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## Film financing: thrilling scenes and investing schemes

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**Film Financing: Thrilling Scenes & Investing Schemes**

by

**Charlotte Ann Moore**

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**An Honors Thesis in partial fulfillment of the requirements for the degree**

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**Sam M. Walton College of Business**

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## Table of Contents

<b>Chapter 1: Introduction</b> .....	<b>3</b>
<b>Chapter 2: Background Information</b> .....	<b>5</b>
<b>Chapter 3: Techniques to Entice Investors</b> .....	<b>9</b>
<b>Chapter 4: Investor Lawsuits</b> .....	<b>11</b>
<b>Chapter 5: Conclusion</b> .....	<b>13</b>
<b>References</b> .....	<b>16</b>
<b>Appendix A: SOP 00-2</b> .....	<b>18</b>
<b>Appendix B: Louisiana Investment Credits—Motion Picture Investments</b> .....	<b>20</b>

## Chapter 1: Introduction

“...As a non-correlated asset class<sup>1</sup>, films (including film finance) have outperformed every non-correlated asset class in the world. If you look at the more than \$6 billion dollars poured into motion picture finance deals in the last three years, the IRR across the spectrum for both studios and independents are resilient to global economic declines in other industries.”<sup>2</sup> Is this what you believe about the film industry? Does this make you want to finance films in the hopes of earning a greater ROI than in other industries? When we read articles about the film industry, articles tell us Johnny Depp made \$40 million dollars for *Alice in Wonderland* and *Harry Potter: The Deathly Hollows Part II* made \$169.2 million in the first week.<sup>3</sup> By covering stories of Hollywood celebrities, the media plays up their glamorous lifestyles and entices us to fall into the belief that we can have a piece of that success by investing in independent films; we can become a part of that glamorous lifestyle. However, what the media does not tell you is how unlikely it is that you will actually make money off of your investment. By learning the industry and making knowledgeable investment decisions, there is money to be made in the film industry, but it is not very likely unless you are able of pouring large sums of financial resources into films. As analyst of the film industry Art Murphy stated of the motion picture business, “When the well comes in, cash flows in abundance rarely seen in any other industry.”<sup>4</sup> Despite the high risk and low chance of making a profit, people spend their lives contributing to film. If money is not a factor, what else is?

The film industry is one of the most complex industries in the world and is constantly changing due to businesses such as Netflix and Redbox. Over the past four decades, the film industry has survived financial crises, tax law changes, and a myriad of business ventures attempting to modify Hollywood. This ever-changing industry has managed to remain glamorous in the public eye and continues to bring in over ten billion dollars of annual revenue from box offices<sup>5</sup> but not without changing how they conduct their business. The film industry has begun to embrace these different venues of entertainment and learned to use them to their advantage. Because of these different venues and the high costs to produce major motion pictures, the theater is becoming more of a marketing mission which foreshadows how well the film will do in other venues instead of a major money-maker. Nowadays, revenue from box office sales “account for less than half a film’s total value to its studio.”<sup>6</sup>

Films are as diverse as the people who create them. They vary in their genre, their budget, location, type of distribution, etc. This thesis discusses investing for independent films specifically for several reasons. Major motion pictures, such as *Batman: The Dark Knight Rises*, are supported by major corporations which use their own finances, as well as slate deals (discussed in Chapter 2), to fund films. Because major firms already have resources for their

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<sup>1</sup> This term refers to investments that have alternative classes, such as bonds or stocks, and do not rely on success based on a price increase.

<sup>2</sup> Rutman, Yuri. "How To Invest in Film." *NuWire Investor*. 01 Apr. 2011. 27 Jan. 2012.  
<<http://www.nuwireinvestor.com/howtos/how-to-invest-in-film-54622.aspx>>.

<sup>3</sup> "'Harry Potter' Faces Steep Drop in Its Sales." *Dawn.com*. 19 Jul. 2011. 11 Feb. 2012.  
<<http://www.dawn.com/2011/07/19/harry-potter-faces-steep-drop-after-record-start.html>>.

<sup>4</sup> Daniels, Bill, David Leedy, and Steven D. Sills. *Movie Money*. Beverly Hills: Silman-James Press, 2006. 2<sup>nd</sup> ed. Pg. 240.

<sup>5</sup> "U.S. Movie Market Summery 1995 to 2012." *The Numbers*. 11 Apr. 2012 <<http://www.the-numbers.com/market/>>.

<sup>6</sup> Lewis, Jon. *American Film: A History*. New York: W.W. Norton & Company, 2008. Pg. 425.

films, it is not likely for them to have independent, financial investors. However, when a new writer is attempting to sell their film and does not have the credibility as a major studio, they must rely on independent investors in order to make their vision available to the public. And to make this process more complicated, it is much more risky to financially back a director that does not have big “money-makers” on their resume. It seems that every group in Hollywood has a different definition for what an independent film truly is. A compiled definition of independent film is as follows: a film with a budget of around \$20,000,000 or less which is not attached to any major studio during production. Independent films also tend to push the envelope such as *October Baby* which opened in theaters March 23 of this year and tells the story of a child born because of a failed abortion.

During the 1990s, the independent film industry grew, but in order to compete, major studios began producing films that cost much more than independent films could accumulate. Studios also began creating their own smaller divisions that produced lower-budget films which could then be entered into film festivals. The major studios continued to dominate the market. Independent film will always be around, but their presence on the big screen has decreased the last decade.

This thesis investigates the film industry, particularly looking at how independent films raise money. Depending on what type of film is being produced and how large their budget is, this can be done in several different ways. This research focuses on independent investors and looks at techniques to draw in investors, specifically for independent films; accounting practices; and professional advice in an attempt to answer the following question: Is investing in films a scam?

