credit whose BTL wages are not within industry standards, equivalent with other crew in similar positions, or above $100,000 for DGA positions.

5. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in the Top Stratum of Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing.

6. For exceptions noted in the payroll test in procedure 2 above, for the sample identified in Stratum 1 in Appendix A, adjust the Qualified California Production Expenditures for known errors noted during your testing and project the misstatement results of the sample to all items from which the sample was selected. For purposes of calculating the projected misstatement, divide the monetary amount of misstatement of the exceptions identified by the sample population total amount (rate of misstatement). Multiply this rate of misstatement to the total expenditure population from which the Stratum 1 sample was selected. Perform the following procedures based upon the results of the calculation of the projected misstatement:

    a. If the projected misstatement does not exceed 2% of Qualified California Production Expenditures, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for the projected misstatement.

b. If the projected misstatement exceeds 2% of Qualified California Production Expenditures, select a second additional sample according to the sampling methodology noted in Appendix A for Stratum 1. Recalculate the projected misstatement for the second additional sample. If the projected misstatement for the second additional sample does not exceed 2%, document the projected misstatement in the Report. Do not make adjustments to the California Production Expenditures for a projected misstatement; however, do adjust the California Qualified Expenditures for noted known errors in this second sample. If the projected misstatement from the second sample selection exceeds 2% of Qualified California Production Expenditures, adjust the Qualified California Expenditures for the average of the two projected misstatements.

c. Attach a listing of any exceptions noted in the payroll test in procedures 2 and 5(b) above. The listing should include amount, person or entity, and nature of discrepancy.

<u>Non Qualified Testing for Independent Motion Picture</u>

Expenditures (other than payroll)

1. Select a sample of non-qualified expenditures (other than payroll) from the detailed cost ledger according to the sample methodology noted in Appendix B.

2. For each expenditure item selected in the sample, Inspect invoices and cancelled checks or other equivalent documentation. Verify that the expenditure was not qualified as defined in Section 17053.85(b)(18)(B)(i)-(iv) or 23685(b)(18)(B)(i)-(iv),

3. For exceptions noted in the expenditure test in procedure 2 above (not including payroll), adjust the Non Qualified Expenditures and the Qualified California Production Expenditures for known errors noted during your testing.

Payroll:

1. Select a sample of employees from the Non-Qualified Wages account in the detailed cost ledger according to sampling methodology noted in Appendix B. For each employee selected in the sample, perform the following procedures:

   a. Compare the amount of the Non-Qualified Wages in the detailed cost report for the individual with the payroll report.

   b. Inspect time cards, production reports, call sheets or other equivalent documentation. Verify that the wage amount is incurred for services performed outside of California OR that the wage amount was not a qualified expenditure as defined as qualified in Revenue and Taxation Code Section 17053.85(b)(18)(B)(i)-(iv) or Section 23685(b)(18)(B)(i)-(iv).

2. For exceptions noted in the payroll test in procedure 1 above, adjust the Non Qualified Expenditures and the Qualified California Production Expenditures for known errors noted during your testing.

<u>Related Parties & Other Affiliations:</u>

1. Obtain from the production company a schedule listing of all related party transactions (including parties with a 5% or greater ownership in or affiliation with the production company) for which the

production company is including the transactions in the California Qualified Expenditures. The listing should note the type of relationship between the related party and the production company and the nature and amount of the transactions.

2. Obtain a signed letter from a production company representative stating that the applicant (indicated in the Credit Allocation Letter) has properly disclosed all related parties and related party transactions and that the schedules produced in accordance with item number 1 above are complete and accurate.

3. From the schedule in item number 1, select a sample of related party transactions for testing. Select all transactions greater than $25,000. For the transactions less than $25,000, haphazardly select 15 transactions for testing. Perform the following procedures for each related party transaction selection:

    a. For wages paid to related parties, verify that no amounts are included in the California Qualified Expenditures.
    b. For non-payroll expenditures, inspect studio rate cards or comparison bids to determine that related party transactions did not exceed the highest rate/bid. In addition, inspect pass-through vendor invoices to determine no markup was added. Any expenditures above the highest rate/bid and/or which were marked up when passed through the related party must be noted and explained on the related party transaction listing attachment, see procedure #4.

4. Attach a listing of all related party transactions obtained in procedure #1. Note and explain any sampled transactions that did not have comparison bids, were above the higher rate/bid, and/or were marked up when passed through the related party.

