

EMPIRE STATE DEVELOPMENT
FILM TAX CREDIT PROGRAM

PRELIMINARY AGREED UPON PROCEDURES
OCTOBER 2014

The purpose of this document is to describe the Agreed Upon Procedures (AUP) a qualified CPA firm must follow for verifying a final application for the New York State Film Tax Credit Program on behalf of a production company.

Background

The New York State Film Tax Credit Program is administered by Empire State Development (ESD) and provides incentives to qualified production companies that produce feature films, television series, relocated television series, television pilots and television movies, and/or incur post-production costs associated with the original creation of these productions. Program credits of \$420 million a year can be allocated and used to encourage companies to produce projects in New York and help create and maintain industry jobs.

An application is first submitted as an initial application prior to the start of the project and includes estimated project costs. When an applicant completes the project, a final application must be submitted with actual project information. An applicant may include an Agreed Upon Procedures (AUPs) verification by a third-party along with the final application. The AUPs must be completed by a Certified Public Accountant (CPA) on the ESD vendor list of CPA firms determined to be pre-qualified to conduct a third-party verification. In addition, the CPA firm must conduct the third-party verification (CPA Verification) according to the AUP indicated in this document.

Qualified production companies must submit a **complete** final application in order to be allocated tax credits. When complete, the application documents and forms must be emailed to filmcredits@esd.ny.gov with the project title in the subject line of the email. Further information about the NYS Film Production Tax Credit Program can be found at <http://esd.ny.gov/BusinessPrograms/filmCredit.html>

Regulatory References

See Title 5 of the New York Codes, Rules and Regulations (NYCRR), Part 170 for regulations governing third-party verifications [§§ 170.2 (w), 170.2 (ah), 170.7].

Qualified Certified Public Accountant

The third-party verification conducted according to the AUP may only be performed by a qualified CPA that has been pre-selected by ESD to conduct such verification on behalf of a film production company submitting a final application to the Film Tax Credit Program.

The CPA Verification

The purpose of the CPA Verification is to ensure and verify that the production company has met the eligibility requirements of the Program and has submitted as qualified expenditures only those costs that are outlined in Program Materials as eligible for the NYS Film Production Tax Credit. The CPA Report must include the following information:

1. The CPA's name, address, and telephone number,
2. The name of the production and its Application Approval Number,
3. The date that the agreed upon procedures were completed.

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

The CPA shall perform the following procedures. Any exceptions are to be listed as a finding in the CPA Verification using the sampling method outlined in the AUP.

Eligibility

1. Obtain from the production company a **complete** final application that consists of the following documents:
 - a. Project Summary – Final
 - b. Budget Cost Qualifier – Final
 - c. End Credit Requirements
 - d. Employment Report
 - e. Daily Production Reports
 - f. Shoot Days Summary
 - g. Production Budget (locked)
 - h. General Ledger (GL) in its entirety
 - i. General Ledger separate reports from the GL for each category of costs, (indicated on the budget cost qualifier), that are eligible for the tax credit
 - j. Cast & Crew List

For further information about these documents, see the Film Tax Credit Program Guidelines at <http://esd.ny.gov/BusinessPrograms/Data/Film/2014/FilmCreditGuidelines052314.pdf>

2. 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.
3. Verify that only costs paid or incurred as of the post-production completion date, (as documented by step 2), are included in qualified expenditures.

4. Inspect the application materials to determine that the production has met the eligibility requirements indicated below:
 - a. For a production with a budget of less than \$15 million and no more than 5% affiliated with a publicly traded entity, one day of principal photography on a set at a Qualified Production Facility (QPF) is required. If principal photography also occurred at a Non-Qualified Production Facility, 75% of all qualified costs related to principal photography at all production facilities must be incurred in relation to principal photography at a QPF.
 - b. For a production with a budget of more than \$15 million or more than 5% affiliated with a publicly traded entity, 10% of principal photography days on a set or sets at a QPF is required. If principal photography also occurred at a Non-Qualified Production Facility, determine that 75% of all qualified costs related to principal photography at all production facilities were incurred in relation to principal photography at a QPF.
 - c. A pilot has the same eligibility requirements as outlined in paragraph (a) above.

