

# Why Entertainment Royalty Audits Are Like a Box of Chocolates: Tips from the Experts

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Sponsored by the Licensing  
Division of the ABA Forum on  
Sports and Entertainment

# Faculty



## Ben Sheppard

- President, Sheppard Consulting
- CPA (CA/TX), CVA
- 20+ years Entertainment industry experience
- Performed/supervised over 200 Entertainment royalty audits around the world
- Author of new chapter in Wiley's *Litigation Services Handbook* entitled, "Royalty Audits and Contract Compliance Investigations"

# Faculty



## David Halberstadter

- Partner & Deputy General Counsel, Katten Muchin Rosenman LLP
- 30+ years of Entertainment Litigation
- Represented motion picture studios and television production companies/networks in connection with 50+ audits and audit disputes
- Advised on and drafted dozens of contingent compensation definitions

# Faculty



## Steven D. Sills

- Partner, Green Hasson Janks
- CPA, Certified Fraud Examiner, Certified Financial Forensic, attorney
- 30 years of entertainment accounting experience
- Specializes in audits of motion pictures and television programs
- Author of *Movie Money: Understanding Hollywood's Creative Accounting Practices*, 1998 (2nd edition published in 2006)

# Objectives

- Identify issues that arise in entertainment royalty audits
- Focus on the roles attorneys can and should play in connection with the drafting, administering and/or enforcing royalty-providing agreements
- Familiarize attorneys with how audits are initiated, conducted and resolved
- Share lessons learned from the speakers' varied experiences

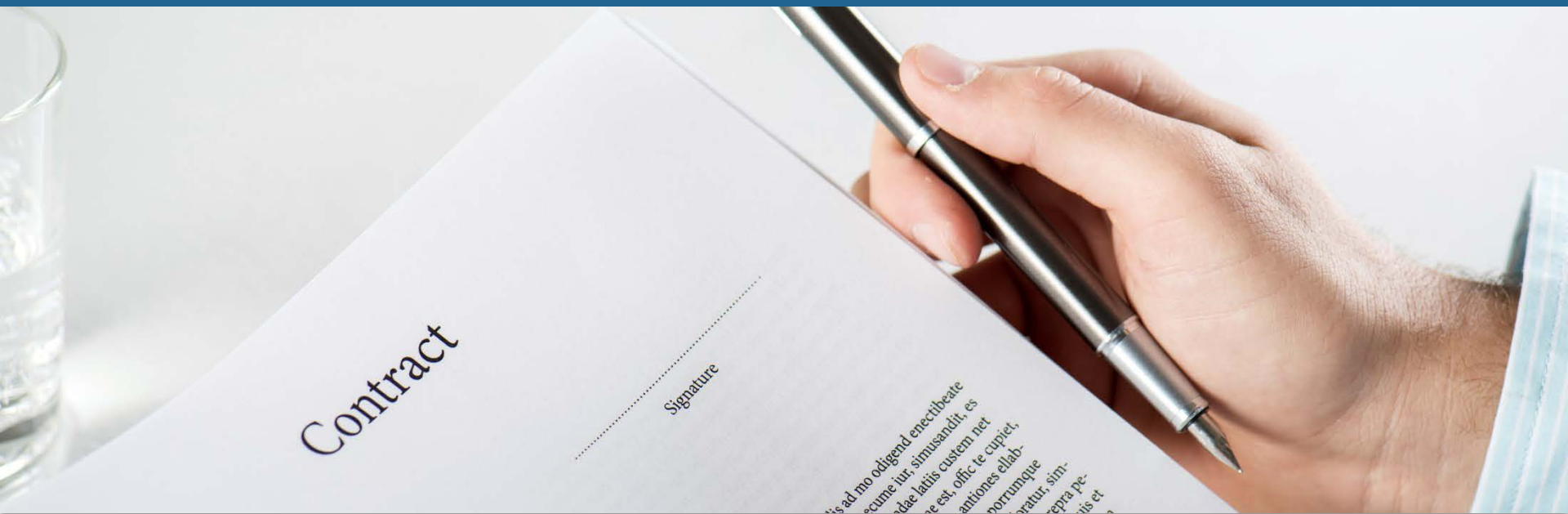


# Webinar Agenda

- Types of agreements served by royalty audits
- Types of royalty audits/compliance investigations and how they are performed
- What auditors expect to do and see
- How attorneys can assist their clients
- Teachable moments

