

Audit Instructions

1. Introduction:

To ensure compliance with Section 12-217jj of the Connecticut General Statutes regarding digital media and motion picture tax credits, the Connecticut Commission on Culture & Tourism (the “Commission”) requires an independent audit of qualified production expenses clearly and demonstrably incurred in the state by an eligible production company producing a state-certified qualified production. Incurred in the state means payments made for goods or services used in the state in connection with a qualified production. Only a completed project phase may be audited. A project is divided into three phases: pre-production, production and post production. As such, an audit of the detailed cost report must be performed by an independent certified public accountant and paid for by the production company/tax credit applicant (“applicant”) prior to the issuance of a production tax credit certificate (“certificate”).

2. General:

- (a) The auditor must be a certified public accountant licensed in Connecticut and must be an independent third party, as defined under generally accepted auditing standards.
- (b) The auditor's opinion must be addressed to the party that has engaged the auditor (e.g., the officer of the applicant).
- (c) The auditor's name, address, and telephone number must appear on the report.
- (d) The auditor's report must be dated as of the completion of the audit fieldwork.
- (e) The audit must be performed in accordance with auditing standards generally accepted in the United States of America and the auditor must have sufficient knowledge of accounting principles and practices generally recognized in the film, television, commercial and digital media industry.

3. Identification of the Production:

- (a) The title of the production and, when applicable, the episode numbers, must be disclosed.
- (b) The period during which the expenditures were clearly and demonstrably incurred in Connecticut must be disclosed. The period during which the expenditures were incurred outside of the state must also be disclosed, if the project phase that is the subject of the audit includes work that was performed both inside and outside of the state.

4. Detailed Cost Report of Production Expenses:

- (a) The detailed cost report must be in US dollars.
- (b) The detailed cost report must be provided on Form F in an excel format. (Form F is available at www.ctfilm.com)
- (c) Only actual paid expenses clearly and demonstrably incurred in Connecticut for the qualified production can be recorded as qualified production expenses. Accounts payable, accrued charges or deferrals do not constitute qualified production expenses. These costs must be charged to the proper budgetary item and shall not include any mark-ups or profit additions to the actual costs.
- (d) Refunds, recovery amounts based on insurance claims and credit notes received for discounts, rebates, invoicing errors, purchase returns or through other methods must be credited against the production costs. Similarly, proceeds from the sale of props and other production assets must be deducted from the costs presented in the detailed cost report. In cases where props and other productions assets are kept in inventory for future productions, please refer to section six below for the allocation of costs.
- (e) Completion bond expenditures must reflect any "no-claims rebate" received (the amount reported must be net after rebate).
- (f) Amortization of series costs must be allocated to specific cost categories.
- (g) Evidence of qualified production expenses clearly and demonstrably incurred in the state shall be based on collaborating evidence including, but not limited to: (1) crew call sheets; (2) second unit call sheets; (3) production reports; (4) payroll records; and (5) vendor invoices.

5. Certifying Costs for the Ownership of Real Property

- (a) An eligible production company that owns and uses a facility in Connecticut to produces a qualified production may be eligible to allocate a percentage of the operational and ownership costs of the facility as a qualified production expense. The applicant may select one of two allocation methods set forth below.

Allocation Method One.

- (b) The applicant may use deemed operational and ownership costs in the detailed cost report based on the average lease value method. To arrive at the total deemed operational and ownership costs, the applicant will multiply the average per day lease value of comparable realty by the number of Connecticut work days per a given phase of a project.
- (c) The average per day lease value of comparable realty will be provided by the Commission at the request of the applicant.

- (d) If method one is selected, the notes to the independent auditor's report must provide the average per day lease value of comparable realty and the number of Connecticut work days per a given phase of a project.

Allocation Method Two

- (e) Actual operational and ownership costs are allocated by multiplying the production square footage ratio times all actual operational and ownership expenses associated with the realty. The resulting amounts are further prorated, as needed, based on the number of Connecticut work days per a given phase of a project.
- (f) The production square footage ratio is the ratio obtained by dividing the square footage of the portion of the realty used predominately for the qualified production by the total square footage of the realty.
- (g) Actual operational and ownership costs of facilities include, but are not limited to: (1) utilities; (2) real property taxes; (3) depreciation; (4) insurance; (5) property management fees; (6) mortgage payments; (7) repairs; and (8) maintenance.
- (h) If method two is selected, the notes to the independent auditor's report must provide a list of all actual operational and ownership costs; square footage predominantly used for the qualified production, total building square footage; the number of days in any period cost (e.g., a monthly mortgage payment has a 30 pay period cost); and the number of Connecticut work days per a given phase of a project..