If the production has not met eligibility standards as noted above (procedure #4), there is no need to continue with the CPA Verification using the AUP. The CPA should notify the production company management to inform ESD that they are ineligible for the film tax credit.

5. Inspect the application materials to determine whether costs incurred outside the qualified production facility,(i.e. location days), in NY qualify for the credit as indicated below:
 - a. If less than \$3 million dollars on QPF stage related costs were incurred, 75% of principal photography location days in NYS are required in order for NY location days to qualify for the credit.
 - b. If more than \$3 million dollars were incurred on QPF stage related costs, then any NYS location days are eligible for the credit
6. Inspect the application materials to ensure that the information in the Project Summary, Budget Cost Qualifier and Employment Report reconciles with the information in the GL and separate GL reports. The production company should be notified of any discrepancies and asked for an explanation and for revisions where necessary.

Expenditures (excluding payroll)

1. Analyze the separate qualified expenditure general ledger reports to identify any non-qualified costs as indicated on the Schedule of Qualified Expenditures. Any non-qualified cost items identified should be disallowed and adjustments made to the Qualified Costs Summary.
2. Verify that any qualified expenditures included in insurance claims have been credited both in the GL and in the Budget Cost Qualifier – Final.
3. Select a sample of expenditures, (excluding payroll), from each of the GL separate reports according to the sampling methodology noted in the Sampling Chart.
4. For each expenditure item selected in the sample, perform the following procedures:
 - a. Inspect invoices and cancelled checks or other equivalent documentation. Verify that the expenditure amount is correct, incurred and paid for services rendered or goods used in NYS.
 - b. Verify that the expenditure is an allowable cost (refer to statute, regulations and the Schedule of Qualified Expenditures). If unsure, contact the ESD Film Tax Credit Program staff.
 - c. Verify that the expenditure was not for in-kind services.
 - d. Verify that the expenditure was recorded net of any refunds, discounts, rebates, invoicing errors, and purchase returns, as recorded in the GL reports.
 - e. Verify that the expenditure was recorded net of proceeds from any sale of the production assets.
5. Obtain a listing from the production company of assets that were not destroyed in the film production process and that are being held for future productions or other purposes and have a purchase price over **\$2,000**. A copy of the listing should be attached to the CPA Report). For all assets on the listing perform the following procedures:
 - a. Verify that no greater than **30%** of the costs of office, post–production or effects equipment, including but not limited to computers, hardware and relevant components, printers and copiers being held for future productions or use were included as a qualified expenditure, (and were identified as such in the GL reports.)
 - b. For all other assets, verify that no greater than 50% of the costs of such assets were included as a qualified expenditure, (and were identified as such in the GL reports).

- c. If percentages greater than those cited above (in a. and b.) were included in qualified expenditure reports, make the adjustment in the Qualified Costs Summary.
 - d. Obtain a list from the production company of visual effects and digital effects 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 NYS and verify that only the amount of work within NYS is included in qualified expenditures.
6. For disqualified costs noted in the expenditure test in procedure 2 above, for the sample identified in Category 1 of the Sampling Chart, adjust the Qualified Costs Summary to reflect the results of your testing.
7. For disqualified costs noted in the expenditures test in procedure 2 above, for the sample identified in the Category 2 and Category 3 of Sampling Chart, 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 Category 2 and Category 3 sample was selected.
8. Perform the following procedures based upon the results of the calculation of the projected misstatement:
 - a. If the projected misstatement does not exceed 1% of qualified expenditures, document the projected misstatement in the CPA Report. Do not make adjustments to the Qualified Costs Summary for the projected misstatement.
 - b. If the projected misstatement exceeds 1% of qualified expenditures, select a second additional sample according to the sampling methodology noted in the SAMPLING CHART for Category 2 and 3. Recalculate the projected misstatement for the second additional sample.
 - c. If the projected misstatement for the second additional sample does not exceed 1%, document the projected misstatement in the CPA Report and do not make adjustments to the qualified expenditures. If the projected misstatement from the second sample selection exceeds 1% of qualified expenditures, adjust the Qualified Costs Summary using the average of the two projected misstatements.