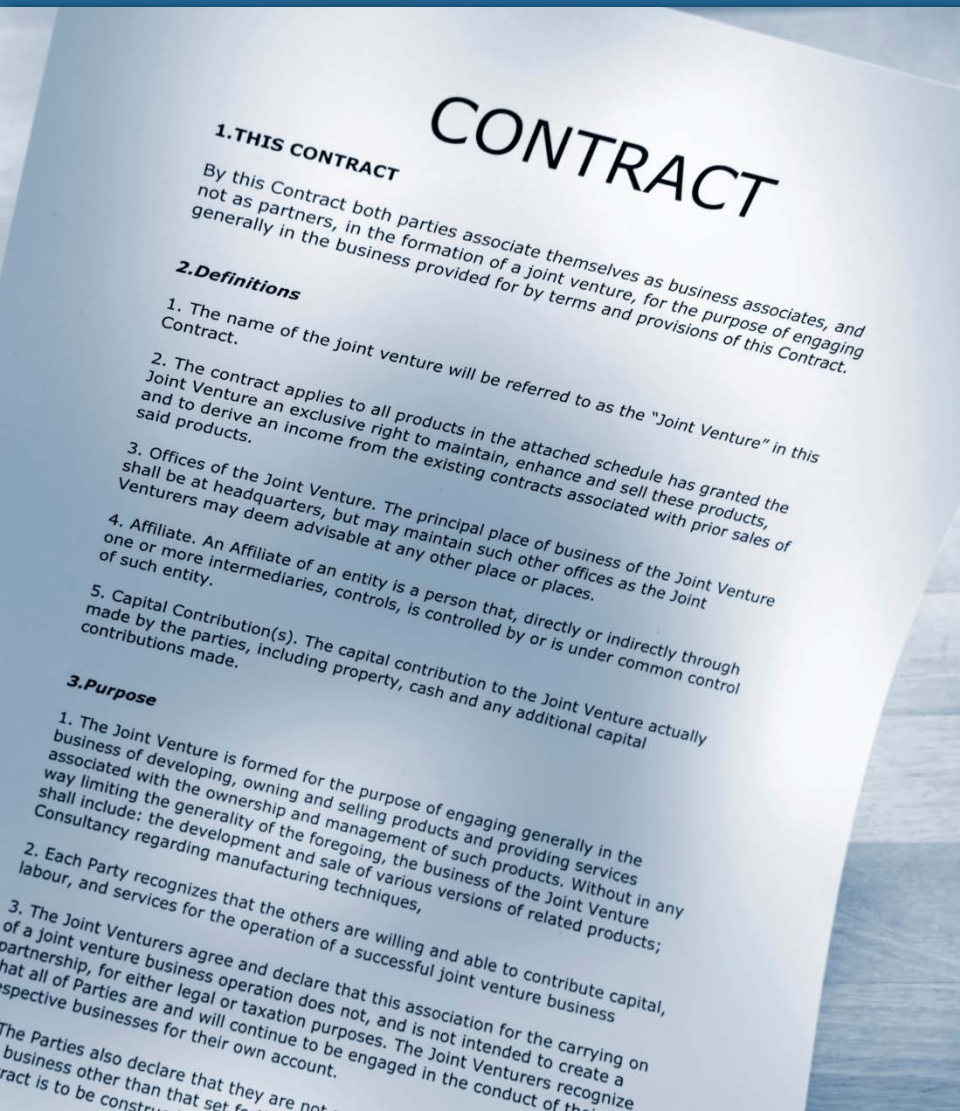


# Entertainment Agreements Served By Royalty Audits



- Licenses to distribute trademarked merchandise
- Licenses to distribute copyrighted content
- Licenses to distribute broadcasted programming signals

# Entertainment Agreements Served By Royalty Audits



- “Talent” profit participation agreements for motion pictures or television content
- Third-party equity/debt financing agreements
- Vendor-customer agreements for manufacturing and/or distribution of content media

# Royalty Audits: Why And How They Are Performed



- Why Are Royalty Audits Performed?
  - Increase proceeds to licensee
  - Manage oversight and collaboration
  - Investigate potentially adverse issues
  - Preparation for litigation

# Royalty Audits: Why And How They Are Performed



- What Drives the Decision to Commence a Royalty Audit?
  - Cost of doing vs cost of not doing
  - Misperceptions of risk and reward
  - “Putting a stake in the ground”

# Royalty Audits: Why And How They Are Performed

- How Royalty Audits Are Performed
  - Planning
  - Fieldwork
    - Commonly performed tests
    - Commonly identified findings
  - Follow-up
  - Reporting



# Royalty Audits: Why And How They Are Performed

- How Royalty Audits Differ from Financial Statement Audits
  - Bases of accounting
  - Professional standards
  - Materiality concerns
  - Scope of activity tested



