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A Model Audit Clause for Use in Motion Picture/Television Participation Agreements

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*"Sills & Adelman Audit Clause" by Joseph D. Schleimer, Esq., Steven Sills, C.P.A.,
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During transactional negotiations in the motion picture field, the most neglected part of the contract is often the audit clause. This may be due to the studios' relative intransigence about negotiating changes expanding the artist's audit rights, or it may be as a result of the assumption that the audit clause is not very important. In either case, experience in profit participation litigation shows that the audit clause is critically important, and this article proposes a model audit clause, for use by transactional attorneys, agents, and other negotiators who are interested in meaningful enforcement of their clients' participation rights.

The following is a summary explanation for the various provisions in the Audit Clause:

General corporate records:

Most of the existing studio audit clauses expressly deny access to "general corporate records." This ill-defined concept can best be analyzed by reference to Generally Accepted Accounting Principles ("GAAP"), which most

companies are required to adhere to. "Participation accounting" records usually do not comply with GAAP, whereas (as a general rule) "general corporate records" must be in accordance with GAAP, because of requirements by the SEC, IRS, and (in some cases) bondholder and shareholder agreements. When people speak of the studios keeping "two sets of books," this is not just rhetorical. The distinction between participation accounting records and "general" accounting records (also referred to as "management" records, or "financial reporting" records, or "corporate accounting" records) can be substantial. Accordingly, the most important restriction contained in most standard audit clauses now in use is a restriction denying access to general "corporate" records--irrespective of the relevance of those records in an audit.

This restriction can seriously undermine a contractual audit. Among other things, denial of access to GAAP records can prevent meaningful analysis of "company-wide" revenue reporting; identification and discovery of "side deals"; determination of whether inter-company transactions have been used to divert revenue attributable to the picture; and similar, underhanded accounting tactics. Detecting and proving unreported and/or underreported revenue is the most difficult task the auditor faces, and without access to the "general" corporate books, such detection may depend as much on luck as methodology.

On the expense side, refusal of access to general corporate records also prevents auditors from, among other things, determining whether expenses charged to the participants have been treated differently on the corporate books; whether "hypothetical" expenses have been charged to the picture; whether the studio has improperly delayed recognition of revenue (which delays recoupment, and thereby inflates contractual charges for interest); whether the same expenses have been charged to more than one picture; and whether overhead charges have been improperly treated as direct expenses.

The Audit Clause attempts to remedy this situation, by (among other things) requiring the studio to harmonize participation accounting with GAAP accounting; providing for the establishment of a "product subledger" for each motion picture; requiring full integration of the product subledger (and all other participation accounting) into the studio's GAAP general ledger system; requiring the studio to maintain GAAP-consistent distribution ledgers, showing how individual revenue and expenses are allocated among the different motion picture/television products on a company-wide basis; and providing for an "open architecture" to company-wide bookkeeping and accounting.

Ad hoc restrictions on access to contracts:

At times, the studios will arbitrarily deny access to particular source documents such as output contracts, rebate and discount agreements, package contracts and "side deals"-- without any contractual justification for doing so. The obvious motive for such conduct is to prevent detection of claims.

There have also been instances in which the studios have conditioned access to records on a coerced agreement by the auditor to adopt a "neutral" position on a related issue, i.e., disclosing the facts in the audit report--but not expressly raising a claim. Again, the studio's motive for this is obvious: an "open item" recital in an audit report is not actually a claim, and by its very nature weakens the artist's claim for an adjustment.

The Audit Clause attempts to correct this, by requiring the studio to provide access to all licenses, contracts, invoices, and other "source" documents which directly or indirectly concern the production, exhibition, distribution, and exploitation of the picture; requiring express disclosure of all "side deals" and other contracts with licensees and vendors during the relevant time period (whether related to the picture or not); and forbidding the studio from imposing any conditions or restrictions on the report by the auditor.

Right to audit foreign records in Los Angeles:

The studio audit clauses currently in use do not provide that foreign records will be produced in Los Angeles, even though foreign exploitation for some pictures may involve more income and expense than the domestic market. As a result, contractual audits of foreign income and expenses are limited to arithmetic checks using studio-generated summaries and top sheets.

