# LOSING LIKE FORREST GUMP: WINNERS AND LOSERS IN THE FILM INDUSTRY

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## ABSTRACT

*There are a number of high-profile cases where films that by most standards of revenue minus cost are very successful, but are reported as providing net losses to the studios. Most of the public attention on these cases arises from lawsuits brought by participants who contracted to receive payment based on a percentage of the profit of the film.*

*This paper highlights some of the unique costing practices in the film industry and examines several of these well-known "losers" in light of the difference between the gross receipts of the film and the direct costs of production. It provides some insight into the difference between what would be considered a rational indirect cost allocation basis for other industries and the apparently erratic allocation process used in film.*

*The analysis includes an examination of the relationship between the gross receipts and the production costs of films in a number of categories that might be considered measures of success in the film industry.*

## INTRODUCTION

In 1999, entertainment accounts for less than one percent of the gross national product of the United States (Berton & Harris, 1999). Despite its small percentage, the film industry gains much attention in the nineties because of its finances (Cheatham, Cheatham, & Davis, 1996). Buzzwords like "creative accounting" are used, and some accountants assert, "The accounting department is the most creative part of Tinseltown" (Cheatham et al., 1996, p. 1). Several major disputes aid in bringing the film industry's accounting practices into the limelight.

In the 1990 court case *Art Buchwald v. Paramount Pictures Corporation*, the court rules in Buchwald's favor *Coming to America*, it makes sense that he should receive the compensation set forth in his original contract with Paramount Pictures Corporation. In addition to a fixed fee, Buchwald's original contract awards him a share of the net profits of the film. The film is a box office success. However, according to Paramount, it lost $18 million. The author of the novel *Forrest Gum* contracts to receive $350,000 and 3% of the net profits of the film for the rights to his book. When Groom tries to collect his 3%, he learns that Paramount is reporting a loss on the film. *Forrest Gump* earns millions at the box office in 1994, yet Paramount reports its profitability in the red. Also fueling the controversy is the fact that director Robert Zemeckis and actor Tom Hanks receives a percentage of the films fees, but they are awarded their money based on gross box office receipts instead of net profits (Pfeiffer, Capettini, & Whittenburg, 1997). Other popular films report losses too. *Batman* shows a $20 million loss, and net profit participants sue Warner Brothers. Net profit participants of the movie *JFK* go to court after no net profits are reported for the film. (Goldberg, 1997). *Rain Man, Dick Tracy, Ghostbusters, Alien, On Golden Pond, Fatal Attraction* are all films grossing over $100 million in the 1990's for which no net profits were reported (Pheiffer, Capettini, & Whittenburg, 1997).

The intriguing conflict surrounding the motion picture industry in the 1990's understandably brings attention to the accounting methods and practices of Hollywood. Accountants uncover costing methods specific to the film industry, and changes are made in recent years to in an attempt to rectify any wrongdoing. Beyond the actual costing methods, however, are the numbers themselves. After a discussion of the unique accounting methods of the film industry, data is provided to illustrate some relationships that exist between financial figures of films. Specifically, the study examines the relationship between profitability as measured as the difference between the budget of the film and the gross receipts of the film and the success of films as measured by gross receipts.

Studios offer gross profits to certain participants for several reasons. First, many actors require this kind of contract, and studios realize that actors draw audiences to movie theaters. Also, if an actor or director knows that his or her compensation is linked to the gross profitability of a film, he or she may be more likely to promote the film and go the extra mile to ensure its success at the box office (Goldberg, 1997). Goldberg (1997) asserts that when gross profit participants become involved in films, net profits are likely to disappear. He cites examples like the 1993 movie *Indecent Proposal*, which reports a loss of $35 million after paying its five gross profit participants. Star Robert Redford reportedly receives over $20 million. Others cite similar examples like *Hook*, in which 40% of the film's gross profits were given to Julia Roberts, Dustin Hoffman, Robin Williams, and Steven Spielberg (Pfeiffer, Capettini, & Whittenburg, 1997). According to Goldberg (1997), *Indecent Proposal* and *Hook* are naturally doomed for net profit failure because of their large number of gross profit participants. Lesser talent and participants often do not receive gross profit rights.

In the nineties, the film industry is surrounded by major public concern and controversy relating to its accounting methods and practices. The financial accounting and reporting regulations for the film industry are originally established and governed by the Statement of Financial Accounting Standards Number 53. In June 2000, the findings from the investigation prompted the Financial Accounting Standards Board to issue the Statement of Financial Accounting Standards Number 139. This new standard rescinds the Statement of Financial Accounting Standards Number 53 and amends three other regulatory statements. The findings recognize that, first, the film industry is continuously undergoing many relevant changes that affect their financial position and financial reporting; particularly regarding revenue recognition as an increase in film revenue through ancillary forms and international markets is apparent; second, film studios apply the Statement of Financial Accounting Standards Statement 53 differently; and third, the accuracy of the film industry's financial statements are questionable (Financial Accounting Standard Board, 2000).

