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Accountants and Business Advisors

Red Flags to Help You Assess the Need for a Profit Participation Audit

Whether you are an individual, company stakeholder or the beneficiary of a trust or estate with profit participation rights to movies and television shows, you may be at risk for underpayment or delayed payment of your participation profits by a studio or other distribution company. At a minimum, we recommend that you review your statements periodically. Depending on certain risk factors, you may consider consulting an expert to perform a participation audit.

What should you look for as you review your participation statements? As you assess the need for an audit, you may want to consider the following risk factors related to statements, agreements and market trends.

The Statement

In the Black vs. Red

If you are being paid by the studio in excess of the initial advance or minimum guarantee, the studio may be more focused on minimizing their risk of overpayment. They may do this by delaying reporting of revenues or over-reporting expenses such as reserves. Although you should review all statements, you should be more diligent with review of the statements after the recoupment of your initial advance or minimum guarantee. If new or unusual entries were added soon before or after you are recouped, this may represent a red flag.

Potential Inconsistency between the Statement and the License Agreement

The statement is often issued by someone who was not directly involved with drafting the license agreement's terms, conditions or intent of the agreement's language. This increases the risk of errors and omissions in developing the statement template.

Additionally, when developing the template or algorithm, participation staff could be interpreting unclear or "grey" terms and conditions of your agreement subjectively, this likely may be in favor of the studio and could potentially result in under-reporting of revenues or over-reporting of expenses.

To mitigate this risk, you should review the statement for improper application of the agreement terms within the statement. If you identify any inconsistencies, this could be a symptom of larger issues, and therefore, would also represent a red flag.

Unusual Entries on the Statement

The high volume of statements issued by studios combined with the limited studio staff (the result of studios' efforts to minimize overhead) may reduce statement quality control and lead to increased errors on your statements. Unusual entries, such as negative revenues and unfamiliar expense accounts could indicate a risk of other errors on the statement.

The Agreement

Complexity of the License Agreement

Generally, the more complex your deal is, the higher the risk of errors and omissions. This represents an inherent

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risk which should be considered as part of your decision to conduct a participation audit.

Versions of the Agreement

If an agreement remains unsigned due to unresolved differences between you and the studio, there is potentially an expectations gap in reporting on the statement. The studio may be applying its version of the terms of the agreement. You should be aware of the differences between the agreement versions. Also, as part of your monitoring process, you should scan the statement to identify instances where the studio has reported in a manner different from your expectations. If any are identified, it may require further evaluation.

Audit and Tolling Rights

Remember that the studio will not be calling you the day your audit or tolling rights expire. While you may have concerns about the statements, depending on your agreement, it may be too late. If your rights will soon expire, you may want to consider evaluating the need for an audit.

Market Trends

New Media Reporting

In recent years, there has been a growing risk of underreporting for new media revenues. Studio systems and processes are yet to be upgraded to identify and account for all new media revenues. Such challenges will continue as new forms of revenue streams are developed. Also consider that your agreement may not have addressed new media exploitation, resulting in potential underreporting of revenues on your statement. Be sure to monitor the statement for new media revenue reporting.

Foreign Activity

As distribution overseas is becoming more significant, so is the question of accuracy and completeness of foreign distribution revenues. Depending on the studio monitoring controls and specific laws and regulations at the various territories, revenues may not be transmitted or classified properly, potentially resulting in errors and omissions. Although it may be difficult to monitor the overall accuracy, this inherent risk should be considered as part of the overall decision to audit.

Distracted Studios

If the studio is going through a significant change such as an acquisition, merger, lawsuit, change in leadership, layoffs or system changes that you become aware of through news articles or rumors, it could potentially mean that the level of quality controls in statement issuance has been impacted.

Other Factors to Consider

There may be many other factors specific to your circumstances, such as a dispute with the studio, lack of transparency and delays by the studio in response to your inquiries which may increase the potential risk of underreporting of your profit participation.

Additionally, if you become aware of other profit participants who are considering an audit or have already sent in an audit notice, you may want to consider the possibility of joining their audit, which can both reduce your risk and reduce the expense of an audit.

If any, some, or all of the above risks are present, you may want to consult with a participations auditor to further evaluate the possibility of performing an audit on your behalf. &

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