This situation is woefully unfair to the artist. Indeed, use of the term "audit" to describe that kind of forensic analysis is a misnomer, because no meaningful scrutiny of income and expenses can be conducted by comparing one company-generated summary against another company-generated summary.

If the studio refuses to produce foreign records in Los Angeles, the only alternative is to send auditors to the foreign branch offices, a prohibitively expensive project, because the major studios maintain records in 50 or more foreign territories.

Moreover, the same arbitrary and unreasonable restrictions on access to

records are imposed on auditors who travel to the foreign branch offices, as are imposed during audits conducted in Los Angeles. For these reasons, the studios think their foreign operations are effectively immune to scrutiny, and the worst abuses and financial manipulations usually occur overseas.

Accordingly, a strong incentive exists to negotiate for the right to force the studio to produce foreign records locally.

The Audit Clause accomplishes this, by requiring the studio to provide detailed expense and revenue itemizations for revenue and expenses for the foreign territories; requiring the studio to provide all requested ledgers and "back up" for the ten largest foreign territories plus any two minor foreign territories of the auditor's choosing, in Los Angeles; and contractually authorizing the auditor to extrapolate the results of an audit of the "12 foreign territories" on a worldwide basis.

Package allocations:

The practice of licensing films and television programs as part of "package" sales is an area ripe for abuse. Typical package contracts contain a recital that the license fee is negotiated for each picture separately, but in most cases such recital is a sham. In reality, the hits and the flops are tied together during negotiations, and "cherry picking" is prohibited. This is usually reflected by a clause in the license requiring that the entire fee has to be paid--whether the licensee exploits all of the pictures included in the package or not.

Through the use of package contracts, the studio can easily divert huge amounts of revenue to less successful films. In the past, the studios have discouraged auditors from reviewing this aspect of their accountings, by denying access to package contracts, "output" contracts (which are a form of packaging-in-advance), side deals, and "parallel" contracts. Alternatively, the studios have at times conditioned access to such documents on an agreement by the auditor to adopt a "neutral" position on the package allocation, i.e., issuing an audit report which discloses the information and refers to the package allocation in neutral language, or as an "open item."

The Audit Clause responds to this situation by requiring the studio to provide access to all "relationship" documentation between the studio and each licensee; requiring disclosure and providing access to all "side deals" with each such licensee; requiring disclosure of the methodology used to allocate package contracts; and expressly prohibiting the studio from placing any restrictions on the analysis and opinions rendered by the Artist's Auditor.

Hypothetical expenses:

The Audit Clause requires the studio to report expenses on a cash basis, including details on the date of actual payment. This disclosure is required whether or not the contract permits the deduction of expenses on an accrual basis, to prevent charges for "hypothetical" expenses, i.e., expenses incurred but never paid.

Self-dealing:

The Audit Clause requires the studio to disclose all "self-dealing" transactions, defined as any license, sale, or transfer to any entity in which the studio has an equitable or legal interest. The purpose of such disclosure is to alert the auditor to affiliated-party transactions which should be scrutinized for fairness.

Production expenses:

After-the-fact audits of production expenses are problematic, because of the difficulty of challenging particular expenses once the picture has been completed. The Audit Clause allows participants to informally and/or formally monitor expenses being charged to the production while it is underway, or shortly after completion. Additionally, the Audit Clause provides, and the author recommends, that participants conduct an audit of production expenses as soon as the picture becomes successful enough to justify the expense. If opening weekend box office is large enough, the audit of production expenses should be commenced immediately.

The Audit Clause implements the monitoring and scrutiny of production expense by requiring the studio to provide weekly production expense itemizations and informal access to "back up" documentation, during the production phase and at any time after theatrical release. Where studio facility charges are imposed, the Audit Clause allows unfettered access to records reflecting similar charges to other productions for similar services and facilities.

Restrictions on selection of auditors:

Many studio contracts purport to restrict the selection of auditors to a few pre-selected C.P.A. firms, and purport to grant the studio a right of approval over any other auditors selected by the artist. This practice is legally subject to challenge, and raises the spectre that a studio might declare a particular C.

P.A. to be persona non grata, and thereby restrain the ability of that auditor to obtain employment. The Audit Clause eliminates this form of studio pressure, by expressly authorizing the artist to use any licensed C.P.A. (or qualified person working under the direction of a C.P.A.) to conduct the audit.

