EMPIRE STATE DEVELOPMENT
FILM TAX CREDIT PROGRAM

POST-PRODUCTION CREDIT

AGREED UPON PROCEDURES

July 2016

The purpose of this document is to set forth the Agreed Upon Procedures (AUPs) a qualified CPA firm must follow for inspecting a final application for the New York State Film Tax Credit Program Post-Production Credit on behalf of a production company.

Background

The New York State Film Tax Credit Program – Post-Production Credit is administered by Empire State Development (ESD) and provides incentives to qualified production companies that incur post-production costs associated with feature films, television series, relocated television series, television pilots, and television movies. Program credits of $25 million per year can be allocated and used to encourage companies to incur post-production costs in New York to help create and maintain industry jobs.

An initial application is submitted no later than the last day of principal photography (or, in the case of a television series, no later than the last day of principal photography on the first episode of the series) and includes estimated project costs. The Department may determine that applications submitted after the above dates are eligible as long as no qualified costs have been incurred in New York State. 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) inspection by a third-party along with the final post-production 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 CPA inspection. In addition, the CPA firm must conduct the CPA Inspection according to the Agreed Upon Procedures indicated in this document.

Qualified production companies must submit a **complete** final post-production application in order to be allocated tax credits. The Project Summary Form is to be submitted online and the remainder of application is to be uploaded through the secure file transfer site. Please refer the applicant to our webpage http://esd.ny.gov/BusinessPrograms/filmCredit.html for the link and instructions to the online application.

Regulatory References

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

The Agreed Upon Procedures

The purpose of the AUPs is to ensure and confirm 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 – Post- Production Credit. The AUP Report must include the following information:

1. The CPA's name and contact information for the CPA responsible for the review and final sign off of this Report
2. The name of the production
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 findings in the AUP Report.

Eligibility

1. Obtain from the production company a **complete** final application that consists of the following documents. A complete final application means that all required information is provided in the form and manner prescribed by the Film Tax Credit Program. (e.g., the Budget Cost Qualifier must reconcile to the General Ledgers [GL]. The Employment Report must reconcile to the employment section in the Project Summary-Final Form).

    a. Project Summary – Final
    b. Budget Cost Qualifier – Final
    c. End Credit Requirements
    d. Frame Grab of End Credits
    e. Employment Report (includes payroll, loan-outs paid via accounts payable)
    f. Separate Reports from the GL for each Category of Costs (indicated on the Budget Cost Qualifier) that are eligible for the tax credit and also for each category of costs that are ineligible for the tax credit.
    g. General Ledger in its entirety for Post- Production

    For further information about these documents, see the Film Tax Credit Program Guidelines at http://esd.ny.gov/BusinessPrograms/Data/Film/2016/FilmCreditGuidelines.pdf

2. Obtain and inspect post-production documents for film (e.g. vendor invoices) evidencing the date the final elements (e.g., final composite answer print, air master, or digital cinema files) were created. For television, the qualification period ends at the time the last expenditure directly related to the applying production is paid or incurred. Determine and document the qualification period of the production. The qualification period commences at post-production start date and culminates with post-production end date. These dates must reconcile to section 1-3 in the Project Summary-Final application form.

3. Verify with a responsible official at the production company (Applicant) to determine that only costs paid or incurred as of the post-production completion date (as documented by item 2, above) are included in qualified expenditures.

4. Obtain the production company's (Applicant) documentation to support the basis of eligibility. A film production company can qualify for the post-production credit if it meets either one or both of the following thresholds or meets the criteria set forth in #5 :

   A) Visual Effects and Animation - the qualified VFX/Animation costs incurred at a qualified post-production facility in NYS must EITHER meet or exceed:

      - Twenty (20) percent of the total VFX/Animation qualified costs paid or incurred for VFX/Animation for the qualified film at any post-production facility anywhere; **OR**

      - $3 million in qualified VFX/Animation costs

   B) Post-Production – the qualified post-production costs incurred at post-production facilities in NYS, (excluding cost for VFX/Animation), must meet or exceed seventy five (75) percent of the total qualified post-production costs paid or incurred in the post-production of the film at any post-production facility.

5. Fully Animated Production: A company engaged in the production of a fully animated film is eligible for the Post- Production Credit if the qualified production and post-production costs meet the VFX/Animation threshold of 20 percent; certain expenses in the Producer, Director and Deliverable Elements categories indicated in the Animation Schedule of Qualified Expenditures are also qualified if they meet the Post- Production seventy five (75) percent threshold.

6. Verify that the eligibility thresholds defined above are met after all adjustments have been made to the QCS.

If the production has not met eligibility standards as noted (item 4 & 5, above), there is no need to continue with the CPA Inspection using the AUP. The CPA should notify the production company management to inform ESD that they are ineligible for the credit.

