

**Independent Review of the
Empire State Film Production
and Post Production Tax Credit
Programs for 2019 and 2020**

**New York State
Urban Development Corporation**

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BACKGROUND

The New York State Film Tax Credit Program is designed to increase the film and television production and post-production industry presence in New York State, and to provide an overall positive impact to the State's economy. The Program provides tax credit incentives to qualified production companies that produce feature films, television series, television pilots and films for television, and/or incur post-production costs associated with these productions.

The Empire State Film Production Credit was first enacted in 2004 (Chapter 60) and was subsequently amended several times to either increase and extend program funding or to increase the amount of credit for a project (e.g. 10% to 30% of qualified costs). In 2010, the Empire State Post Production Tax Credit was enacted. Total funding authorized as the first pool of program funds is \$1.035 billion for tax years 2004 to 2013. An additional pool of \$6.3 billion of funds were authorized for tax years 2010 through 2024 (\$420 million/year). In 2020, \$420 million of funds were authorized for tax year 2025.

The Post Production Tax Credit is financed out of this additional pool and the amount of funds dedicated to Post Production projects were increased from \$7 million/year for the period 2010 – 2014 to \$25 million/year for the period 2015 through 2025. Beginning in 2015, continuing through 2025, film companies are eligible for an additional 10% credit for labor costs incurred in certain upstate counties for production budgets over \$500,000.

As a result of budget legislation signed by Governor Cuomo on April 1, 2020, the Film Production credit was reduced from 30% to 25%. In order to qualify for the credit, production of qualified films must have a budget of a minimum of \$1 million if the majority of shooting is done in the five boroughs, and \$250,000 if the majority of the shooting occurs elsewhere in the state. The Post-Production credit was also reduced from 30% to 25%. However, there is a potential 30% Post-Production credit if qualified post-production costs are incurred outside the New York Metropolitan Commuter district.

In addition to the reduction of the base tax credits enacted as a result of the budget legislations, effective April 1, 2020 variety talk, variety sketch and variety entertainment shows are no longer eligible for the Program.

ENGAGEMENT OBJECTIVE AND SCOPE

Pursuant to Section 6 of Part B of Chapter 59 of the Laws of 2013, EFPR Group (“EFPR”) was engaged to perform an independent review of the Empire State Development’s (“ESD”) Empire State Film Production and Post Production Credit Program (“Program”) and provide a report detailing the results of this review. Included in the report must be an assessment of each component of the Program with respect to the following areas:

- Efficiency of ESD’s operations with regard to processing the Empire State Film Production and Post Production Credit initial and final applications
- Accuracy of tax credits granted by ESD (representing the distribution of assets and funds) following its application reviews
- Reliability of ESD’s financial tracking of application data and tax credit amounts issued
- Adherence to, and compliance with, laws and regulations promulgated for the program, specifically regarding matters including, but not limited to:
 - Applicants eligible for the program
 - Applicants’ applications clearly reflect only those costs specifically deemed eligible under program guidelines and regulations, and clearly and specifically excludes costs not eligible for the program
 - Applicants’ projects in the program are not of a nature that would render such project, or portions thereof, ineligible for the tax credit provided

The procedures performed are detailed in the accompanying report, but generally consisted of a review of the Initial and Final Applications for the Tax Credits, supporting documentation, Program policies and procedures, and legal requirements of the Program. Our procedures also included interviews with relevant Program personnel. We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the accounting records. Accordingly, we do not express such an opinion. Had we performed additional procedures; other matters might have come to our attention that would have been reported to you.

The scope of this engagement included a review of Program activities for the period January 1, 2019 through December 31, 2020.

INFORMATION OBTAINED AND INDIVIDUALS INTERVIEWED

In performing our review, we examined the following information:

- New York State Film Tax Credit Guidelines
- Empire State Development Film Tax Credit Program – Application Process
- Empire State Development Film Tax Credit Program – Application Materials
- Sample Application Documents:
 - Initial Application – Template
 - Final Application – Template
 - Budget Cost Qualifier – Template
 - Employment Report – Template
 - End Credit Requirements – Template
- Shoot Days Summary – Template
- Schedule of Qualified Expenditures – Film Production/Post Production
- Summary Tax Credits Issued by Year – Production/Post Productions
- Summary Tax Credit Projections by Year – Production/Post Production
- Film Tax Credit Quarterly Reports – Q1 2019 – Q3 2019
- Detail of Tax Credits Issued – 2019-2020 – Production/Post Production.
- Detail of Applications:
 - Production – Initial Submitted – 2019-2020
 - Production – Final Received – Qualified – Credits Issued
 - Production – Final Received/Pending Review – No Credit Issued Yet
 - Post Production – Final Received – Qualified – Credits Issued
 - Post Production – Final Received/Pending Review – No Credit Issued Yet
- Audit Review Procedures Memo
- Program Director Job Description
- Senior Program Manager Job Description
- CPA Finalized Agreed Upon Procedures (AUP) – Third Party Verification
- CPA Inspection AUP Checklist
- Final Applications and Supporting Documents for Selected Projects Issued Tax Credits During 2019 – 2020

We also interviewed the following ESD personnel:

- Director of Film/TV Tax Credit Program
- Senior Program Manager
- Project Associate
- Associate Auditor

PROCEDURES PERFORMED

The procedures performed by EFPR Group (EFPR) over the course of this engagement include:

- 1.) Obtained and reviewed available documentation regarding the Tax Credit Program either through the ESD/Program website or directly through ESD personnel.
- 2.) Obtained and reviewed New York State Regulations and related statutory guidance regarding the Tax Credit Program.
- 3.) