



Department of Development

Film Tax Credit Program Audit

Audit Period: February 1, 2011 through June 10, 2011



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Executive Summary

Background

The Ohio Motion Picture Tax Credit was created within the Department of Development (DEV) in 2009 to encourage and develop a strong film industry in Ohio. The program provides a refundable, non-transferable tax credit to be taken against a business' corporate franchise tax or an individual's Ohio personal income tax obligations. The credit is based on eligible production expenditures (EPE's) in Ohio, as defined by Ohio Revised Code §122.85 (A)(4). Through information provided by the department, DEV had approved tax credits up to \$9.9 million dollars in fiscal year 2010 and approximately \$19 million dollars in fiscal year 2011. In return, the State stands to benefit through planned investments of approximately \$100 million in Ohio's infrastructure for the 25 projects approved since the inception of the program. Additionally, per initial documentation submitted, these approved tax credit eligible projects are expected to create 12,690 jobs in Ohio.

During the audit, OIA identified opportunities for DEV to strengthen internal controls and improve business operations. A summary, along with detailed observations, have been provided. OIA would like to thank DEV staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.



Scope and Objectives

OIA staff was engaged to perform assurance work related to the Ohio Motion Picture Tax Credit Program. This work was completed between February 1, 2011 and June 10, 2011. The scope of this audit included the following areas:

- Communication process
- Program application process
- Program awarding/approval process
- Program monitoring process
- Tax certificate issuance process
- External reporting process

The following summarizes the objectives of the review along with a conclusion on the effectiveness of management's internal controls.

Objective	Conclusion ¹
Evaluate the design and adequacy of communication related to program requirements to recipients.	Well Controlled
Evaluate the design and adequacy of the application process for the program.	Improvements Needed – see Observation 3 and 5
Evaluate the design and effectiveness of controls over the awarding/approval process.	Major Improvements Needed – see Observation 2 and 3
Evaluate the design and effectiveness of controls over the program monitoring process.	Improvements Needed – see Observation 3 and 4
Evaluate the design and effectiveness of controls over the issuance of the tax credit certificate.	Major Improvements Needed – see Observation 1 and 3
Evaluate the design and adequacy of the tax incentive reporting.	Well Controlled with Improvements Needed

¹ Refer to [Appendix A](#) for classification of audit objective conclusions.



Summary of Observations

The Summary of Observations includes only those risks which were deemed high or moderate. Low risk observations were discussed with individual agency management and are not part of this report. However, the low risk observations were considered as part of the audit objective conclusions on the previous page.

No.	Observation	Risk ²
1.	Ineffective Monitoring of Production Expenditures – Management has not defined a required report format and CPA reports received have little consistency in the level of detail included. Management does not have a formal process in place to review and validate the CPA reports in order to gain timely and reasonable assurance of the accuracy of the amounts reported. The Film Office is currently working with the Department of Taxation (Taxation) to develop a process to review the CPA reports for reasonableness prior to a tax credit certificate being issued; however, this is still under development.	High
2.	Timely Receipt of Application Fees – There is not a procedure in place to reconcile the application fees received to ensure they were accurate and deposited in-tact. Additionally, it is not apparent if the application receipt date is being tracked to ensure the payment was received within the 45-day requirement. During sample testing of approved applications, multiple errors were identified regarding the timeliness of receipt for the application fees.	High
3.	Policies and Procedures – Within the Film Office, there is a lack of formal documented policies and procedures regarding the reviewing of application forms and determining tax credit eligibility; procedures completed by the Review Committee; sending of certification/rejection letters to applicants; receiving, processing, and reconciling the application fee deposits; reviewing of progress report forms; reviewing independent CPA reports; and sending of tax certificates to the applicants and Ohio Department of Taxation.	Moderate
4.	Implementation of the Program Monitoring Process – One year after the effective date of program rules established in April 2010, the Film Office has not developed or implemented a standard progress report format for the tax credit-eligible productions to submit. Additionally, nearly two years after the effective date in statute, there was no evidence management had enforced the progress report submission requirements, nor was there a formalized process to review progress reports.	Moderate



5.	Implementation of the Application Review Process – Nearly two years after the program was implemented, the Film Office has not formalized its application review process. Management is developing an application checklist tool to review applications for completeness and appropriateness. Additionally, there currently is no evidence of the decisions/recommendations made by the review committee.	Moderate
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Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

² Refer to [Appendix A](#) for classification of audit observations.



