**Michigan Film Office**

**Michigan Film and Digital Media Incentive**

# Auditor's Guidelines for Audit and Expenditure Certification

## Authority

As a part of each Production Company's Michigan Film and Digital Media Incentive Agreement (Agreement) with the Michigan Film Office (MFO), the Production Company must provide "the information and independent certification the office deems necessary" … "which may include a report of Direct Production Expenditures (DPE), Michigan Personnel Expenditures (MPE), Crew Personnel Expenditures (CPE), and Qualified Personnel Expenditures (QPE) for the qualified production audited and certified by an independent Certified Public Accountant"(CPA). MCL 125.2029h(4)(f)

Refer to MCL 125.2029h (statute) and additional guidance issued by the MFO for more information regarding the statutory requirements, regulation, scope and the detailed definitions of qualified productions, including DPE, MPE, CPE and QPE. The additional guidance, including frequently asked questions (FAQs), can be found on the MFO's website at www.michiganfilmoffice.org.

It is the responsibility of the management of the Production Company to ensure that all of the required information is provided and conforms to the requirements and guidelines outlined in the Statute.

To ensure independence, the CPA shall be paid in full prior to submission of the Certificate of Completion Request (COCR) and no portion of the audit fee shall be contingent upon the amount of the final Incentive awarded.

## General Guidelines

- All reports and schedules should be in **US Dollars**
- Recorded costs must be **actual costs** and shall not include any mark-ups or profit additions by the Production Company
- Only actual paid expenditures clearly and demonstrably incurred in Michigan by the eligible Production Company for the qualified production may be recorded and certified as eligible production expenditures
- Per statute, eligible expenditures must be "directly attributable to the production or development of a qualified production"
- Expenditures must be incurred and paid after the effective date of the Agreement and ends when the COCR is submitted to the MFO (**Eligible Period**)

- Credit Card expenditures are considered incurred on the date of the underlying purchase and paid on the date the credit card company was paid. The underlying purchase (from the seller of the good or services and not the credit card company) must be “made in this state”.
  - If an expenditure is incurred over a time period that extends beyond the Eligible Period, it must be pro-rated to include only the portion that was incurred during the Eligible Period
  - Prepaid expenditures for goods or services after the Eligible Period are not eligible
  - Accounts payable, accrued charges, or deferrals are not eligible
- **Incentive percentages** in effect on the effective date of the Agreement will be applicable to the entire project covered by that Agreement
- **Production Services Companies** can be hired by the Production Company to make purchases and to perform services. These companies must be Michigan vendors and meet all the vendor requirements in order for these expenditures to be eligible for the Incentive.
- **Related party transactions** must be disclosed and identified in the audit report notes (notes). GAAS and GAAP require reporting of the economic substance of transactions, regardless of their legal form. The CPA must satisfy himself or herself that any related party relationships and material transactions are properly accounted for and adequately disclosed in the notes. Mere disclosure of related party transactions without further analysis and explanation is insufficient. For further guidance on defining related parties and applicable procedures that should be considered by the CPA, see AU Sec. 334 on related parties.

## Procedures to Include in the Audit

The procedures identified below should be included in the audit. They are not meant to comprise an exhaustive audit program. **The CPA must exercise his or her professional judgment when certifying expenditures for the Incentive, and shall perform any additional procedures he or she deems necessary to certify expenditures.** A review of internal control is required by AU 314.40 and must be a component of the audit.

To the extent practicable, review all documentation on all eligible expenditures as defined in the Statute. If a review of all documentation for all such expenditures is not practicable, then the CPA may use his or her professional judgment to select a representative sample of expenditures.

**1. Certificate of Completion Request (COCR)**

- Verify that a statutory minimum of $100,000 has been spent on MPE + DPE
- Make sure the applicant has signed and dated the COCR

**2. Detailed General Ledger Listing**

- Verify the detailed General Ledger balances to zero

- Verify all payables accounts and accruals balance to zero, or contain no items included in eligible expenditures
- Verify that work started on the production within 90 days of the effective date of the Agreement, or within the time allowed under any written extension granted by the MFO
- Scan entries for deposits, refunds, recovery amounts from insurance claims, and credits derived from discounts, rebates, invoicing errors, purchase returns or through other methods.  These must be credited against the production costs.

**3. Report of Expenditures**

- Trace Project Item Expenditure Amounts on the schedule back to the adjusted totals on the detailed listings in the Report of Expenditures Workbook
- Verify correct Incentive Rates are being used
- Recalculate, foot, and cross-foot totals
- Trace Project Item Expenditure Amounts forward and verify that they agree to the COCR
- Verify days of production in Michigan and that they agree to line 8 of the COCR
- Verify days in a Qualified Facility and/or days in a Post-Production Facility and that they agree to line 9 of the COCR

**4. Direct Production Expenditures**

Obtain the invoice (or equivalent documentation) and proof of payment support for each expenditure or sample selection and verify:

- Transaction meets the definition of "made in this state" as defined in MCL 125.2029h(13)(d) and (f)
- Amount of the expenditure
- Expenditure was both incurred and paid during the Eligible Period
- Expenditure was clearly and demonstrably incurred in Michigan
- Expenditure was directly attributable to the production or development of a qualified production
- Vendor is registered with the Michigan Department of Licensing and Regulatory Affairs (LARA)
- Vendor is "**a source within Michigan**" defined in the statute as a business with an established physical presence in Michigan that includes both a non-temporary "bricks and mortar storefront" and at least one full time permanent employee working in Michigan.  "Non-temporary" and "permanent" will generally be indicated by a presence of at least one year. The one year standard would be met with a prior presence as well as a planned future presence evidenced by a documented commitment such as a one year lease for office space.  The requisite physical presence of a qualified vendor and the transaction at issue must have a nexus.  Michigan physical presence unrelated to the transaction would not satisfy the criteria of "made in this state"; the vendor must be regularly engaged in the type of business that relates to the invoice.
- Vendor Affidavit, if applicable, appears reasonable