Incontestability:

Because of the high cost of an audit, many participants will adopt a "wait and see" approach, holding off until it is clear that the picture will approach break-even before commencing an audit. The studios exploit this natural tendency toward procrastination, by placing "incontestability" clauses in their contracts, purporting to cut off audit rights after a certain period of time. If a picture does not achieve break even until three or four years after issuance of the first participation statement, the studio will take the position that everything on the first statement (production cost, most theatrical revenue, and most distribution expenses) is not subject to the audit.

Additionally, based on the "incontestability" clause, the studio may deny access to the records necessary to audit the early statements. Thus, by the time the participants have the financial incentive to audit--it may already be too late to assert the largest and most significant claims.

The Audit Clause corrects this, by tolling the running of the incontestability period until two years after the studio declares break even, or four years after the release of the picture, whichever occurs first. That will eliminate the unfair pressure on the participant to conduct a premature audit--and allow the artist sufficient time to consider whether an audit is a prudent expenditure of funds.

Interest calculations:

Current industry practice is to calculate interest based on a formula so complex that the expense of scrutinizing such charges is prohibitive. Calculating interest charges during the production phase requires the use of a "step up" matrix of daily or weekly principal amounts. After release, interest charges are based on a fluctuating principal balance. Myriad calculations are required, to determine the correct interest charges, and if information is missing for even one time period, the entire calculation may be thrown off. Implementation of special software and many days of keypunch operator time is required to analyze interest charges--even if all the necessary information is provided.

There is no reason why the calculation of interest should be so complex.

This charge is an artificial construct, based not on actual interest incurred but on the studio's desire to enrich itself, in the guise of charging an "expense." Accordingly, interest calculations should be greatly simplified, so an auditor can analyze the studio's "interest" charge without undue consumption of time and money.

The Audit Clause simplifies the auditing of interest charges, by commencing the running of interest from delivery of the answer print and charging interest for the production phase using a "mid-point" calculation, based on the date of commencement of principal photography. Similarly, the Audit Clause simplifies recoupment calculations, by using a mid-point calculation for each distribution period.

Participation statements:

Most participation statements are short summaries, one or two pages in length, with little or no detail. Hence, the first difficulty faced by an auditor is to obtain a line-itemization, so that particular "back up" documentation can be identified and scrutinized. Opportunities abound for the studio to "muddy the audit trail" if allowed to provide summaries or partial itemizations, because these minimal disclosures make it difficult or impossible to trace line items to the relevant back up documentation.

The Audit Clause corrects this, by establishing an "open architecture" to studio bookkeeping and requiring an itemized general ledger for each production (the "Product Subledger"), which ties--and can be traced--to the relevant back up and feeds into the GAAP general ledger system for the entire company.

Enforcement of audit rights:

Current usage does not provide for any effective means of enforcing audit rights. If the studio denies access to records, the participant can sue for breach of contract, but in order for such a lawsuit to be worth filing, it must allege and prove that the denial of access to records caused actual and recoverable damages, i.e., that the audit "would have" turned up money due. Thus, the artist is in a "Catch 22" situation. The denial of access makes it speculative whether money is actually due, even though the denial of access, by itself, is a breach of contract. In practice, the studios tend to be very arrogant, acting on the assumption that the artist will not sue based solely on a denial of access to records.

The Audit Clause attempts to correct this problem by providing for

automatic enforcement. The auditor is expressly permitted to dispute any aspect of the participation statement based solely on non-compliance with the Audit Clause. Expenses may be rejected solely on the grounds that they are not documented. If the studio improperly denies access to revenue records, the Artist's Auditor may dispute the revenue disclosures on the statement, and/or use "any reasonable alternate means to estimate revenue."

Additionally, if the Audit Clause is materially breached, the studio is liable for any attorney and accounting fees incurred to enforce it. Audit rights are also made enforceable through an action for specific performance. Although there is no way to guarantee that malfeasance by the studio will always be discovered, through full access to records and the means of enforcing such access rights, the artist will at least have the opportunity to perform a first-rate forensic analysis.