Detailed Observations and Recommendations

Observation 1 – Ineffective Monitoring of Production Expenditures

According to Ohio Administrative Code 122:21-1-04 (B), the required independent certified public accountant (CPA) report due to the department shall certify that the applicant's reported costs are eligible production expenditures as defined in Ohio Revised Code Section 122.85. Also, Ohio Administrative Code Section 122:21-1-04 (D) requires within sixty days of receipt of the CPA report, the Director shall review and provide a written notice to the applicant accepting the report or identifying deficiencies in the report. The Director is to identify any disallowance of expenditures claimed and provide the reason for such disallowance.

Management has not defined a required report format and CPA reports received have little consistency in the level of detail included. Management does not have a formal process in place to review and validate the CPA reports in order to gain timely and reasonable assurance of the accuracy of the amounts reported. Based on discussions with the program administrator, the Film Office is currently working with the Department of Taxation (Taxation) to develop a process for the CPA reports. However, this new process is still in the early stages and has not yet been implemented, and to date, there have not been any procedures put in to place to validate the eligible production expenditures certified by the CPA. During testing, it was noted that for one of three projects sampled which were awarded a Film Tax Credit certificate, the certificate was issued 120 days after the department had received the CPA report; for these same three projects, there was no documented evidence the CPA report and support had been reviewed prior to the tax credit issuance. Furthermore, two of these three projects were issued an incorrect tax credit amount due to mathematical errors in the estimated tax credit which was the maximum credit allowed if the project's actual eligible expenses exceeded the budgeted eligible expense. One project was awarded \$14,140 more than appropriate and another project was awarded \$7,166 less than appropriate, for a net effect of \$6,674 tax credits over awarded.

Without any type of validation procedures in place over the CPA report, the Film Office puts the program and the department at risk of issuing a tax credit to a production company for ineligible expenses or for an amount higher than allowed.

Recommendation

Management should establish a standard CPA report format which contains agreed-upon procedures for CPAs to address when completing the reports. The Film Office should also develop and implement validation procedures immediately to ensure reports are reviewed within 60 days and obtain reasonable assurance as to the accuracy of the CPA reports submitted.



Management Response

A standard CPA report format is in development for implementation. The format mimics the original submitted budget for our grantees and will contain agreed-upon audit procedures for CPAs to address when completing the reports. This format will be sent to the Department of Taxation and internal agency audit staff for review and feedback prior to being posted on the website. The new format of the CPA report will also be sent, in concert with the certificate copy, to the Department of Taxation. Additionally, the report along with the newly created FAQs, will allow productions to track Film-office specific expenditures early in the process. Film Office staff will review eligible production expenditures indicated in the CPA report by comparing the expenditures with the estimated production budgets indicated in the original application. Upon review of the CPA report's indicated eligible production expenditures, Film Office staff plans to issue a CPA report acceptance form packaged with a tax credit certificate within two weeks of receipt. In the case Film Office review identifies expenditure discrepancies, requests for follow-up information will be sent immediately.

Risk	Remediation Owner	Estimated Completion Date
High	Executive Director, Ohio Tax Credit Authority	July 2011



Observation 2 – Timely Receipt of Application Fees

Production companies have 45 days from the invoice date to submit the application fees to the Film Office. If an eligible production company does not submit payment timely, the department is required to rescind the application approval. Good business practices necessitate a timely review and reconciliation of revenues received and outstanding.

However, based on discussions with the program administrator, there is not a procedure in place to reconcile the application fees received to ensure they were accurate and deposited in-tact. Additionally, although the current program administrator records the receipt date when application fees are received, it is not apparent if it is being tracked to ensure the payment was received within the 45-day requirement. In a sample of fifteen applications tested, there were two instances where invoices were not created or sent to the applicant; one instance where application fees were collected two months before the applicant's application was approved for the tax credit; three instances where application fees were collected beyond the 45-day requirement (a total of 125 days overdue) and the applicant's application was not denied; and four instances where application fees were never collected even though the 45-day requirement had passed and the applicants' eligibility approvals were not rescinded.