Producers and investment companies use techniques which lead potential investors to believe that the glamour and fame from the film industry can be ours. Is this true? Does investing in feature films promise returns? The following thesis will provide some background information on the film industry (where films make their money, how likely it is for a film to be successful, and different ways companies finance their films); techniques used to entice investors; and lawsuits that have been brought about due to miscommunication in accounting practices.

## Chapter 2: Background Information

The film industry plays a major role in the United State's economy. Annually, Americans spend "130 billion hours and more than \$260 billion on legal forms of entertainment."<sup>7</sup> The film and television industries also provide over two million jobs for Americans each year and are expected to grow twelve percent in the next decade.<sup>8</sup> Exports in these industries have also "become a very important component of the U.S. economy."<sup>9</sup> According to these statistics, many assume this industry provides enough room for success for many. However, this does not seem to be the case. Even though a big part of American life revolves around the entertainment industry, whether it is music, movies, or video games, we do not understand how the logistics work, and there is more room for failure than we realize. The competition for an audience's attention is fierce, and many films are vying to capture that attention.

### Competition

Temple Fennell, founder and CEO of ATO Pictures, presented at the Atlanta Film Festival a segment called "Money Matters: A Film Investor's Guide" on March 26, 2012. In this presentation, he discussed the likelihood of a film having success and making it to distribution. As an example, he used the Sundance Film Festival, which is the largest independent cinema film festival in the United States. Fennell stated that around 4,000 independent films are submitted, a little more than 100 are chosen to appear at the festival, and only twelve are purchased for more than \$1 million.<sup>10</sup> That means only 0.3% of films are worth more than \$1 million.

It is very difficult for an independent film to become a box office hit and compete against the major motion pictures. Films with large budgets have an ability to use technology and capture an audience in ways that independent films cannot achieve. You will not see an independent film with action scenes such as those found in *The Avengers*. Independent film must capture you in a much more subtle way and make you think in a different way than before. There are films such as *Juno* and *Little Miss Sunshine* which confront you with social issues such as teen pregnancy, homosexuality, and suicide. They are targeted to a specific audience unlike box office hits which tend to attract several different target audiences.

### Financing Films

There are several different ways producers can raise funds for their films which range from individual investors to partnerships; "the methods of financing a motion picture are limited only by the imagination of the producer or financier."<sup>11</sup> Actors, producers, and the crew are all costs included in making a film, and that is just the beginning of expenses. A film can range from \$8,000,000, such as *Little Miss Sunshine*, and \$30,000,000, such as *The Passion of the*

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<sup>7</sup> Vogel, Vogel, Harold L. *Entertainment Industry Economics: A Guide for Financial Analysis*. 6<sup>th</sup> ed. Cambridge: Cambridge UP, 2004. Preface i.

<sup>8</sup> Variety, "Film beats TV at job fair." New York. Jan 30-Feb 5, 2012. Vol. 425, Iss. 11; p. 2 (1 page)

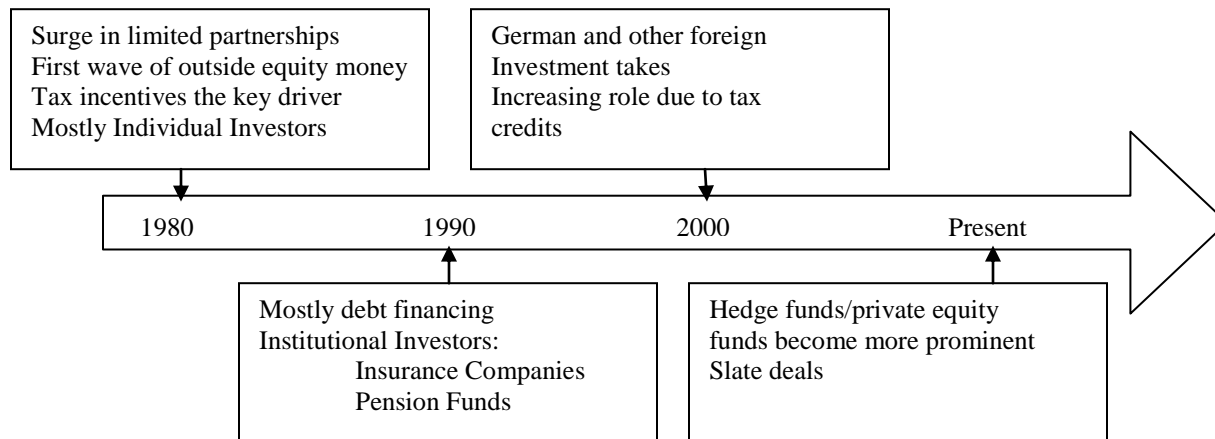
<sup>9</sup> Bao, George. "Film, TV industry bedrock of U.S. economy." *English.news.cn*. 06 July 2010. 12 Feb. 2012. <[http://news.xinhuanet.com/english2010/business/2010-07/06/c\\_13385883.htm](http://news.xinhuanet.com/english2010/business/2010-07/06/c_13385883.htm)>.

<sup>10</sup> Fennell, Temple. "Money Matters: ATO Pictures Presents a Film Investors Guide." Atlanta Film Festival. Atlanta, Georgia. 26 Mar. 2012.

<sup>11</sup> Daniels, pg. 240.

*Christ*,<sup>12</sup> up to over \$200,000,000 for movies such as *Avatar*.<sup>13</sup> Over the past two decades, the film industry has changed in a way never seen before. Now films are more expensive, there are a plethora of more film streams (for example, airplane televisions and iPads), and the way films raise finances has evolved.