Expenditures (Excluding Payroll)

1. **Inspect the GL reports for non-qualified expenses.** Deduct any errors from the Qualified Cost Summary (QCS) and **remove** them from the population to be sampled. Consult the New York State Film Tax Credit Program Schedule of Qualified Expenditures for Post-Production Credit. Attach a list of any non-qualified costs found. The list is to include GL report coding, amount, vendor/person/entity and nature of discrepancy from the Schedule of Qualified Expenditures.

2. For each expenditure specified below, the Applicant is to provide a New York State Registered Sales Tax Vendor certification downloaded from the New York State Sales Tax website. Prepare a schedule listing those expenditures which **do not** have accompanying certification. These expenditures are to be disallowed. The Qualified Costs Summary is to be adjusted accordingly. **Do not** include the vendor certification downloads with the Report. The applicant should retain all documentation in the event the Film Tax Credit Program staff requests that it be provided.

   The expenditures are: Office equipment (administrative not editorial), catering, car service

3. For productions that submitted initial applications to the NYS Film Tax Credit Program on or after August 1, 2016, obtain from the production company a completed Related Party Transaction Report Form which is located in the Final Application Template Book. Related party transactions are transactions with parties that have a 5% or greater ownership (directly or indirectly) with the applicant entity and are included as qualified expenditures. Attach schedule to the AUP Report.

4. For productions that submitted initial applications to the NYS Film Tax Credit Program on or after August 1, 2016, obtain from the production company a completed Retained Assets Report which is located in the Final Application Template Book. The Form must list assets that were not destroyed in the film post-production process and which are being held for future productions or other purposes and have a purchase price over **$2,000.** Attach schedule to the AUP Report.

5. Verify with a responsible official at the production company (Applicant) that any qualified expenditures included in insurance claims have been credited both in the GL and in the Budget Cost Qualifier – Final. If the production company filed an insurance claim and received funds, the CPA is to inspect the supporting documentation of the claim to ensure the expenditures were properly credited to the correct accounts in the General Ledger and Budget Cost Qualifier.

6. Select a sample of expenditures (excluding payroll) from each of the GL separate reports of qualified costs (Downstate/NYC+MCTD*; NYS Upstate Outside MCTD; NYS Upstate Labor) according to the sampling methodology noted in the Sampling Chart.

   *MCTD stands for Metropolitan Commuter Transportation District which includes NYC, Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester counties.

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

    a. Determine if the expenditure is an allowable cost (refer to the Schedule of Qualified Expenditures). If unsure, contact the ESD Film Tax Credit Program staff.

    b. Inspect invoices; proof of payment (i.e. canceled checks, check images, check copies, bank statements, credit card statements, etc.). Inspect the expenditure in order to establish the accuracy of the entry, e.g., the expenditure was paid or incurred for services rendered or goods used in NYS.

    c. Determine that the expenditure was paid by the applicant entity and recorded net of any refunds, discounts, rebates, sale proceeds, invoicing errors, and purchase returns as recorded in the GL reports.

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

8. Provide a list, obtained from the production company (Applicant), of visual effects and/or digital effects companies who were contracted by the production company (Applicant). Inquire of an authorized representative of the Applicant whether all listed parties have provided the production company with a signed letter on letterhead indicating the total dollar amount of work performed within NYS. Verify that only work performed within NYS by the vfx/digital fx company is included in qualified expenditures. Adjust the QCS for any non-qualified spend. Attach letters with Report.

9. For non-qualified costs noted in the expenditure test for the sample identified in Category 1 of the Sampling Chart, adjust the Qualified Costs Summary to reflect the results of your testing.

10. Prepare a list of transactions from Category 2 and Category 3 in accordance with the number of invoices required on the Sampling Chart. Any non-qualified expenditures found during procedure 1 listed above is to be excluded from the sample population. Category 2 and Category 3 are to be evaluated independently from each other and not aggregated. <u>Adjust the QCS for known errors noted during your expenditure tests for Category 2 and Category 3.</u> Calculate the rate of misstatement from the expenditure test for each category, 2 and 3 by dividing the dollar amount of the misstated items in each category by the dollar amount of the sample population in each category. This is your rate of misstatement.

11. Perform the following procedures based upon the results of the calculation of the rate of misstatement:

    a. If the rate of misstatement does not exceed 1% of qualified expenditures in the sampled population for Category 2 and/or Category 3, no further action is required.

    b. If the rate of misstatement for Category 2 and/or Category 3 exceeds 1% of qualified expenditures (excluding payroll) in the sampled population, select a second sample set.

    c. According to the sampling methodology noted above for Category 2 and Category 3, test a second sample set and recalculate the rate of misstatement for this second sample set. Do not include the previously selected invoices in the second sample. If the number of invoices available for the sample does not meet the minimum number according to the Sampling Chart, include 100% of the invoices not previously included in the samples.

d. If the rate of misstatement for the second sample does not exceed 1%, adjust the QCS for any known errors in the second sample and no further action is required. If the rate of misstatement from the second sample selection exceeds 1% of qualified expenditures, adjust the QCS for known errors found in the second test AND adjust the remainder of the applicable categories untested expenses by the projected misstatement. The projected misstatement is obtained by multiplying the remaining untested population by the average of the two rates of misstatement. In summary, when the expenditure tests for Category 2 and/or Category 3 exceed 1% for both tests, the deduction for that category will include the known errors found in each of the sample tests plus the projected misstatement on the remainder of the untested population in the applicable category.