Without tracking the timeliness of application fees received, the department could be allowing ineligible projects to continue.

Recommendation

A tracking schedule for application fees should be maintained to ensure compliance with program requirements. Account reconciliation for the Ohio Film Tax Credit should entail keeping good accounting records and carefully inspecting the general ledger reports for accuracy. At a minimum, management should perform monthly reconciliations of the Ohio Film Tax Credit transactions to ensure funds are recorded and allocated properly. Any errors noted as a result of the reconciliations should be addressed in a timely and proper manner.

Management Response

Since February of 2011, The Office Manager of the Ohio Tourism Division (where the Film Office currently resides since Jan. 2011) receives all checks from production companies. That information is logged on a spreadsheet and then the information is shared with the Film Office Coordinator. Moving forward a shared spreadsheet will be created and updates will automatically be forwarded to the Film Office coordinator for immediate reconciliation. This list will be double-checked at month's end to verify accuracy.

In addition, the Film Office Coordinator currently logs and maintains a schedule of application fees and due dates which is updated at least weekly. The Coordinator proactively contacts applicants who are nearing the deadline as a reminder. Moving forward, they will also be logged in the master status sheet and the project file will note most recent date of contact on the subject, so the information will be easier to access and verify from several points.



Risk	Remediation Owner	Estimated Completion Date
High	Film Office Coordinator	July 2011



Observation 3 – Policies and Procedures

Policies and procedures help ensure the actions initiated by management to address risks are achieved and the entity’s objectives are effectively carried out. In addition, detailed procedures help ensure tasks are performed consistently and comply with laws and regulations.

Within the Ohio Film Office, there is a lack of formal documented policies and procedures regarding the:

- reviewing of application forms and determining tax credit eligibility,
- procedures completed by the Review Committee,
- sending of certification/rejection letters to applicants,
- receiving, processing, and reconciling the application fee deposits,
- reviewing of progress report forms,
- reviewing independent CPA reports, and
- sending of tax certificates to the applicants and Ohio Department of Taxation.

There have been several staffing changes of management administering the Motion Picture Tax Credit program over the past two years. The current program administrator developed a program process flow depicting action steps when he took over the program in February 2011. However, there was no evidence of documented policies and procedures being in place since the program’s inception in July 2009. As a result, there has not been consistency in the administration of the program.

Recommendation

Management should continue its process of developing and documenting the policies and procedures over the key processes of the program. Such procedures should define the individual roles/titles, responsibilities, and detail the actions that should be taken at each stage in the process. Policies and procedures should be reviewed periodically by management and updated as needed.

Management Response

The current flowchart exists that contains procedural notes listed below will be maintained. In addition to the maintenance of the process flow-chart, management will implement step-by-step procedures to ensure more staff awareness and accountability in each procedural category. The step-by-step procedures will include task-owners, the ability to make ad hoc process improvements and procedural changes, and a consistent quarterly review of process flow and office procedures.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Film Office Coordinator	July 2011



Observation 4 – Implementation of the Program Monitoring Process

Ohio law requires motion picture companies to submit sufficient evidence of progress to the Ohio Film Office within ninety days after certification of a motion picture as a tax credit-eligible production. If the motion picture company fails to present sufficient evidence, the department has the option to deny the certification.

One year after the effective date of program rules established in April 2010, the Film Office has not developed or implemented a standard progress report format for the tax credit-eligible productions to submit for consistency. Additionally, nearly two years after the effective date of program being implemented in statute, there was not any evidence management had enforced the progress reports to be submitted, nor was there a formalized process to review progress reports. In May 2011, the program administrator finalized a standard progress report format and sent it to all certified grantees for completion. In a sample of 15 projects tested, five projects were identified where progress reports were received after the 90-day requirement and seven projects where progress reports were never received after the 90-day requirement.

As a result, obligated funding to tax credit-eligible productions that did not make sufficient progress could have prevented other potential projects from being approved because of budget restrictions.

Recommendation

Management should continue to implement and enforce the progress reporting as a way to monitor the activity of the project. If delays in the production are evident, management should have procedures in place to determine whether to work with or rescind the project's film tax-credit eligibility and award to another project.

