

# GOVERNMENT'S FINANCIAL SUPPORT TO FILM INDUSTRY

## Executive Summary

1. The film industry is a flagship of the creative industries in Hong Kong. It is the Government's objective to provide a favourable environment conducive to the long-term and healthy development of the film industry. The Government provides financial support to the film industry through:

- (a) the Film Development Fund (FDF);
- (b) the Film Guarantee Fund (FGF); and
- (c) funding for the Hong Kong International Film Festival (HKIFF) Society.

The Film Services Office (FSO) of Create Hong Kong is responsible for administering the financial support. The Audit Commission (Audit) has recently conducted a review of such support.

## Strategic review

2. *Strategic review of FDF.* The FDF funds film-production projects and film-related projects to help develop the film industry. As at July 2007, the FDF had an approved funding of \$320 million. The FDF has since financed 22 film-production projects and 79 film-related projects. The FDF incurred expenditure of roughly \$38 million per year, and would be depleted by mid-2015. As the Government considers its next step, it is opportune to conduct a review of the future funding strategy and direction of the FDF and take into consideration the following observations:

- (a) *Use of FDF funds.* The FDF has a primary objective of financing film productions. However, from April 2005 to June 2012, \$148.2 million (72%) was spent on film-related projects while only \$58.1 million (28%) was on film-production projects. The Government needs to review the

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appropriateness of the funding distribution between the two types of projects;

- (b) ***Funding of film events.*** Four film events were annually funded by the FDF. They rely largely on FDF funding. From January 2008 to June 2012, FDF funding for these four film events amounted to \$88.8 million, which was 49% of total funding of \$180.4 million spent on film-related and film-production projects by the FDF. The significant amount of funds provided for these four film events reduced the FDF funds available for other film activities. The Government needs to review the extent to which these four film events should continue to be funded by the FDF and motivate the organisers to expand their sources of funding and income; and
  - (c) ***Review of the current mode of financing film-production projects.*** Audit noted that in 10 films financed by the FDF and theatrically released before 2012, the Government could not recover part or all of its contributions, with very low recovery for some of the films. The overall recovery rate was 44.2%. Audit recognises the high investment risk that may be faced by the Government for financing film production. However, because public funds are involved, the Government needs to evaluate the acceptability of the low overall recovery rate, review the current mode of financing film-production projects, and assess the effectiveness of the safeguards in ensuring their commercial viability.
3. ***Strategic review of FGF.*** The FGF was established in 2003 to provide guarantee to local film production companies for obtaining loans from lending institutions for financing film production. It received and approved 12 applications between April 2003 and June 2007. However, since the FDF (see para. 2 above) started to finance film production in July 2007, up to July 2012, the FGF had received no applications. It is unlikely that the FGF will attract many applications as long as funding is available from the FDF, as the terms and conditions of the FDF are more favourable. The Government needs to review whether the FGF meets the needs of the film industry.
4. ***Strategic review of provision of funding for HKIFF Society.*** Create Hong Kong provides annual funding of some \$11 million to the Society for organising mainly the HKIFF. The Society also receives funding under the FDF for organising the Asian Film Awards and the Hong Kong-Asia Film Financing Forum. Given the different sources of funding, the FSO needs to review the funding arrangement for the Society.

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### Administration of FDF film-production projects

5. *Securing third-party financing.* To substantiate the commercial viability of a proposed film, the applicant has to secure financing from a third-party. Audit examination of 15 applications revealed that in 6 applications, the applicant was the third-party financier and in 5 applications, a related company of the applicant was the financier. As such, the objective of having a third party evaluate and affirm the commercial viability of a proposed film might have been compromised.

6. *Film promotion and distribution expenses.* Sales agents and distributors (SA&Ds) are engaged for film promotion and distribution. Their expenses and commissions are payable from the revenue of the film. The FSO has imposed caps on SA&D expenses and commissions. If the caps are likely to be exceeded, film production companies have to seek prior endorsement from the Film Development Council and the Film Vetting Committee. Audit examination revealed that in 3 of the 5 cases examined, the caps were exceeded but prior endorsements were not obtained.

7. *Collection of film revenues.* A collection agent is appointed to manage the revenue collection under a collection account management agreement. The agent needs to issue to the FSO and the third-party financier collection statements on a regular basis. The FSO and the third-party financier will check the statements and give approval to the agent to distribute the net film revenue to them. Audit noted that in 2 of the 5 films examined, the collection agents did not issue collection statements to the FSO on a regular basis, and they had distributed net film revenues without obtaining prior approvals of the FSO.

### Income of FDF film-related projects

8. The organiser of a FDF film-related project has to include a budget in its application form, comprising all anticipated project expenditure, all anticipated project incomes and FDF funding required to meet the project deficit. For three film events held in 2009 to 2011, Audit found that: (a) no anticipated project incomes were stated in the application forms; and (b) for one film event, project

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incomes were also not reported in the project completion reports and the audited accounts. The FSO contacted the organisers of these projects in June 2012 and was informed that these projects had received incomes of \$13.4 million in total for the three years.

### Audit recommendations

9. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Head of Create Hong Kong should:**

#### *Strategic review*

- (a) **conduct a strategic review of the use of FDF funds to support the film industry in future, taking into consideration Audit's observations on the FDF;**
- (b) **critically examine whether the FGF meets the needs of the film industry and whether all or part of the FGF's commitment can be deployed to other uses (e.g. transferring to the FDF);**
- (c) **review the funding arrangement for the HKIFF Society;**

#### *Administration of FDF film-production projects*

- (d) **critically review the existing practice of using the applicant's ability to secure third-party financing as a measure of the commercial viability of a film;**
- (e) **take measures to ensure that film production companies always seek prior endorsements in cases where the caps on SA&D expenses and commissions are likely to be exceeded;**
- (f) **take adequate and prompt actions to follow up with the collection agents on all irregularities found (e.g. failure in issuing collection statements, and distribution of film revenues without the FSO's approvals);**

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### *Income of FDF film-related projects*

- (g) ensure that project organisers provide details of anticipated project incomes in their applications, and include actual project incomes in their project completion reports and audited accounts; and
- (h) follow up with project organisers after the completion of their projects to ascertain the actual project incomes and determine whether there are any surpluses that need to be refunded to the Government.

### **Response from the Administration**

10. The Head of Create Hong Kong agrees with the audit recommendations. He has said that Create Hong Kong will conduct, among others, a review of the usage of the FDF.