Expenditures (Payroll)

1. Compare the qualified payroll expenditures listed in the GL reports to the payroll expenditures on the Employment Report in order to determine that the qualified payroll expenditures are consistent with the New York State Film Tax Credit Program Schedule of Qualified Expenditures for Post-Production Credit. Qualified expenditures do not include the salaries, wages and fees for above-the-line personnel (e.g., producers, directors, actors, composers). Disqualify all salaries, wages and fees for ineligible personnel on the QCS.

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 (not including box rentals, car allowances, per diems, fringes, etc.) in the separate GL reports of qualified expenditures with the amount on the Employment Report.

    b. Compare the amount of expenditures for a loan-out company (for services of employee name) in the separate GL reports of qualified costs with the amount on the Employment Report.

    c. Determine that all wages paid or incurred do not precede the post-production start date identified in the Project Summary nor occur after the post- production completion date indicated on the Project Summary. For any exceptions, the production company must provide a written explanation.

    d. Verify that all direct hire wages do not include compensation for any work incurred out of NYS (review Employment Report, general ledgers, and payroll records).

3. For non-qualified costs noted in the expenditure test in item 2 above, for the sample identified in Category 4 of the Sampling Chart, adjust the Qualified Costs Summary to reflect the results of your testing.

4. For non-qualified costs noted in the expenditures test in item 2 above, for the sample identified in Category 5 of Sampling Chart: divide the dollar amount of misstated entries by the sample population total amount to obtain the rate of misstatement.

5. Perform the following procedures based upon the results of the calculation of the rate of misstatement:

   a. If the rate of misstatement does not exceed 1% of qualified expenditures (payroll), adjust the QCS for known errors discovered in the sample population. No further action is required.

   b. If the rate of misstatement exceeds 1% of qualified expenditures, select a second additional sample according to the sampling methodology noted above for Category 5. Recalculate the rate of misstatement for the second sample set.

   c. If the rate of misstatement for the second sample set does not exceed 1%, document the rate of misstatement in the AUP Report and adjust the QCS for known errors discovered in the second sample population. No further action is required.

   e. If the rate of misstatement from the second sample selection exceeds 1% of qualified expenditures (payroll), adjust the QCS for known errors found in the second test AND adjust the remainder of the untested Category 5 expenses by the projected misstatement. The projected misstatement is obtained by multiplying the remaining untested population by the average of the two rates of misstatement.

Include the following with Agreed Upon Procedures Report:

1. Table of Contents

2. Qualified Costs Summary with adjustments for non-qualified costs and revised total qualified costs. Include in Report and send to applicant as an Excel file.

3. Sampling documentation, including the calculation of misstatement percentages, for both non-payroll (Category 2 and Category 3) and payroll (Category 5) expenditures per the Sampling Chart. Attach a list of any non-qualified costs noted in the expenditure test (both general and payroll). The list is to include GL report coding, amount, vendor/person/entity and nature of discrepancy from the Schedule of Qualified Expenditures.

4. Attach all verification letters (e.g. vfx letters).

5. Attach final element verification.

6. Related Party Transactions (if applicable).

7. List of Retained Assets (if applicable).

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AGREED UPON PROCEDURES FOR CPA INSPECTION OF FINAL APPLICATION

SAMPLING CHART

EXPENDITURES (EXCLUDING PAYROLL)

Samples must be chosen from each column of qualified costs on the Budget Cost Qualifier in proportion to their percentage of the total qualified costs for the project.

	CATEGORY 1	CATEGORY 2	CATEGORY 3
	Items $5,000 and over	Items under $5,000 and over $500	Items $500 and less
QUALIFIED EXPENDITURES			
$0 - $1,000,000	All items	25	20
	$10,000 and over	Under $10,000 and over $1,000	Items $1,000 and less
$1,000,001 - $3,000,000	All items	45	20
$3,000,001 +	All items	60	20

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SAMPLING CHART

PAYROLL EXPENDITURES

QUALIFIED EXPENDITURES	CATEGORY 4 Employees with top 5 Total Qualified Wages	CATEGORY 5 Employees with Total Qualified Wages under top 5
0 - $1,000,000	All items	5
$1,000,001 - $3,000,000	All items	10

	Top 15 Total Qualified Wages	Under Top 15 Total Qualified Wages
$3,000,001 +	All items	15