Management Response

Film Office staff is currently sending, and has retroactively sent, 90-day progress report forms to be completed by all grantees to ensure grantees are fulfilling the requirement to report reviewable progress. The design of the progress report requires limited monitoring of such report. Staff will implement the follow-up and re-send of progress report forms to a grantee in the event said grantee's project is placed on hold or is not progressing at an optimal rate. Finally, Film Office staff will establish clear criteria that merits recession of a project that includes budgetary considerations.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Film Office Coordinator	July 2011



Observation 5 – Implementation of the Application Review Process

An effective application awarding/approval process includes a system for objectively evaluating every application received on a consistent set of criteria. Furthermore, the application awarding/approval process and system for evaluating applications should be documented.

The application awarding/approval process has the following design weaknesses:

- Nearly two years after the program was implemented, the Film Office has not formalized its application review process. As of May 2011, management finished developing an application checklist tool to review applications for completeness and appropriateness in accordance to the application instructions and program guidelines. Without a formal review process, there is a risk that applications are not consistently evaluated. During testing of fifteen approved applications, ten applications were identified where the budgeted eligible production expenditures listed were mathematically inaccurate and of those, nine instances where the estimated Tax Credit amount approved for a film project were mathematically inaccurate. Three instances were identified where the applicants were sent approval letters before the Director approved the submitted application. Additionally, two instances were noted where the applications were not properly signed and dated by the applicant acknowledging an understanding of the program rules.
- A review committee comprised of various officials within the department meets periodically to evaluate the tax credit applications received and determine whether projects should be approved. Currently there is no evidence of the decisions/recommendations made by the committee. Without documentation of the review committee's decisions/recommendations, the department may find it difficult to defend the committee's recommendations should it come into question. During testing of fifteen approved applications, there were three instances where there was not documentation showing whether the Tax Credit applications were either approved or denied.
- Applications entered into the Film Tax Credit database by the program administrator were not consistently dated upon receipt. In most instances, this occurred prior to January 2011. Although there is no required due dates associated with the receipt of the application, the Film Office has indicated it is a two-week turnaround goal for reviewing/processing applications. In a sample of four applications tested, three instances were identified where the application receipt date was not properly recorded. Inconsistent tracking for the application receipt dates can lead to untimely consideration of applications.

Recommendation

Management should develop and consistently apply procedures to track the receipt of applications through the subsequent stages of the awarding process in the Film Tax Credit database.



Furthermore, management should finalize and place into operation the application checklist and related review process for all applications received.

Finally, management should formalize the review committee process with documented evidence of the committee's actions and recommendations made during each meeting. Such documentation could be evidenced through meeting minutes.

Management Response

The application checklist is something that is currently being utilized and will continue to be on a going forward basis. It is on the application checklist that the Film Office staff will record the application receipt date for tracking purposes. Additionally, the Film Tax Credit internal review panel will include recorded minutes and written minutes from each meeting. Finally, due to increased competition of grantees seeking assistance with the program, a scoring sheet will be implemented to ensure uniform written documentation of project determinations.

Risk	Remediation Owner	Estimated Completion Date
Moderate	Executive Director, Ohio Tax Credit Authority	July 2011



Appendix A – Classification of Audit Objective Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Major Improvements Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.
Improvements Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Well-controlled with Improvements Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	State Audit Committee, Senior Management, Department Management
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	State Audit Committee, Senior Management, Department Management
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Department Management, Senior Management (Optional), State Audit Committee (Not reported)



Appendix B – Audit Follow-up Procedures

OIA will periodically follow-up on management's plans to remediate high and moderate risk audit observations. Follow-up activities may generally be broken down into three categories:

- Detailed** Detailed follow-up is usually more time-consuming and can include substantial audit customer involvement. Verifying and testing procedures implemented as well as substantiating records are examples. The more critical audit observations usually require detailed follow-up.

- Limited** Limited follow-up typically involves more audit customer interaction. This may include actually verifying procedures or transactions and, in most cases, cannot be accomplished through memos or telephone conversations with the audit customer but requires onsite observation or testing.

- Informal** This is the most basic form of follow-up and may be satisfied by review of the audit customer's procedures or an informal telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical observations.

Low risk audit observations will not result in an OIA audit follow-up, although these observations will be factored into the continuous risk assessment process for future OIA engagements.