<u>Wrap Up Procedures</u>

1. If applicable, based upon the results of the Non Qualified Testing for Independent Motion Pictures, verify and note that the independent film exceeded or did not exceed the $10 million qualified expenditure budget threshold. For those independent films that exceeded the $10 million qualified expenditure threshold, adjust Exhibit A to reflect a 20% credit allocation percentage.

2. If applicable, recalculate the 75% spend test (e.g. eligibility procedure number 6) after accounting records are revised for findings in payroll and expenditure procedures. Confirm that 75% of the Total Production Budget was spent for California Qualified Expenditures.

3. Provide the following data requested on Exhibit A which agrees with the cost report utilized by the CPA for the procedures above, as adjusted for the exceptions noted above:

    a. Qualified Wages & Fringes - excluding post-production
    b. Qualified Non-wage Spend - excluding post-production
    c. Total Qualified Expenditures – excluding post-production
    d. Qualified Wages & Fringes – post-production
    e. Qualified Non-wage Spend – post-production
    f. Total Qualified Expenditures – post-production only
    g. Total Tax Credit Allocation Due

4. The CPA must include the information requested above (wrap procedures, procedure 2) in the Report utilizing the format in “Exhibit A”.

5. The CPA must indicate on the Report that the specific program minimum and maximum thresholds as applicable to the type of production have been met.

EXHIBIT A

QUALIFIED EXPENDITURES:	
E: Qualified Wages & Fringes (excluding post): ______________________________	**E2:** Qualified Wages & Fringes - Post-Production only: ______________________________
F: Qualified (Non-Wage) Spend (excluding post): ______________________________	**F2:** Qualified (Non-Wage) Spend Post-Production only: ______________________________
*** G:** Total Qualified Expenditures **(E+F)** (excluding post): $0.00	*** G2:** Total Qualified Expenditures Post-Production only **(E2+F2)**: $0.00

*** Tax Credit Allocation Due (G+G2):**

$0.00 **x** ________ % = $0.00

Eligible Tax Credit

Enter .20 or .25

Credit Allocation Letter Amount: ______________________________

*** FINAL CREDIT AMOUNT (whichever is less):** $0.00

*** Automatic calculations are programmed in the form.**

Appendix A

California Film & Television Tax Credit Program
Sampling Chart
Feature Films/Movies of the Week/Miniseries
Television Series*

	Payroll		Non-Payroll*		
	Top Stratum	Stratum 1	Top	Stratum 1	Stratum 2
Total Qualified Expenditures	Employees with top 10 total qualified wages	Employees with total qualified wages under $100,000	Items $25,000 and over	Items under $25,000 and over $500	Items $500 and less
0 - $500,000	All Items	10	All Items	50	25
$500,001 - $1,000,000	All Items	20	All Items	50	25
$1,000,001 - $5,000,000	All Items	25	All Items	50	25
$5,000,001 - $10,000,000	All Items	25	All Items	60	25
$10,000,001 - $25,000,000	All Items	25	All Items	75	25
$25,000,001 - 50,000,000	All Items	25	All Items	100	25
$50,000,001 +	All Items	25	All Items	100	25

*For a Television Series, excluding payroll, the sampling should be based upon aggregating all episode and amortization costs together from a series for purposes of determining the total qualified expenditures above. Once a sample size is determined, the CPA must sample items from each episode, including amortization costs.

Appendix B

Non-Qualified testing for Independent Motion Pictures

California Film & Television Tax Credit Program

Sampling Chart

Feature Films/Movies of the Week/Miniseries

Television Series*

	Payroll		Non-Payroll*
	Top Stratum	Stratum 1	Top Stratum
Total Non-Qualified Expenditures	Employees with top 10 total non-qualified wages	Employees with total non qualified wages under $100,000	Items $25,000 and over
0 - $500,000	All Items	10	All Items
$500,001 - $1,000,000	All Items	20	All Items
$1,000,001 - $5,000,000	All Items	20	All Items
$5,000,001 - $10,000,000	All Items	20	All Items

*For a Television Series, excluding payroll, the sampling should be based upon aggregating all episode and amortization costs together from a series for purposes of determining the total nonqualified expenditures above. Once a sample size is determined, the CPA must sample items from each episode, including amortization costs.