Payroll Expenditures

1. Verify that all production employees are listed on the Employment Report, with credit eligible hours and wages listed separately from all hour and wages for all production employees, (both qualified and non-qualified). Verify that ineligible wage costs (as identified in the Schedule of Qualified Expenditures) have been excluded from the credit eligible hours and wages on the Employment Report and from the qualified costs identified on the Budget Cost Qualifier. Also verify that the header on the Employment Report which summarizes data for NYS employees is in accordance with data reported on the Project Summary – Final. Refer to the GL, separate GL reports and payroll reports, as necessary, for this verification.
2. Select a sample of employees according to the methodology described in the Sampling Chart. For each employee in the sample perform the following procedures:
 - a. Compare the amount of qualified wages in the separate GL reports with the payroll report and verify that both are in concurrence with the amount on the Employment Report.
 - b. Inspect production reports or other equivalent documentation, as necessary, and verify that the wage amount is incurred for services performed in NYS.
 - c. Inspect invoices from loan out companies and verify that the loan out company name, (including for services of employee name), is listed on the Employment Report and that the amount of expenditure is in agreement with the GL reports and payroll records.
 - d. Verify that all wages paid or incurred do not precede the pre-production period identified in the Project Summary nor follow the post production completion end date indicated on the Project Summary. Any exceptions must be documented by the production company and validated.
 - e. Verify that any insurance claims including qualified wages have been credited in the GL and on the Budget Cost Qualifier.
3. For non-qualified costs noted in the expenditure test in # 2 above, for the sample identified in Category 1 of the Sampling Chart, adjust the Qualified Costs Summary to reflect the results of your testing.
4. For disqualified costs noted in the expenditures test in procedure 2 above, for the sample identified in the Category 2 and Category 3 of Sampling Chart, 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 Category 2 and Category 3 sample was selected.

5. Perform the following procedures based upon the results of the calculation of the projected misstatement:
 - a. If the projected misstatement does not exceed 1% of qualified expenditures on the Budget Cost Qualifier, document the projected misstatement in the Report. Do not make adjustments to the Qualified Costs Summary for the projected misstatement.
 - b. If the projected misstatement exceeds 1% of qualified expenditures, select a second additional sample according to the sampling methodology noted in the SAMPLING CHART for Category 2 and 3. Recalculate the projected misstatement for the second additional sample.
 - c. If the projected misstatement for the second additional sample does not exceed 1%, document the projected misstatement in the CPA Report and do not make adjustments to the qualified expenditures.
 - d. If the projected misstatement from the second sample selection exceeds 1% of qualified expenditures, adjust the Qualified Costs Summary using the average of the two projected misstatements.

Related Parties

1. Obtain from the production company a listing of all related party transactions, (including parties with a 5% or greater ownership in or affiliation with the production company applicant), that the production company is including as 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. For up to the top 25 items in costs, verify the items according to the procedures as described above in step #4 for Expenditures (excluding payroll).

Summary

1. Verify that the NYS minimum threshold requirements for the qualified production facility and on location principal photography days have been met.
2. Verify that all documentation is complete, accurate and uniform in its reporting of production-related information and expenditures.
3. Attach a listing of assets that were not destroyed in the film production process.
4. Attach a list of any non-qualified costs noted in the expenditure test, (both general and payroll). The list should include general ledger report coding, amount, vendor/person/entity, and nature of discrepancy from the Schedule of Qualified Expenditures.
5. Attach sampling documentation including the calculation of misstatement percentages for both payroll and non-payroll expenditures per the Sampling Chart. In addition, attach related party documentation.
6. Attach the Qualified Costs Summary with adjustments for disqualified costs, revised total qualified costs and the tax credit amount.
7. Provide a cover letter noting the inclusion of all revised, (as necessary), and completed documentation required by the NYS Film Tax Credit Program (noted under Eligibility #1 of this document). Also note all required documentation listed above. Include information in regard to any special circumstances, or unusual procedures followed by the production company in their preparation of the application for third-party verification.