- The expenditure is properly included or excluded from the correct Project Item for the Incentive
- If the expenditure is an **Internet purchase**, verify the seller's physical presence in Michigan and that the items purchased were picked up at the bricks and mortar location of the vendor

**Proceeds from the sale** of props, equipment, production assets and other tangible personal property purchased by the Production Company for use in the qualified production, less any gain, must be deducted from the expenditures presented in the COCR for the qualified production.

**Assets retained** after the Eligible Period must be depreciated. The CPA must use her or her professional judgment to determine what constitutes a depreciable asset. The amount depreciated during the time the production was occurring in Michigan is the "expended" amount. Assets include, but are not limited to, props, equipment, and wardrobe. Allowable costs to the qualified production will be calculated using IRS class life categories under federal depreciation rules and will be determined according to the following method, or a method the CPA determines using professional judgment that appropriately allocates the cost associated with the use of such tangible personal property to the production that is the subject of the Incentive:

- Divide the acquisition cost of the tangible personal property by the applicable IRS class life to determine an annual expense. The applicable IRS class life is the general depreciation system life as identified in IRS Revenue Procedure 87-56.
- The annual expense is further adjusted by multiplying it by the ratio of the number of days that the tangible personal property was in use (or "available for use") during the time the qualified production was actively occurring in Michigan over 365. "Available for use" is defined as: 1) in the possession of and available for use by the production company 2) not in use on any other production, and 3) not in use by any other entity for any other purpose.
- The notes to the CPA's audit report must identify:
    - each item of tangible personal property retained
    - the item's applicable IRS class life (or the life as determined by the professional judgment of the CPA)
    - the number of days the item was used or available for use by the production while production was actively occurring in Michigan

Verify that **eligible interest** was correctly calculated as described in the *Notice on Eligible Interest*.

## 5. Personnel Expenditures

Extras and stand-ins should be included in MPE or CPE and not be classified as QPE or DPE.

**Michigan withholding must be withheld for all employees and loan outs.** The only exceptions are employees from reciprocal agreement states. To the extent practicable, review all documentation regarding the payment of compensation for each individual. If a review of all documentation for all individuals is not practicable, then the CPA may use his or her professional judgment to select a representative sample of individuals. Perform the following procedures:

- For Michigan resident personnel, verify that the individual was a resident of the state of Michigan on the first day of employment by the Production Company, and inspect their *Declaration of Residency* and supporting documentation
- For qualified personnel and crew personnel from reciprocal states verify that the individual was a resident of a state with a reciprocal agreement
- Read ATL contracts
- Verify ATL salaries/wages are directly attributable to the qualified production (for example, they are not for interviews or other public relations functions beyond the scope of the qualified production or not for travel days out or work performed out of state)
- Verify compensation is for work completed during the Eligible Period
- Verify that fringes are related to and classified the same as the compensation of the employee or loan-out
- Verify that handling fees, if eligible, appear as "Contracted Services" under DPE
- Verify that payment and compensation (wages, salary, fringes, box rentals, taxable portion of per diems and allowances, etc.) included as eligible expenditures for any one employee does not exceed $2,000,000
- Verify that payment and compensation requested for all non-resident producers combined does not exceed 5% of MPE + DPE
- Verify that payment and compensation requested for all Michigan resident producers combined does not exceed 10% of MPE + DPE
- Obtain payment support and verify:
  - against the General Ledger and invoice(s)
  - that the Production Company paid the expense
  - the expense was incurred during the Eligible Period
  - state income tax (and local income tax if applicable) was withheld on salaries and wages paid
- Review payroll reconciliation:
  - trace Michigan earnings from payroll reports to payroll reconciliation
  - trace eligible earnings from the reconciliation to the detailed schedules in the Report of Expenditures Workbook
  - Verify reconciling items
- Examine *Form 4737 Michigan Income Tax Withholding Transfer Authorization and Report of Payments Made on Behalf of Employees and Loan-Out Companies* if any Entertainment Payroll Company was used. This form is required for each entity that reports Michigan withholding under an FEIN different than that of the Production Company unless determined otherwise by the MFO.

## Audit Report

- The CPA must include a copy of their most recent letter of acceptance of peer review by the MACPA in their audit report
- Exceptions must be noted in the audit report. If a transaction (or group of transactions) is disallowed during the audit, they must be discussed in the report or accompanying schedules.
- All transactions between related parties as defined by the AU Sec. 334 must be disclosed, including the following:
  - The name of the related party
  - The nature of the relationship between the related party and the Production Company
  - The nature of the transaction
  - The amount of the transaction
- If there are no related party transactions, the audit report must include a note to that effect
- If the CPA chooses to certify a transaction as an MPE, QPE, CPE or DPE and that certification conflicts with guidance issued by or prior decisions made by the MFO, the CPA must disclose these transactions within the notes
- Upon receipt of final payment of the audit fee from the Production Company, the CPA shall provide the Production Company with a statement indicating that all audit fees have been paid

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