APPENDIX

"Sills & Adelman Audit Clause"

_____ is referred to herein as "Artist."

_____ is referred to herein as "Studio."

_____ is referred to herein as "Picture."

PRODUCTION ACCOUNTING

a. Disclosure of production expenses during production:

Production expense information shall be made available to Artist during the production process, without the necessity of a formal audit. Production expense records shall be maintained as follows:

(i) Weekly Production Expense Listing: Studio shall issue weekly, itemized listings of production expenses covering all expenses incurred the prior week (herein "Weekly Production Expense Listing"). Studio shall maintain a compilation of all Weekly Production Expense Listings from the inception of production until the last expense is incurred, and make the same available for inspection by Artist and/or Artist's representative in the production office and at the principal office of Studio. The Weekly Production Expense Listing shall be organized in the same categories that were used in the pre-production budget. Each expense listed in the Weekly Production Expense Listing shall

include the date incurred, the amount, the purpose, the identity of the recipient of the funds, the check number (if paid by check), and all identifying information needed to locate and review the "back up" documentation for that expense.

(ii) Weekly Production Expense Summary: Studio shall issue a weekly compilation of production expenses incurred to date (the "Weekly Expense Summary"). The Weekly Expense Summary shall be organized in the same categories that were used in the pre-production budget and the Weekly Production Expense Listing.

(iii) Artist's right to access to production expense documentation during the production process: Studio shall make the Weekly Expense Listings and the Weekly Summaries available to Artist and/or Artist's Auditor, at the production office, during normal business hours, within 14 days of the completion of each business week. At the request of Artist or Artist's Auditor, Studio shall provide copies of the Weekly Expense Listings and Weekly Summaries. At the request of Artist and/or Artist's Auditor, Studio shall make available "back up" documentation and information for any particular items in the Weekly Expense Listings. Studio shall promptly respond to all reasonable requests by Artist and/or Artist's representative for an explanation of any expenses charged to the production.

b. Negative Cost Statement: Within 90 days after creation of a timed answer print of the completed Picture ("Answer Print Delivery Date"), Studio shall provide Artist with a final summary of production cost by category ("Negative Cost Statement"), using the same categories used in the original budget, the Weekly Production Expense Listing and Weekly Production Expense Summary. The Negative Cost Statement shall state the amount included in the original budget for each category, shall identify and state the amount of any approved overages in each budget category, and shall identify and state the amount of any unapproved overages in each budget category.

c. Artist's right to access to production expense documentation after issuance of the Negative Cost Statement: After issuance of the Negative Cost Statement, upon request by the Artist and/or Artist's Auditor, Studio shall provide a copy of the Weekly Expense Listings and the Weekly Summaries to Artist. At the request of Artist and/or Artist's Auditor, Studio shall promptly make available "back up" documentation for all items in the Weekly Expense Listings. Studio shall promptly respond to all reasonable requests by Artist and/or Artist's representative for an explanation of any expenses charged to the production, within a reasonable time.

d. Production Expense Subledger: Studio shall maintain, as an integrated part of its general ledger system, a Production Expense Subledger, maintained in accordance with Generally Accepted Accounting Principles ("GAAP"), identifying and itemizing all production expenses and providing categorical subtotals organized in the same categories used in the pre-production budget, Weekly Production Expense Listings and Weekly Production Expense Summaries. Each expense listed in the Production Expense Subledger shall include the date incurred, the date paid, the amount, purpose, classification, identity of the recipient of the funds, the check number and identification of the checking account (if paid by check), and all identifying information needed to locate and review the "back up" documentation for that expense. All charges for use of Studio's facilities and/or personnel shall be clearly identified. All charges incurred to an entity affiliated with Studio shall be clearly identified. All adjusting journal entries shall include an explanatory note and include all identifying information needed to locate and review the "back up" documentation for that adjusting journal entry. Where expenses are incurred that are allocated to more than one picture, the subledger shall identify those expenses and provide identifying information sufficient to enable Artist to locate and review the "back up" documentation for said expense and the basis for the allocation thereof. Upon request by Artist and/or Artist's Auditor, Studio shall make the Production Expense Subledger available to Artist's Auditor on computer disc and/or on paper, at the Artist's election.

____ Studio shall supply Artist's Auditor with any and all software needed to read and analyze the computer disc version of the Subledger on a personal computer.