**Figure 1: Film financing timeline<sup>14</sup>**



In the 1980s, producers mainly began financing films through outside investments. This was through individual investors and limited partnerships. According to Merrill Lynch’s report on Filmed Entertainment, this occurred because the tax law “allowed investors to depreciate their film investments in a relatively short time frame... [which] was deductible for tax purposes.”<sup>15</sup> This evolved to include debt financing and insurance companies in the 1990s then to foreign investment, particularly Germany because of their lax tax laws, in the early twenty-first century. By selling the film to foreign territories, the American film companies were able to buy it back through lease payments which were set up at a price lower than what the film originally sold for. The German investors took a tax deduction, and the American companies ended up paying less for the film.<sup>16</sup>

Now major motion films are mostly funded by institutions, whether it is Disney themselves that are funding films from other areas of revenue or smaller studios which are supported by other companies. Slate deals are also a popular way that studios co-finance their films. Instead of investing in one film at a time, investors help finance ten to twelve films at the same time with a payment of \$100,000,000 or more. The investor has some say in which films are included in the agreement and a distribution party is “committed to providing theatrical distribution.”<sup>17</sup> When the film earns revenue, the investor is paid a percentage of revenue from

<sup>12</sup> Zimmerman, Cali. "Indie Film Investments." *NuWire Investor*. 22 Feb. 2008. 27 Jan. 2012. <<http://www.nuwireinvestor.com/articles/indie-film-investments-51440.aspx>>.

<sup>13</sup> Keegan, Rebecca. “How Much Did *Avatar* Really Cost?” *Vanity Fair: The Hollywood Blog* 22 Dec. 2009. 24 Apr 2012 < <http://www.vanityfair.com/online/oscars/2009/12/how-much-did-avatar-really-cost>>.

<sup>14</sup> “Filmed Entertainment: Inside Film Financing.” Merrill Lynch. Pg. 3. 13 Sept. 2006. 10 Apr 2012 <[http://www.outofobscurity.com/downloads/Merril\\_Lynch\\_Report-Sept06.pdf](http://www.outofobscurity.com/downloads/Merril_Lynch_Report-Sept06.pdf)>.

<sup>15</sup> “Filmed Entertainment: Inside Film Financing,” pg. 3.

<sup>16</sup> “Filmed Entertainment: Inside Film Financing,” pg. 3-4.

<sup>17</sup> “Slate Financing Arrangements/v.3.0.” 16 Mar. 2008. 24 Apr. 2012

<<http://www.cfoyesq.com/SLATE%20FINANCE%20OVERVIEW%203.0.pdf>>.

all the films in all territories. This is the second-riskiest form of investment apart from independent film finance.

Another option to raise finances for a film, which can be seen as less risky, is to use step deals. Step deals allow the financier to gradually contribute funds during stages of production. They have the option to supply more resources, or, if certain predetermined conditions are not met, they have the option to withdraw from the project. The producer also can conduct presales. In this case, the producer sells “various exhibition or distribution rights to the completed picture prior to its being produced.”<sup>18</sup> Presales guarantee a certain amount of revenue upon completion of the film depending on how much the producer spends in production.

In order to insure complete financial backing of a film, producers can use financial backing called packages/negative pickups. The producer “assembles the key elements of a project and then attempts to interest a studio in financing that project.”<sup>19</sup> When the project is complete, the studio then gets that film. Banks will usually loan against this promise as long as the producer obtains a guarantee of completion. This type of funding and private funding are more likely for an independent film.

### **Accounting Principles**

Accounting for the entertainment industry is a complex process where everyone uses different terms and no one can calculate the true value of a company. In every industry, there are standards set by the American Institute of Certified Public Accountants (AICPA) which must be met not only for auditing purposes but for public information as well. In 1973, the AICPA made head-way in resolving the conflicts of financial reporting. The group published an accounting guide, *Accounting for Motion Picture Films*, “that pragmatically resolved many (but far from all) controversial issues”, and it allowed interested parties to compare the companies’ success.<sup>20</sup>

Before the AICPA published standards, there were several issues with film industry accounting that needed to be addressed; however, the main problem was transparency. When a company listed the amount of operating income from a film, they did not explain the steps that gave them that number nor was there an industry standard to clarify the term “operating income.”

In 2000, the American Institute of Certified Public Accountants created SOP 00-2 called Accounting by Producers or Distributors of Films to keep up with how quickly the film industry was changing. The statement of position requires more disclosure on costs and covers revenue recognition in cases such as licensing and delivery which requires a contract to be kept on file and does not allow the company to recognize revenue if it is doubtful that a party cannot fulfill their obligations as promised in the contract (SOP 00-2.09, SOP 00-2.10, and SOP 00-2.11: See Appendix A). SOP 00-2 also includes information on costs and how to allocate them on the balance sheet.

This transition has not been easy. The authors of *Movie Money* state, “Motion picture and television profit definitions stand in stark contrast to the financial reporting requirements promulgated by the American Institute of Certified Public Accountants...”<sup>21</sup> The film industry is a unique entity when it comes to investing; therefore, it is crucial that potential investors,

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<sup>18</sup> Vogel, pg. 144.

<sup>19</sup> Vogel, pg. 144.

<sup>20</sup> Vogel, pg. 133.

<sup>21</sup> Daniels, pg. 253.



individuals as well as institutions, understand what the financial statements are telling them before making a decision on who to invest in.

Another issue that the industry faces today is how contracts are created. According to Vogel, “contracts are usually initially agreed on in outline... with the innumerable details presumably left for later structuring by professionals representing both sides.”<sup>22</sup> This leaves both parties room to interpret the deal in their own way; therefore, it is very difficult to construct a contract with terms that cannot be easily misinterpreted. As stated in the previous paragraph, terms can easily be confused and misconstrued even when the individual is knowledgeable of film accounting. The film industry revolves on contracts from actors to distribution to advertising. It is crucial to be as clear as possible when constructing contracts and not leave anything up for interpretation.

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<sup>22</sup> Vogel, pg. 133.

### Chapter 3: Techniques to Entice Investors

After reading background on the film industry and how it works, it is easy to see that it is difficult for an investor to make money. On the other hand, it is also easy for a private investor to be sucked into promises of glitz and glam. In 1998, The Federal Trade Commission, Bureau of Consumer Protection, and the Office of Consumer and Business education released a FTC consumer alert on investing in films. To warn potential investors, in the first paragraph the organization states, "... films, infomercials and the Internet are among the most risky of ventures."<sup>23</sup> Investors always hope they are investing in the next *Blair Witch Project*, *Juno*, or *Lost in Translation*, but they do not take into account how unlikely it is for that type of success to occur for an independent film.

When a company approaches a potential future investor, there are several different techniques they use to draw in the person. The most-used technique revolves around tax incentives. In some states the tax write-off can help you recover up to thirty percent of your investment. This supplies you with a return before the profits start kicking in which is usually about a year after the movie is released.<sup>24</sup> Louisiana offers a thirty percent investor tax credit rebate, for investments larger than \$300,000, as well as other incentives for the producers.<sup>25</sup> If you choose to back the film with \$1,000, in the state of Louisiana, you will receive \$300 tax credit (See Appendix B for further detail.)

The producers also promise a great return on your value. They state that they have strong relationships with distributors, and they discuss possible merchandising and music sales.<sup>26</sup> There are so many sources of revenue which include television, DVD sales, foreign markets, etc. that one cannot imagine how the film they are investing in could not make money. Unless the producer has a signed contract with a distributor, there is no way they can predict whether or not the film will be successful. This statement is reiterated in *Movie Money*; "Since each picture is an individual artistic work and its commercial success is primarily determined by audience reaction (which is volatile and unpredictable), there can be no assurance as to the economic success of any motion picture."<sup>27</sup> In 2010, four hundred thirty films were released in theaters across the United States. These films included *The Last Song* with Miley Cyrus, which earned \$16.01 million opening weekend, and *Iron Man 2* with Robert Downey, Jr., which earned \$128.12 million opening weekend. What made these films stand out? Was it the well-known actors and actresses? *Wonderful World* also premiered that year which starred Matthew Broderick but only earned \$4,582 its opening weekend. Helen Mirren and Paul Giamatti starred in *The Last Station* which only debuted in three theaters and earned \$73,723 its opening weekend.<sup>28</sup> Potential investors are also sometimes told certain big-name actors and actresses have either signed on to be in the film or are very interested.

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<sup>23</sup> "Lights! Camera! Rip-Off!" Federal Trade Commission, Bureau of Consumer Protection, and Office of Consumer and Business Education. August 1998. 01 Apr. 2012 <<http://nara-wayback-001.us.archive.org/peth04/20041019163134/http://www.ftc.gov/bcp/online/pubs/alerts/filmalrt.pdf>>.

<sup>24</sup> The Owner. Personal Interview.

<sup>25</sup> Burr, Sherri L. *Entertainment Law*. St. Paul: Thomson/West, 2007. 2<sup>nd</sup> ed. Pg. 26.

<sup>26</sup> "Industry Trends." *Enriching*. 01 Apr. 2012

<[http://enrichingpictures.com/enrichingpictures.com/Enriching\\_Opportunities.html](http://enrichingpictures.com/enrichingpictures.com/Enriching_Opportunities.html)>.

<sup>27</sup> Daniels, pg. 247.

<sup>28</sup> "Film Release Schedule for 2010." *Film Releases*. 09 Apr. 2012. <<http://www.film-releases.com/film-release-schedule-2010.php>>.

Another way producers help investors feel comfortable is by telling them “[they] are typically repaid their initial investment before anyone else receives anything from the project.”<sup>29</sup> This again makes the investor feel safe and gives the impression that the producer has their best interest at heart.

What attracts people to invest in films? Is it the fame? Michael Donovan, president of Rushing Wind Pictures in Seattle, stated, “Money is one thing, but the idea of being involved in a film—being in and around something that’s so creative and energizing—can be just as big a motivation,” Donovan said. “[Investors can] leave a legacy...seeing their name appear in the credits for many years to come.”<sup>30</sup> Because the film industry is such a tight knit community, it is exciting to have the opportunity to join the crowd. Those coming into money via inheritance or lottery need to be cautious that they are investing for the right reasons and understand the precautions.

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<sup>29</sup> Zimmerman.

<sup>30</sup> Zimmerman.

## Chapter 4: Investor Lawsuits

This happens more often than we realize, but the media usually interprets the reason for the disagreement to be greed on the investor's part. However, we never search for other possibilities. Are there people out there who intentionally scam investors out of their money? The following cases discuss some of the most recent and infamous disputes regarding financial resources in the film industry.