6. Certifying Costs for the Use of Tangible Personal Property

- (a) In cases where any tangible personal property is purchased for use in a qualified production and kept for future productions, the allowable costs will be calculated using IRS class life categories under the federal depreciation rules.
- (b) The cost of the tangible personal property is divided by the applicable IRS class life to determine an annual expense. The annual expense is further reduced based on the ratio of the number of Connecticut work days that the tangible property was in use during a given phase of a project over 365.
- (c) The applicable IRS class life is the general depreciation system life as identified in IRS Revenue Procedure 87-56.
- (d) The notes to the independent auditor's report must identify the assets kept for future productions; the assets' applicable IRS class life and the number of Connecticut work days the tangible personal property was used in Connecticut for a given phase of a project.

7. Certifying Costs for Services Some of Which Incur Outside of the State

- (a) Costs for services or wages paid on a daily or hourly basis shall be allocated to Connecticut based on the total time spent in Connecticut.
- (b) Where the applicant incurs service costs for services partially performed in Connecticut and these costs are not paid on a daily or hourly basis, the applicant shall allocate these costs to Connecticut based on the ratio of the number of days worked

in Connecticut over the total number of working days for a given phase of a project. Collaborating evidence regarding services rendered, amounts owed and paid during a given project phase includes, but is not limited to: (1) fully executed contracts; (2) other written agreements; (3) memorandums of understanding (4) payroll report and (cancelled checks).

8. **Loan Out Companies.**

- (a) Any person who maintains an office or transacts business in Connecticut and who is considered an employer for federal income tax withholding purposes and who pays Connecticut wages to employees is required to register with the Connecticut Department of Revenue Services (DRS) as an employer for Connecticut income tax withholding purposes and to deduct and withhold Connecticut income tax from the Connecticut wages of employees.

Connecticut wages are:

- all wages paid to an employee who is a Connecticut resident (irrespective of the location at which the employee is employed by the employer);
- all wages paid to an employee who is a nonresident of Connecticut, if the services of the employee are performed entirely within Connecticut and
- all wages paid to an employee who is a nonresident of Connecticut, if the services of the employee are performed both partly within Connecticut and partly outside of Connecticut (unless the employer maintains adequate current records to determine accurately the amount of the wages that is paid for the performance of services within Connecticut, or unless the employee files a **Form CT-W4NA, Employee Withholding or Exemption Certificate-Nonresident Apportionment**, with the employer). However, an employer may not withhold Connecticut income tax on the basis of an employee's Form CT-W4NA if the employer knows or has reason to know that the apportionment shown on the Form CT-W4NA is not correct.

For more information, see the most recent edition of *Circular CT, Employer's Tax Guide*, which may be downloaded from the DRS website: www.ct.gov/drs

- (b) Where the applicant has contracted with business entities for the provision of individual personnel for the performance of services ("Loan Out Companies") the applicant must produce a registration confirmation notice from the Connecticut DRS evidencing that the Loan Out Company has registered. The auditor will review all such letters. No expenses for Loan Out Companies will be considered a qualified production expense without a registration confirmation notice.
- (c) In performing the audit, the applicant and the auditor should examine and consider all Loan Out Company contracts and the number of Connecticut work days per a

given phase of a project. The Commission may request information regarding this supplemental documentation as additional support.

9. Ownership

- (a) In performing the audit, the auditor must determine the owner of the copyright to the qualified production. In the event the applicant is not the copyright owner, the applicant must provide evidence that the copyright owner has contracted for the qualified production with the applicant. Collaborating evidence regarding copyright ownership includes, but is not limited to: (1) fully executed contracts; (2) other written agreements; or (3) memorandums of understanding.
- (b) The notes to the independent auditor's report must provide the name of the copyright owner.

10. Reporting:

The audit of the detail cost report must be conducted in accordance with auditing standards generally accepted in the United States of America. Once the audit engagement is completed, please submit two copies of the auditor's report to the production company. The production company must submit the auditor's report with its tax credit certificate application. The auditor's report shall include the: Independent Auditor's Report, Exhibit I; Detailed Cost Report, Exhibit II and Notes to the Independent Auditor's Report, Exhibit III. Tax credit certificate applications not containing an Independent Auditor's Report will be considered in-complete and will not be reviewed.

11. Tax Credit Certificate Application Deadline:

The applicant shall file a tax credit certificate application with the Commission on such forms and accompanied by such information as may be required by the Commission, not later than 90 days after the last production expense is clearly and demonstrably incurred in the state. For applications with production expenses some of which may incur outside of the state, then those applications must be filed not later than 90 days after the completed project phase that is the subject of the audit. For example, an applicant with a final Connecticut qualified production paid expense dated June 1, 2007 and a final out-of-state production paid expense dated July 1, 2007, shall file a tax credit certificate application not later than 90 days from July 1, 2007.