____ The Subledger shall be supplied to Artist's Auditor as a Lotus 1-2-3 file.

e. Studio Facility Charge Subledger: Studio shall maintain a Studio Facility Charge Subledger, as part of its general ledger, maintained pursuant to GAAP, identifying the amounts charged to all productions, for all fiscal years in which the Picture incurs any charges for use of studio facilities. The Studio Facility Charge Subledger shall identify all productions which used the studio facility, state the amounts charged, the dates when the facilities were used, identify the facilities and services provided, and contain sufficient identifying information to allow Artist's Auditor to locate and review "back up" documentation for such charges. Studio shall maintain a library of historic "rate sheets" showing its standard charges for such facilities, property, material, and personnel for not less than five years prior to commencement of principal photography on the Picture. The Studio Facility Charge Subledger shall clearly record all rebates, discounts, or other variances from the "rate

sheet" granted to any person or entity during said time period. Upon request by Artist and/or Artist's Auditor, Studio shall make the Studio Facility Charge Subledger available to Artist's Auditor on computer disc and/or on paper, at the Artist's election.

___ Studio shall supply Artist's Auditor with any and all software needed to read and analyze the computer disc version of the Subledger on a personal computer.

___ The Subledger shall be supplied to Artist's Auditor as a Lotus 1-2-3 file.

f. Participation Statements: Within 90 days after the period ending six months after the First Exploitation of the Picture, Studio shall issue a Participation Statement to Artist, stating the total revenue received and total expenses charged to the Picture, and the amount due Artist. Thereafter, Participation Statements shall be issued on a quarterly basis, for a period of ___ years; on a semi-annual basis for a period of ___ years; and on an annual basis thereafter, for not less than ___ years, unless waived by Artist in writing. In the event Picture reaches break even, Studio shall issue annual Participation Statements for not less than ___ years after the last statement in which an amount due to Artist (or Artist's successors or assigns) is stated, unless waived by Artist in writing. The obligation to issue Participation Statements shall be reinstated for a period of ___ years if at any time thereafter, money becomes due to Artist after the foregoing obligation to issue statements expires. The Participation Statement shall advise Artist of (a) the availability of the Product Subledger provided for hereinbelow, and (b) the name, address, and phone number of all other persons, including representatives of those persons, receiving Participation Statements related to the Picture. The Participation Statements shall include financial information totalled from inception, as well as current period information, and shall use the same categories and subcategories as the Product Subledger.

(i) Disclosure of revenue: Each Participation Statement shall disclose the total amounts due and received from exploitation of the Picture in theatrical, non-theatrical, cable, pay-per-view, video device, "free television," direct satellite broadcast, merchandising, soundtrack, publishing, and all other markets now known or hereinafter invented. Each Participation Statement shall provide a territorial break-down, showing the amounts received from exploitation of the picture in each of the foregoing categories, in the United States, Canada, Germany, France, Great Britain, Eire, Italy, Japan, Mexico, South Africa, Brazil, Norway, Sweden, Denmark, Switzerland, and Belgium. All figures in the Participation Statement shall be readily traceable to the identical categorical, subcategorical and territorial figures in the Product

Subledger.

(ii) Disclosure of expenses: The Participation Statement shall include categorical listings, showing the amounts charged to the Picture for prints, advertising, promotion, taxes, shipping, residuals, re-editing, distribution fees, subdistribution fees, and miscellaneous expenses, shown for the most recent period and a total since inception. Each Participation Statement shall provide a territorial break-down, showing the amounts charged against the picture in each such category that were incurred in the United States, Canada, Germany, France, Great Britain and Eire, Italy, Japan, Mexico, South Africa, Brazil, Norway, Sweden, Denmark, Switzerland, and Belgium. All figures in the Participation Statement shall be readily traceable to the same categorical, subcategorical and territorial figures in the Product Subledger.

g. Product Subledger: Studio shall maintain a Product Subledger for the Picture, which shall be an integrated part of the general ledger for Studio, maintained pursuant to GAAP. A "run dated" copy of the Product Subledger that corresponds to each Participation Statement shall be maintained on "hard copy" (paper or microfiche) and as a computer file. The Product Subledger shall tie directly to the summary, categorical, subcategorical and territorial information on the Participation Statements, and shall include a detailed itemization of all transactions affecting the Picture, both foreign and domestic. Upon request by Artist and/or Artist's Auditor, Studio shall make the Product Subledger available to Artist's Auditor on computer disc and/or on paper, at the Artist's election.