### Michael Moore

Recently, a case came to a close involving the film *Fahrenheit 9/11* from 2004. Michael Moore, who directed and produced *Fahrenheit 9/11*, recently sued Harvey and Bob Weinstein, owners of The Weinstein Company which is a film studio located in New York City, for \$2.7 million. Moore stated that he and the Weinstein brothers agreed to a 50/50 split of the profits from the film; however, after conducting an audit of the finances, Moore found several accounting irregularities surrounding the movie. The first was a "secret" deduction of \$2.5 million which the brothers "claimed was paid to acquire an interest owned in the film by a predecessor company called Icon Entertainment International."<sup>31</sup> The other deductions included advertising expenses, travel expenses, distribution consultant expenses, etc. which Moore states the deal with the brothers did not permit them to deduct those costs. They recently settled the argument out of court, and rumors are spreading of them working on another project together.

### Joseph Medawar

One of the most notorious cases involving investment fraud was led by Joseph Medawar from 2003 to 2005. He scammed investors into giving him money by stating he was creating a television series which included twenty-six episodes and had distribution contracts with 137 overseas distributors. The episodes involved the Homeland Securities Department and promised personal interviews from national security officials. During the two-year time frame, Medawar scammed seventy investors into giving him around \$5.5 million which he pocketed to support a luxurious lifestyle from himself and his leading lady in the series, Alison Waterbury. He also encouraged investors to go ahead and buy stock before his company went public, assuring them the stock price would increase dramatically once the show aired. Needless to say, Medawar did not produce the episodes.<sup>32</sup>

He was arrested in September of 2005 and charged with "five counts of mail fraud, six counts of wire fraud, ten counts of money laundering, and two counts of obstructing justice."<sup>33</sup> Medawar cut a deal in 2006 and was only sentenced to one year and one day in prison, nine month's home detention, a restitution payment of \$2.6 million, and 3,000 community service

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<sup>31</sup> Belloni, Matthew. "Michael Moore, Harvey Weinstein settle *Fahrenheit 9/11* Lawsuit." *The Hollywood Reporter*. 15 Feb. 2012. 21 Feb. 2012 < <http://www.hollywoodreporter.com/thr-esq/michael-moore-harvey-weinstein-fahrenheit-911-lawsuit-291581>>.

<sup>32</sup> Hanley, Christine and Greg Krikorian. "TV Series Pitch Ends in Arrest on Fraud Charges." *Los Angeles Times*. 24 Sept. 2005. 7 March 2012 < <http://articles.latimes.com/2005/sep/24/local/me-hollywood24>>.

<sup>33</sup> Hanley, Christine and Greg Krikorian. "U.S. Jury Indicts Man Accused of TV Series Scam." *Los Angeles Times*. 21 Oct. 2005. 8 March 2012 < <http://articles.latimes.com/2005/oct/21/local/me-homeland21>>.

hours.<sup>34</sup> Even though he was sentenced to pay restitution, there are investors who have yet to see a dime.<sup>35</sup>

Despite the lack of progression, Medawar continued to gain financial support for his television series through several different techniques. The first technique he used to draw people in was his trailer that he created to promote the series. Because potential investors saw footage of what Medawar had in mind for the series, they were confident he would carry out the project. It was not until the scam surfaced that investigators realized some footage from the trailer was taken from different films and television series.<sup>36</sup>

Medawar was also able to rally the media in support of the television series. He befriended a congressman who helped create relationships between Medawar and Washington's elite, without knowledge of the scam, which even led to articles stating President Bush's support of the series. Because of the media, investors did not think twice that the project was phony. As Ramon Alvarado, an investor in the series, stated, "It seemed like a sure hit."<sup>37</sup> Another way to insure investors was to tell them he was working with various networks that were interested in buying the series; however, he had no proof.

The main reason people invested in his company came down to one thing: Medawar's charisma. As stated in the CNBC series *American Greed*, "Medawar came across as a warm-hearted person."<sup>38</sup> He also told investors their money was refundable if they wanted out which further insured their trust in him.

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<sup>34</sup> Hanley, Christine and Greg Krikorian. "Producer Gets Short Sentence in TV Scam." *Los Angeles Times*. 05 Dec. 2006. 8 March 2012 < <http://articles.latimes.com/2006/dec/05/local/me-medawar5>>.

<sup>35</sup> "Some People Will Do Anything for Money." *American Greed*. CNBC. 2007. 06 April 2012 <<http://video.cnbc.com/gallery/?video=1204427024&play=1>>.

<sup>36</sup> "Some People Will Do Anything for Money."

<sup>37</sup> "Some People Will Do Anything for Money."

<sup>38</sup> "Some People Will Do Anything for Money."

## Chapter 5: Conclusion

The truth is that most people who invest in films will not earn any return, but that does not mean that the industry is attempting to scam investors out of their money. The fact is that no one knows how profitable a film will be regardless of the amount of publicity created, the actors involved in the film, or even the director behind the project. There are people in the film industry with an agenda to either not follow through with making the film or to increase the amount of marketing spent which in effect decreases the amount of profit investors earn. Therefore, if you choose to invest in a film, the most important aspect is to walk into a potential investment with the knowledge and understanding that what you are told might not necessarily be the full picture and equip yourself with tools in order to decrease your risk as much as possible.

After several attempts at discussing my thesis with a professional in the field, I was finally able to get in touch with the owner of a US Productions company. Writers submit their scripts and the company then decides which ones to pursue. The production company helps them fund their project and produce the film. They have two main investors that back all of their projects, so they normally do not conduct business with private investors. This type of financing, production, and distribution option is known as “in-house production/distribution.”<sup>39</sup>

It was refreshing to hear the owner tell me up front that most people who invest in films will lose money. The owner was passionate about his work and spent several hours on the phone answering my questions. He stressed that most people who understand how the film industry works also understand that the money is not what is important. People pour their finances and hearts into films to create art and see scripts come to life. However, he did offer some advice on how to decrease your risk when investing in a film.