In August 2000, the American Institute of Certified Public Accountants (AICPA) issues a news release titled "AICPA Issues New Rules for Film Industry" that states three major changes in accounting for the film industry. These include advertising expenses, film amortization, and abandoned projects. According to Berton and Harris (1999), advertising costs are now to be amortized against revenues for the appropriate market rather than against revenues for a specific film. Film amortization is to be based on ten years rather than the twenty-year standard previously used by most film studios. Finally, abandoned projects cannot be written off to the overhead pool as commonly done before.

The production budget for films includes all the classifications of costs accountants would generally associate with direct costs of a film. Gross receipts is a relatively concrete number analogous to what would be considered revenues in accounting for most products, not amenable to easy "management." The controversy may be simplified to a question of what indirect costs should be assigned directly to films and what costs should be borne by the studio. Since major participants in the success of a film are paid on gross receipts it seems that the less powerful providers of contract services for the film industry are forced to bear a disproportionate burden of paying indirect costs.

In general GAAP requires that indirect costs be assigned in rational and consistent manner (Horngren, Foster & Datar, p. 486). In most products this rational and consistent manner would be based on some measure of the cost of the direct inputs.

In spite of the film industry's unique costing methods, an examination of the relationships between profitability and the success of films as measured by gross receipts and production costs offers interesting insight into whether or not some of these films that have been the center of controversy would have been considered profitable products using costing methods appropriate to most products.

## ANALYSIS

This study identifies successful films in two distinct ways. First, the top grossing films of each major film studio are studied (*Box Office Report*, 2004).then Academy Award-winning films for Best Picture are considered. (*Academy Awards Database*, 2004). Information on the gross revenues (*ShowBIZ Data*, 2004) and costs )*Internet Movie Database*, 2004) are compared.

Table 1 : Box Office and Budget Information for Top Films in Dollars

| Film | U.S. Gross | Foreign Gross | Budget | Gross/Budget |
|---|---|---|---|---|
| The Lion King | 310,785,532 | 545,000,000 | 79,300,000 | 6.65 |
| Shrek | 267,652,016 | 155,808,898 | 60,000,000 | 7.06 |
| Star Wars | 460,195,523 | 319,100,000 | 11,000,000 | 70.84 |
| Gone with the Wind | 198,933,802 | N/A | 3,900,000 | |
| Titanic | 600,787,052 | 1,234,600,000 | 200,000,000 | 9.17 |
| Spider-Man | 403,706,375 | 380,900,000 | 139,000,000 | 5.64 |
| E.T. | 399,804,539 | 305,000,000 | 10,500,000 | 67.12 |
| The Two Towers | 340,478,898 | 577,400,000 | 139,000,000 | 6.6 |

Note: Data from ShowBIZ Data and Internet Movie Database

*Titanic*, the top grossing film for all major film studios, is budgeted more money than any of the other films, perhaps suggesting the belief that budget can ensure large box office sales. However, this does not seem to be the case. While *Titanic*'s return ratio is high, there are others significantly higher. The high ratios have another partial explanation; these films and *Gone with the Wind* are all re-released. The box office figures for *Star Wars*, *Gone with the Wind*, and *E.T.* actually represent two theatrical runs.

Table 2: Box Office and Budget Information for Academy Award Best Picture Winners

| Film | Worldwide Gross | Budget | Gross/Budget |
|---|---|---|---|
| Return of the King (2003) | 778,174,794 | 94,000,000 | 8.28 |
| Chicago (2002) | 306,664,505 | 45,000,000 | 3 |
| A Beautiful Mind (2001) | 295,256,996 | 60,000,000 | 4.92 |
| Gladiator (2000) | 454,364,866 | 103,000,000 | 4.41 |
| American Beauty (1999) | 336,104,047 | 15,000,000 | 22.41 |
| Shakespeare in Love (1998) | 252,241,322 | 25,000,000 | 10.09 |
| Titanic (1997) | 1,835,387,052 | 200,000,000 | 9.18 |
| The English Patient (1996) | 230,351,430 | 27,000,000 | 8.54 |
| Braveheart (1995) | 202,604,871 | 72,000,000 | 2.81 |
| Forrest Gump (1994) | 629,699,757 | 55,000,000 | 11.45 |

Note: Data from ShowBIZ Data and Internet Movie Database

Based on Table 2, it appears films that win Academy Awards do well at the box office and have higher ratios of box office receipts to budgets. To further analyze this relationship between profitability and success as determined by Academy Award wins, data is analyzed on the four most recent Oscar Best Picture winners compared to their opponents for the award.

The findings offer three very significant insights into the film industry and the relationship between profitability and the success of films. First, a studio cannot guarantee box office success of a film by allocating a large budget to it. Although a substantial budget may lead to large profits as in the case of the 1997 film *Titanic*, other studies show that is not always the case. Second, one way to increase profits is to re-release films. Last, some film studios may view success beyond profits, in qualitative ways such as winning the Best Picture Academy Award. If that is the case, film studios should focus on box office receipts since they seem to indicate winners.

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