OBM | Office of Internal Audit

Development Services Agency

Motion Picture Tax Credits Audit

Audit Period: July 2013 through October 2014

Results Summary:

Objective	Conclusion
Application Review and Approval	Improvement Needed
Program Monitoring	Well-Controlled with Improvement Needed
Issuance of the Tax Credit Certificate	Well-Controlled with Improvement Needed
Tax Incentive External Reporting and Communication	Improvement Needed

Report number: 2015-DSA-03 **Issuance date: December 18, 2014**

Executive Summary

Background

The Ohio Motion Picture Tax Credit was created within the Ohio Development Services Agency (DSA), formerly the Department of Development, 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).

OIA conducted an assurance audit over the Ohio Motion Picture Tax Credit program during state fiscal year 2011, which identified several high and moderate risk audit observations. At that time, DSA implemented corrective action to reduce the risk of those audit comments to a low level. OIA conducted the current assurance audit due, in part, to the prior audit and significant personnel changes within the Ohio Motion Picture Tax Credit program.

During the audit, OIA identified opportunities for DSA to strengthen internal controls and improve business operations. This audit conforms to the *International Standards for the Professional Practice of Internal Auditing*. OIA would like to thank DSA 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 an assurance audit related to the controls over the Ohio Motion Picture Tax Credit Program. This work was completed October through December 2014. The scope of the audit included the key processes related to the motion picture tax credit program. Specifically, the audit objectives were as follows:

1. Evaluate the design and effectiveness of controls over the application review and approval process.
2. Evaluate the design and effectiveness of controls over the program monitoring process.
3. Evaluate the design and effectiveness of controls over the issuance of the tax credit certificate.
4. Evaluate the design and adequacy of the tax incentive external reporting/communication process.

Detailed Observations and Recommendations

The Observations and Recommendations include 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.

Observation 1 – Application Review and Scoring Process

An effective application review and approval process should include a system for objectively evaluating every application received on a concise and consistent set of criteria that is appropriate to the program.

DSA's process for reviewing motion picture tax credit applications consists of the Ohio Film Office program manager reviewing applications for basic eligibility requirements prior to being reviewed by an internal panel. Only those applications meeting the basic eligibility requirements are presented to the panel comprised of the Ohio Film Office staff and select members of DSA's management. Each panel member completes a score sheet to determine if the production company qualifies for the motion picture tax credit. Each panel member assigns a point value to nine factors (i.e. production payroll, established director, post-production takes place in Ohio, etc.) to determine an overall score out of 100 possible points. However, DSA has not developed criteria or guidelines for assigning a point value to each factor, making the scoring process subjective in nature. Additionally, there is no minimum required score to receive a motion picture tax credit award. Based on discussions with Ohio Film Office staff, no motion picture tax credit applications have been denied based on the panel scoring process during the audit period; however there have been applications that were denied based on not meeting basic eligibility requirements.

Failure to have an objective process in place to evaluate motion picture tax credit applications increases the likelihood that tax credits are not awarded to those productions that may have the greatest economic impact to Ohio. An objective evaluation process is critical if the application process becomes competitive and DSA has to support its award decisions.

Recommendation

Update the score sheet to include specific criteria for assigning point values for each factor. For example, if ten points are possible for a factor, develop specific evaluation descriptions for earning 10, 7, 5, 3, or 1 point. Consider including basic eligibility factors (i.e. estimated production budget of at least $300,000) to measure the production's economic impact to Ohio (i.e., percentage of motion picture being shot in Ohio, level of employment of cast and crew who reside in Ohio, etc.), and factors to measure the production's impact to Ohio's image. Consider

a minimum score that an application must receive for a motion picture tax credit award. Additionally, consider the motion picture tax credit program manager completing the score sheet for all applications and presenting all scores to the panel for review and approval for those receiving the highest scores in order to document the receipt and review of all applications.
Management Response
The scoring rubric for reviewing motion picture tax credit applications will be updated. Basic eligibility factors will be documented, a minimum threshold will be determined and applied to the process, and guidance will be provided for the scoring scale which is used. Best practices for scoring will be used to revise the system.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Ohio Film Office Program Manager	March 2015

Observation 2 – Tax Incentive Reporting Website

Ohio Revised Code section 125.20(A)(2) requires DSA to make information available, via a public website, about the tax incentives approved and issued by the department, including the Motion Picture Tax credits. The department's Tax Incentive Reporting website displays tax incentives approved for various tax credit programs administered by the department, and includes a searchable database of incentives approved since January 1, 2008. The website was updated last on November 14, 2014, however it does not include tax credits that have been approved and issued for the Ohio Motion Picture Tax Credit. For the Motion Picture Tax Credit, specifically, eight tax credits were issued between December 2013 and October 2014 that should be listed on the website. Failing to update the website in a timely fashion results in a lack of adequate transparency and accountability which could lead to miscommunication of Ohio Film Credit tax incentives awarded and remaining for potential film makers considering Ohio as a location for film production.
Recommendation
Management should develop a process to ensure that the Tax Incentive Reporting website is updated timely. The website should include, at a minimum, the name under which the tax credit is known, the name of the entity receiving the credit, and the county in which the credit recipient's principal place of business in this state is located.
Management Response

We are developing a system to get the Motion Picture Tax Credit awards into the existing searchable database. Secondly, we are reviewing all tax incentives programs to ensure all programs are properly posted.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Ohio Film Office Program Manager	January 2015

Observation 3 – Communication to the Ohio Department of Taxation

Ohio Revised Code section 122.85(C)(2) requires that, upon issuance of a tax credit certificate, the Film Office certify to the tax commissioner the name of the applicant and the amount of eligible production expenditures shown on the certificate upon which the credit is based.

During this engagement, OIA noted DSA has not developed and implemented procedures to communicate motion picture tax credit issuances to the Ohio Department of Taxation (Taxation).

Lack of effective communication with Taxation increases the ability and likelihood of taxpayers submitting fraudulent tax credit claims.

Recommendation

Develop and implement procedures around the certificate process which include required communications and updates with Taxation regarding certificate issuances. This communication should include the name of the applicant, the amount of eligible production expenditures on which the tax credit is based, as well as the certified tax credit amount for which the production company is being issued. Furthermore, management should ensure communication regarding the final tax credit amounts issued to companies is initiated with Taxation prior to companies filing tax returns and credits. Consider implementing use of DSA's current CRM system (Salesforce) for the Motion Picture Tax Credit program, and adopting existing tax credit reporting procedures DSA has in place with Taxation for other tax credits issued by DSA.

Management Response

Staff will transmit copies of the Motion Picture Tax Credit certificates from the current biennium to the Division Counsel at the Department of Taxation immediately to bring reporting up-to-date. A procedure will be in place to transmit copies of the certificates as they are issued.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Ohio Film Office Program Manager	December 2014

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.

* Refer to Appendix A for classification of audit observations.

Appendix A – Classification of Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
Well-Controlled with Improvement Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Improvement 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.
Major Improvement 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.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
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.	Agency Management and State Audit Committee
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Agency Management and State Audit Committee