EXHIBIT I

Independent Auditor's Report (Independent Certified Public Accountant's Letterhead)

Report Date

Officer of Production Company
Production Company Name
Address, City, State, and Zip

We have audited the accompanying detailed cost report of (Production Company Name) for the period from (the date of the first qualified production expense) through (the date of the last qualified production expense for a completed project phase) incurred by the state-certified qualified production (Eligibility Certificate Application # (provided by the Commission)). The detailed cost report is the responsibility of (Production Company Name). Our responsibility is to express an opinion 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 detailed cost report is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the detailed cost report. An audit also includes assessing the accounting principles used and significant estimates made by (Production Company), as well as evaluating the overall presentation of the detailed cost report. We believe that our audit provides a reasonable basis for our opinion.

The accompanying detailed cost report was prepared for the purpose of complying with the requirements of the Connecticut Commission on Culture and Tourism's Film Division and is not intended to be a complete presentation of (Production Company Name's) financial position.

In our opinion, the detailed cost report referred to above presents fairly, in all material aspects, the qualified costs of producing a qualified production in Connecticut by (Production Company Name) for the period from (insert date of first qualified production expense), the date of the first qualified production expense clearly and demonstrably incurred in the state through (insert date of last qualified production expense) the date of the last qualified production expense clearly and demonstrably incurred in the state and identified in (Production Company Name's) tax credit certificate application dated [insert date on application], in conformity with accounting principles generally accepted in the United States of America.

Firm's signature
City, State

EXHIBIT II

Detailed Cost Report

Attach the audited detailed cost report.

EXHIBIT III

Notes to the Independent Auditor's Report

1. General

This detailed cost report of production expenses represents the production costs attributable to the production entitled (insert title of project) produced by the (Production Company Name) during the period _____ to _____.

2. Sources of Funds

(a) Sources of funds

(1) 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.

(2) 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 auditor's report must include a note to that effect.

As of _____ (insert the ending date of the detailed cost report) the production entitled (insert title of project) was financed from the following sources:

Entry	Amount
_____	_____
_____	_____
_____	_____

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

Entry	Amount
_____	_____
_____	_____
_____	_____

Please disclose the nature of the services provided and the consideration given in exchange for the services for each non-monetary transaction. Include a certification as to the fair market value of each non-monetary transaction.

3. Related Party Transactions

- (a) The notes to the independent auditor's report must provide a breakdown of all related party transactions (in accordance with auditing standards generally accepted in the United States of America), and include the following:
1. The name of the related party;
 2. The nature of the relationship between the related party and the production company;
 3. The nature of the transaction;
 4. The amount of the transaction and
 5. Citation to a source that provides a fair market value estimate of the transaction amount.
- (b) If there are no related party transactions, the notes to the independent auditor's report must include a note to that effect.
- (c) Collaborating evidence of related party transactions shall include an applicant's signed affidavit representing that the applicant has properly disclosed all parties and transactions that meet the definition of a related party. The affidavit must be included as an attachment to the notes to the independent auditor's report.
- (d) The production expenses presented in this detailed cost report include the following related party transactions (as defined under generally accepted auditing standards):

Entry	Relationship	Nature of Transaction	Value
_____	_____	_____	_____

- (e) Disclose the following for each transaction:
1. name of the related party;
 2. nature of the relationship between the related party and the motion picture production company;
 3. The nature of the transaction and
 4. The amount of the transaction.

4. Real Property

Disclose the following:

Allocation Method One

Avg. per day lease
value of comparable
realty

#of CT
production
days

total deemed
operational
/ownership
costs

Allocation Method Two

Actual operational/ ownership cost	Period Cost	Days in Period	# of CT production days	Square footage predominantly used for qualified production	Total realty square footage	Allocated Cost
Utilities						
Real property taxes						
Depreciation						
Insurance						
Property management						
Mortgage						
Repairs						
Maintenance						
Other						

5. Tangible Personal Property

Disclose the following:

<u>Property Description</u>	<u>Cost</u>	<u>IRS Class Life</u>	<u># of production used In CT</u>	<u>Total</u>

6. Copyright Ownership

Disclose the owner of the copyright to the state-certified qualified production.

7. Loan out companies.

Attach to notes to the independent auditor's report the registration confirmation notice for all loan out companies and the applicant.

8. Affidavit of understanding and compliance

The tax credit applicant must present the auditor with a signed affidavit stating that the applicant has read and understood the audit instructions and has presented all supporting documentation as required in the audit instructions to the auditor. Attach to the notes to the independent auditor's report the affidavit of understanding and compliance.