___ Studio shall supply Artist's Auditor with any and all software needed to read and analyze the computer disc version of the Product Subledger on a personal computer.

___ The Product Subledger shall be supplied to Artist's Auditor as a Lotus 1-2-3 file.

(i) Product subledger expense listings: All distribution expenses shall be posted directly into Studio's general ledger system, in accordance with Generally Accepted Accounting Principles ("GAAP"), and shall appear on the Product Subledger as items contained within categorical, subcategorical and territorial totals which correspond to the same categories and territorial break downs listed on the Participation Statements. Each expense listed in the Product Subledger shall include the date incurred, the date paid, the amount, the purpose, the identity of the recipient of the funds, the territory where it was incurred, the check number and identification of the checking account (if paid by check), and all identifying information needed to locate and review

the "back up" documentation for that expense. All charges for use of Studio's facilities and/or personnel shall be clearly identified, and shall be traceable to "back up" documentation. All transactions with entities affiliated with Studio shall be clearly identified. All adjusting journal entries shall include an explanatory note, and include all identifying information needed to locate and review the "back up" documentation for that adjusting journal entry. Where expenses are incurred that are allocated between more than one picture, the subledger shall identify those expenses, and shall contain all identifying information needed to readily locate and review the "back up" documentation for the expense and the basis for allocation thereof.

(ii) Artist's right to access to distribution expense documentation: Upon request by the Artist and/or Artist's Auditor, Studio shall provide, in Los Angeles, California, complete "back up" documentation for all expenses incurred in the United States and Canada and charged to the Picture. Upon request by Artist and/or Artist's Auditor, Studio shall provide, in Los Angeles, California, complete "back up" documentation for all expenses charged to the Picture which were incurred in Germany, France, Great Britain and Eire, Italy, Japan, Mexico, South Africa, Brazil, Norway, Sweden, Denmark, Switzerland, and Belgium. Upon request by Artist and/or Artist's Auditor, Studio shall provide complete "back up" documentation for all expenses charged to the Picture in any other two foreign territories chosen by Artist and/or Artist's Auditor. (Said territories shall be referred to herein, collectively, as the "Audited Foreign Territories.") If Artist demonstrates an overcharge for expenses in the Audited Foreign Territories ("Overcharge Ratio"), in addition to making a claim for such overcharges, Artist may extrapolate and apply said Overcharge Ratio to all other foreign territories.

(iii) Chronological revenue itemization: The Product Subledger shall contain a detailed, chronological itemization of revenue derived from the Picture, broken down by territory and by exploitation category (theatrical, non-theatrical, cable, pay-per-view, video device, "free television," direct satellite broadcast, merchandising, soundtrack, and other sources). Each item shall include the identity of the revenue source, the date of the contract or license, the amount received, the exploitation category, the date accrued, the date of receipt of the funds, and sufficient identifying information as to allow Artist's Auditor to locate and review any and all "back up" documentation, including the "accounting file" and equivalent records for that licensee, the instruments of payment, the relevant entries in the cash receipts journals of the company, all contract documentation pertaining to the relationship between Studio and each licensee, and any transmittal letters, correspondence, statements or reports.

(iv) Licensee revenue itemization: The Product Subledger shall contain an alphabetical listing of all licensees of the Picture, broken down by territory, with a current total of the amount due from each source, the amount received from that source, and a detailed, chronological listing of each payment received from each source, including the date of receipt of each payment. Studio shall maintain an "accounting file" on each licensee, including the documentation customarily maintained in such files, such as contracts, correspondence, payment documentation, statements, and audit reports, covering the entire business relationship with that licensee.