### How to Decrease Risk?

As any accredited person in the film industry will tell you, the most important step is to do your homework. Do not invest in a film until you have researched past projects of the writer and producer. Make sure they have other projects that have been completed and have merit to them. If the writer does not have any past works, do not invest an amount that you are not willing to lose. You should also invest in a film that you believe in and support, so learn about the script and how the producer intends to tell the story.

Pay attention to which genre you are investing in. According to the owner at the Production Company, the horror genre generally makes a greater return on investment than any other genre. Most horror films are fairly cheap to produce. *The Blair Witch Projects* cost was about \$15,000 as well as *Paranormal Activity*. The owner stated that four out of five horror movies break even, and three out of five films actually make money. Horror films are also appealing to foreign countries such as Japan and China. They do not require a box office debut to do well. *Mr. Jingles* went straight to DVD and, as the owner of the production company stated, “... did great.” The owner recommended staying away from drama stating “Russell Crowe has not made money in a while.”<sup>40</sup>

In conducting your research during the first step, pay attention to where you believe that film will do best. When you construct your contract with producers, which are different for every client and occur after you have made your decision to invest in a film, you can negotiate

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<sup>39</sup> Vogel, pg. 145.

<sup>40</sup> The Owner. Personal Interview.

revenue from certain foreign territories. As stated previously, the horror genre tends to do well in China and Japan, so you might want to include those territories to increase your chance of earning a greater return on your investment. Look at past movies that are similar to the one being produced and look at how well they did in other countries.

Temple Fennell discussed three characteristics in order for a film to be a financial success: publicity, a specific target audience, and a positive review base. The film must have the potential to gain positive publicity in order to spread the word. Most films have this credibility because of their well-known cast, writer, director, or story-line. In recent years, there have been several sequels made. A sequel such as “The Dark Knight Rises” will bring in revenue from box offices simply because the past films have built a fan base. This leads into the importance of having a specific target audience. In order to market your film, you need to know the best ways to reach your audience. If you know that women over the age of thirty are your target audience, previews of the film shown on Lifetime will be more beneficial than previews shown on ESPN. The third characteristic is a positive review base. Without the critics behind you, it will be difficult to convince the public that your film is worth seeing.<sup>41</sup> The first two characteristics are easily identified before you invest, but it is unknown what the critics will say. It is also very difficult for a film to have all three aspects.

After deciding on a film, there is some paperwork that you need to ask for. If a producer discusses future distribution plans, ask to see a contract to make sure the deal has followed through. A distribution plan will show how many theaters the film will premiere in and/or the number of other venues the production company has in place. When you have discussed every other detail and are presented with a contract, do not sign a contract that guarantees you a certain percent on return. As stated previously, no one can guarantee how well a film will do.

The film industry is all about who you know and the relationships that you create. When you become involved in a project, ask the producer if you can come on set. If they are serious about making a film, they will be more than happy to share their work with another who loves film and has help supported his vision come to life. If they are apprehensive, check more closely into why they do not want you on set.

### **What Companies Are Doing to Gain Investor Trust:**

Hollywood trade magazine *Variety* created Flixtracker at the end of 2011 in order to protect investors as well as other parties who are involved in films. A Flixtracker subscription costs \$1,000 a year and mainly targets companies which invest in major motion pictures. One of Flixtracker’s competitors is Baseline StudioSystems which was sold to the entrepreneurs behind Movietickets.com by The New York Times in early 2011.<sup>42</sup> Neil Stiles, president of *Variety*, stated, “It’s becoming much harder to make a profit in film and television. People need more insightful information to make decisions, so moving to data and research for us is a logical step.”<sup>43</sup>

### **Closing Statement:**

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<sup>41</sup> Fennell.

<sup>42</sup> Stoeffel, Kat. “Hollywood Trade *Variety* Moves into Data and Research Business.” *The New York Observer*. 09 Dec. 2011. 27 Jan. 2012. < <http://www.observer.com/2011/12/hollywood-trade-variety-moves-into-data-and-research-business/>>.

<sup>43</sup> Stoeffel.

At the end of the day, the overall film financing sector is not a scam. There are several ways to increase your chance of a return; however, the reason to get into the film business is not for the money: it is for the love of films. This industry can be volatile and unpredictable, but the ability to create art and bring cultural issues to light is worth so much more than financial rewards. According to the owner of the Production Company, everyone was shocked at how well *Black Swan* performed at the box office; however, they produced the film anyway because the script spoke to them. Investing in films can be a rewarding experience which allows you to watch a script turn into a full-length film and know that you helped bring a writer's vision to life. However, if you decide this is not for you, listen to the FTC Consumer Report: "... if you want to invest in a movie, buy a ticket."<sup>44</sup>

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<sup>44</sup> "Lights! Camera! Rip-Off!"



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## Appendix A: SOP 00-2

Accounting by Producers or Distributors of Films 20,671

### Section 10,800

### Statement of *Position 00-2*

### ***Accounting by Producers or Distributors of Films***

June 12, 2000

#### NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

#### Summary

This Statement of Position (SOP) provides guidance on generally accepted accounting principles for all kinds of films, except where specifically noted, and is applicable to all producers or distributors that own or hold rights to distribute or exploit films. For purposes of this SOP, films are defined as feature films, television specials, television series, or similar products (including animated films and television programming) that are sold, licensed, or exhibited, whether produced on film, video tape, digital or other video recording format. The SOP requires, among other things, the following.

□ An entity should recognize revenue from a sale or licensing arrangement of a film when all of the following conditions are met.

— Persuasive evidence of a sale or licensing arrangement with a customer exists.

— The film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery.