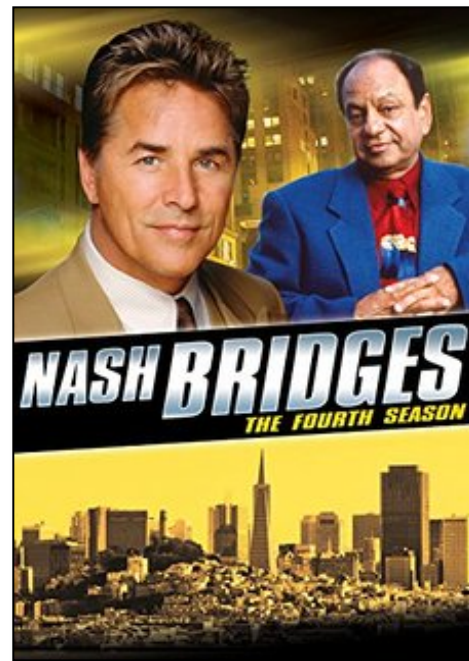
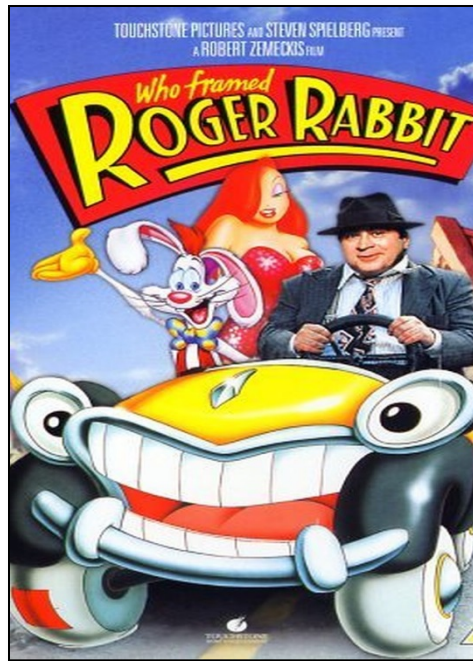
# Royalty Audits: Why And How They Are Performed



- What Auditors Expect
  - Reasonable access to documents
  - Reasonable access to staff who can answer questions
  - Reconcilable audit trails

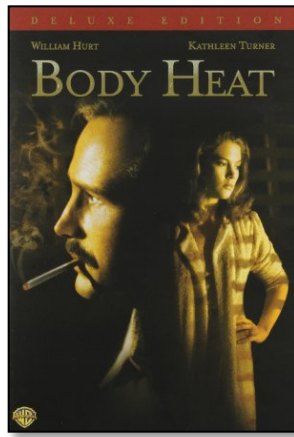
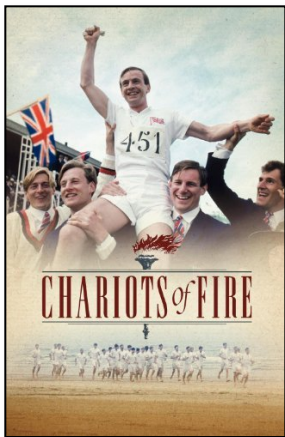
# Royalty Audits: Why And How They Are Performed

- Risk Issues in Profit Participation Audits
  - Fiduciary duty claims
  - Co-ownership claims



# Royalty Audits: Why And How They Are Performed

- Risk Issues in Profit Participation Audits
  - “Package” allocations
  - Foreign territory activity
  - Sub-distributor activity



# Royalty Audits: Why And How They Are Performed

- Risk Issues in Profit Participation Audits
  - “Most favored nations” compliance
  - “Vertical integration”



# How Attorneys Can Prepare Their Clients



- Drafting and negotiation of the contract
  - Royalty calculation provisions
  - “Scope of audit” provisions
  - Dispute resolution provisions

# How Attorneys Can Prepare Their Clients



- Contract performance
  - General oversight of reporting obligations
  - Advising on specific interpretation issues
  - Assessing impact of new transactions or changes to business model



# How Attorneys Can Prepare Their Clients

- After completion of audit
  - Review and analysis of audit claims and/or report
  - Risk assessment
  - Preparation for dispute resolution/litigation



# How Attorneys Can Prepare Their Clients



- What attorneys should expect from auditors
  - Economically reasonable and contract-supported findings
  - Findings capable of recalculation
  - Findings supported by auditor's workpapers

# Significant Legal Issues

- The nature of the relationship between the company and the participant
- The potential impact of “incontestability” and other contractual limitation provisions
- Contractual limitations on the scope of document review



# Anticipating Future Challenges

- How might the licensor/licensee relationship be impacted by:
  - New transactions
  - New Competition
  - Evolution in business model

amazon fireTV



hulu



vue



vuguru

# Teachable Moments & Lessons Learned

- Auditors engaging in contract interpretation
- Audit claims based on conjecture and extrapolation
- Effective tax rates
- “Silent” contracts
- Application of home video historical standard to new media



# Teachable Moments & Lessons Learned



- Contradictory audit claims based on same revenue or expense
- Impact of questionable claims on auditor credibility
- Refusal to compromise leading to larger, subsequent settlement (or judgment)

# Wrap-Up & Questions