(v) Artist's right to access to revenue records: Upon request by the Artist and/or Artist's representative, Studio shall provide, in Los Angeles, California, complete "back up" documentation for all revenue received in the United States and Canada, including all pertinent corporate books, journals, ledgers and licensee "accounting files." Upon request by Artist and/or Artist's Auditor, Studio shall provide, in Los Angeles, California, complete bookkeeping and "back up" documentation for all revenue received from exploitation of the Picture in Germany, France, Great Britain and Eire, Italy, Japan, Mexico, South Africa, Brazil, Norway, Sweden, Denmark, Switzerland, and Belgium, including all corporate books, journals, and ledgers and licensee accounting files. Upon request by Artist and/or Artist's Auditor, Studio shall provide complete bookkeeping and "back up" documentation for all revenue received from the Picture in any other two (2) foreign territories of Artist's choosing. If Artist demonstrates that revenue was underreported in the Audited Foreign Territories ("Foreign Underreporting Ratio"), in addition to making a claim for such underreporting, Artist may extrapolate such Foreign Underreporting Ratio to all other foreign territories.

(v) Revenue Allocation Subledger: Studio shall create, as part of its general ledger system maintained pursuant to GAAP, a detailed Revenue Allocation Subledger, organized alphabetically by revenue source, showing a complete history of payments from each licensee of the Picture, and the allocation of all amounts received from each such source. The Revenue Allocation Subledger shall include a breakdown of accrued and received revenue, including analysis of (a) all contracts with each licensee which are operative as of the date of commencement of principal photography of the Picture; (b) all contracts with each licensee which are operative at any time after commencement of principal photography of the Picture; and (c) all "output," "requirements," "side deal" or equivalent contracts with each licensee, operative at any time within five years before commencement of principal photography of the Picture to the date of the Subledger. Upon request by Artist and/or Artist's Auditor, Studio shall make the Revenue Allocation

Subledger available to Artist's Auditor on computer disc and/or on paper, at the Artist's election.

___ Studio shall supply Artist's Auditor with any and all software needed to read and analyze the computer disc version of the Subledger on a personal computer.

___ The Subledger shall be supplied to Artist's Auditor as a Lotus 1-2-3 file.

h. Access to corporate records: Artist's Auditor shall have access to any and all general corporate books and records of the Studio, to the extent reasonably necessary to determine whether revenue and expenses are being properly reported to Artist.

i. Incontestability: Notwithstanding any other provision to the contrary in this contract, nothing on the Participation Statements shall become incontestable until four years after issuance of the first Participation Statement and Product Subledger or two years after Studio issues a Participation Statement which declares a break even for the benefit of Artist.

j. Audit rights: Notwithstanding any other provision to the contrary in this contract, Artist shall have the right to audit Studio at any reasonable time, and use the services of any Certified Public Accountant as Artist's Auditor. Artist's Auditor may render opinions to Artist, on a confidential basis, concerning compliance or non-compliance with any aspect of this contract, including compliance with custom and practice, usage of trade, and the covenant of good faith and fair dealing. Studio shall place no restrictions on the opinions to be rendered by Artist's Auditor.

k. Self-dealing: Studio shall identify and disclose all self-dealing transactions on the Subledgers described hereinabove. A self-dealing transaction is one involving Studio and any subsidiary, parent, sibling, or affiliated person or entity.

l. Interest calculations: Studio shall calculate interest on production cost during the period prior to the Answer Print Delivery Date by using a mid-point calculation, with the date of commencement of principal photography as the beginning date and the Answer Print Delivery Date as the ending date. Studio shall calculate interest on production cost thereafter by using a mid-point calculation for revenue and expenses for each Participation Statement period. Upon request by Artist's Auditor, work papers shall be provided for each interest calculation on paper or on computer disc, at the election of Artist's Auditor.

m. Enforcement: In the event Studio shall deny access to records as required by this contract, Artist may seek specific enforcement hereof in any Court of competent jurisdiction or (at Artist's election) through an arbitration for specific performance filed under the Rules of the American Arbitration Association in Los Angeles, California. If the arbitrator finds that Studio has materially breached its obligations hereunder, and orders specific performance, and Studio thereafter remains in material breach of this Audit Clause, then Artist may reject all undocumented or insufficiently documented expenses and use any reasonable alternate means to estimate underreporting of income, and such rejection, and estimate, shall be binding on Studio in said arbitration or litigation. In the event an arbitration or lawsuit is filed hereunder, the prevailing party shall be liable for attorney fees and costs. In the event that an award is made to Artist, Studio shall be liable for accounting fees incurred in connection with such audit, arbitration and/or lawsuit.

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