— The license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale.

— The arrangement fee is fixed or determinable.

— Collection of the arrangement fee is reasonably assured.

If an entity does not meet any one of the preceding conditions, the entity should defer recognizing revenue until all of the conditions are met.

AICPA Technical Practice Aids §10,800

**Revenue Recognition—Details*****Persuasive Evidence of an Arrangement***

**.09** Persuasive evidence of a licensing arrangement is provided solely by a contract or other legally enforceable documentation that sets forth, at a minimum, the license period, the film or films affected, the rights transferred, and the consideration to be exchanged. An entity should not recognize revenue if factors raise significant doubt as to the obligation or ability of either party to perform under the terms of an arrangement.

**.10** An entity should have forms of verifiable evidence, such as a contract, a purchase order, or an online authorization, to document the mutual understanding of an arrangement. That evidence should include correspondence received from the customer that details the mutual understanding of the arrangement between the customer and the entity, or evidence that the customer has acted in accordance with such arrangement.

***Delivery***

**.11** In a licensing arrangement that requires the physical delivery of a product to a customer, an entity should not recognize revenue until such delivery is complete. If a licensing arrangement is silent about delivery, physical delivery is required in order to recognize revenue.

**.12** Certain licensing arrangements may not require immediate or direct physical delivery of a film to a customer. In lieu of immediate delivery, an arrangement may provide the customer with immediate and unconditional access to a film print held by the entity or authorization for the customer to order a film laboratory to make the film immediately and unconditionally available for the customer's use (a lab access letter). In such cases, if the film is complete and available for immediate delivery, the entity has met the conditions of paragraph .07(b).

**.13** If a licensing arrangement requires an entity to make significant changes to a film after its initial availability to a customer, the arrangement does not meet the delivery condition in paragraph .07(b). In such instances, the entity should not recognize revenue until it makes those significant changes and meets all of the conditions of paragraph .07. Significant changes are defined as those changes that are additive to a film; that is, an arrangement requires an entity to create new or additional content after the film is initially available to the customer. For example, reshooting a scene or creating additional special effects are significant changes. Mere insertion or addition of preexisting film footage, addition of dubbing or subtitles (which by definition is done to existing footage), removal of offensive language, reformatting a film to fit a broadcaster's screen dimensions, and adjustments to allow for the insertion of commercials are all examples of changes to a film that are not significant and do not preclude revenue recognition prior to their completion. The costs incurred for significant changes should be added to **film costs** and subsequently charged to expense when an entity recognizes the related revenue; the costs expected to be incurred for insignificant changes should be accrued and charged to expense if an entity begins to recognize revenue from the arrangement before incurring those costs.

***Availability***

**.14** Certain arrangements restrict a customer from beginning its initial

## Appendix B: Louisiana Investment Credits—Motion Picture Investments

### Louisiana State Tax Reporter, ¶12-055, Louisiana, Investment Credits— Motion Picture Investments

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#### [Annotations](#)

A taxpayer domiciled in Louisiana may claim a credit against its Louisiana corporation income tax for its qualifying investments in a nationally distributed, state-certified film production. The primary objective of this credit is to encourage the development in Louisiana of a strong capital and infrastructure base for motion picture productions in order to achieve an independent, self-supporting industry. ( [Sec. 47:6007\(A\), La R.S.](#) ; [LAC 61:I.1601](#); [LAC 61:I.1603](#); [LAC 61:I.1611](#), )

#### •Definitions

A number of key terms are specifically defined for purposes of this credit.

**Base investment.**—means cash or cash equivalent investment made and used for production expenditures in the state for a state-certified production . ( [Sec. 47:6007\(B\)\(1\), La R.S.](#) ; [LAC 61:I.1605](#) ) Applicable credits never will exceed the total base investment in a state-certified production. ( [Sec. 47:6007\(C\)\(1\)\(d\), La R.S.](#) )

**Headquartered in Louisiana.**—A corporation incorporated in Louisiana, or a partnership, limited liability company (LLC), or other business entity domiciled and headquartered in Louisiana, for the purpose of producing a nationally or internationally distributed motion picture. ( [Sec. 47:6007\(B\)\(4\), La R.S.](#) ; [LAC 61:I.1605](#) )

**Motion picture.**—A nationally or internationally distributed feature-length film, video, television pilot, television series, television movie of the week, animated feature film, animated television series, or commercial made in Louisiana, in whole or in part, for theatrical or television viewing . (This does not include the production of television coverage of news or athletic events.) ( [Sec. 47:6007\(B\)\(5\), La R.S.](#) ; [LAC 61:I.1605](#) )

**Motion picture production company.**—A company engaged in the business of producing a nationally or internationally distributed motion picture. (This does not include any company owned, affiliated, or controlled, in whole or in part, by any company or person that is in default on a loan made by the state or a loan guaranteed by the state, nor with any company or person that has ever declared bankruptcy under which an obligation of the company or person to pay or repay public funds or monies was discharged as a part of such bankruptcy.) ( [Sec. 47:6007\(B\)\(6\), La R.S.](#) ; [LAC 61:I.1605](#) )

**Production expenditures.**—Preproduction, production, and postproduction expenditures in Louisiana directly relating to a state-certified production, including:

- set construction and operation;
- wardrobes, makeup, accessories, and related services;
- costs associated with photography and sound synchronization, lighting, and related services and materials;
- editing and related services;
- rental of facilities and equipment;
- leasing of vehicles;
- costs of food and lodging;
- digital or tape editing, film processing, transfer of film to tape or digital format, sound mixing, special and visual effects;
- and payroll.

Certain postproduction expenditures are excluded. ( [Sec. 47:6007\(B\)\(9\), La R.S.](#) ; [LAC 61:I.1605](#) )

( [Sec. 47:6007\(C\)\(2\)\(b\)\(ii\), La R.S.](#) ).

**CCH Note:** As of August 15, 2006, the Louisiana Department of Economic Development's Office of Entertainment Industry Development is the successor to the Governor's Office of Film and Television Development for purposes of administering the motion picture investor tax credit, and that all of the acts of the Office of Entertainment Industry

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4, Laws 2007, ¶150-191a; LAC 61:I.1611)

**State-certified production.**—The tax credit is applicable against the Louisiana corporation income tax for a taxpayer domiciled in Louisiana, other than a motion picture production company. The credit is earned by an investor at the time that an expenditure is made by a motion picture production company in a state-certified production, and cannot be claimed until the expenditure is certified by the Governor's Office of Film and Television Development and the state's Department of Economic Development. The credit is calculated as a percentage of the total base investment dollars certified per project. ( [Sec. 47:6007\(C\)\(1\), La R.S.](#) ; [LAC 61:I.1603](#) )

For a state-certified production approved by the above Office and Department after 2003, but before 2006, if the total base investment in the production is in an amount from \$300,000 to \$8 million, then the credit allowed is equal to 10% of the actual investment made by the taxpayer. If the total base investment is greater than \$8 million, then the taxpayer is allowed a credit equal to 15% of the actual investment. ( [Sec. 47:6007\(C\)\(1\)\(a\), La R.S.](#) )

For a state-certified production approved by the above Office and Department after 2005, but before July 1, 2009, or for a state-certified infrastructure project approved by this Office and Department on or after July 1, 2005, if the total base investment is greater than \$300,000, then each investor is allowed a credit equal to 25% of the base investment. To the extent that the base investment is expended on payroll for Louisiana residents employed in connection with a state-certified production, then each investor is allowed an additional credit equal to 10% of such payroll. However, if the payroll to any one individual exceeds \$1 million, then this additional credit excludes any salary for that individual that exceeds \$1 million. ( [Sec. 47:6007\(C\)\(1\)\(b\), La R.S.](#) ; [LAC 61:I.1609](#) )

For a state-certified production approved by the above Office and Department on or after July 1, 2009, if the total base investment is greater than \$300,000, then each investor will be allowed a credit equal to 30% of the base investment. To the extent that the base investment is expended on payroll for Louisiana residents employed in connection with a state-certified production, then each investor will be allowed an additional credit equal to 5% of such payroll. However, if the payroll to any one individual exceeds \$1 million, then the additional credit will exclude any salary for that individual that exceeds \$1 million. ( [Sec. 47:6007\(C\)\(1\)\(c\), La R.S.](#) ; [LAC 61:I.1609](#) )

### •Planning considerations

**Application of the credit.**—An entity taxed as a corporation for Louisiana income tax purposes must claim any credit allowed on its state corporation income tax return. ( [Sec. 47:6007\(C\)\(3\)\(a\), La R.S.](#) ) A corporate partner or member must claim its share of the credit on its own state corporation income tax return. ( [Sec. 47:6007\(C\)\(3\)\(c\)\(i\), La R.S.](#) )

**Certification and administration.**—The above Office and Department will determine what projects and expenses qualify. The Office will submit its initial certification of a project as a state-certified production to investors and to the Department. The initial certification will include a unique identifying number for each state-certified production. Upon completion of the production, a credit certificate will be issued to investors, which will include the identifying number assigned in the initial certification. ( [Sec. 47:6007\(D\), La R.S.](#) ) Finally, for all of the credit periods mentioned above, the initial certification is effective for a 12-month period prior to and a 12-month period after the initial certification date, unless the production has already commenced, in which case the initial certification is valid until the production is completed. ( [Secs. 47:6007\(C\)\(1\)\(a\)\(iii\), \(b\)\(iii\), \(c\)\(iii\), and \(d\)\(iii\), La R.S.](#) ) The regulations lay out the application and certification requirements. ( [LAC 61:I.1607](#) )

**Reimbursement requirements.**—A taxpayer applying for the credit is required to reimburse the Louisiana Department of Revenue for any audit required in relation to granting the credit. ( [Sec. 47:6007\(D\)\(4\), La R.S.](#) )

**Carryforward provisions.**—The credit is allowed against the income tax for the tax period in which the credit is earned or for the tax period in which initial certification authorizes the credit to be taken. If the credit exceeds the amount of such tax due for such tax period, then any unused credit may be carried forward as a credit against any subsequent tax liability for a period not to exceed 10 years. ( [Sec. 47:6007\(C\)\(3\), La R.S.](#) ; [LAC 61:I.1613](#) )

**Transferability.**—An unused credit may be sold or transferred to another taxpayer, or to the applicable state office, subject to certain conditions. A single transfer or sale may involve more than one transferee, and a transferee may subsequently transfer or sell the credit subject to the same conditions. In addition, a transferor and transferee must submit written notification of this transfer to the above Office and to the state's Department of Revenue within 30 days after the transfer or sale. The notification must generally include a processing fee of up to \$200 per transferee. ( [Sec. 47:6007\(C\)\(4\), La R.S.](#) ; [LAC 61:I.1613](#) ) The transferee must apply the credit in the same manner and against the same tax as the taxpayer originally awarded the credit. ( [Sec. 47:6007\(C\)\(5\), La R.S.](#) )

Investors of projects initially certified on or after July 1, 2009, are allowed to transfer the credit back to the state for 85% of the face value of the credit. Transfer back to the state is only allowed for initial investors and does not apply

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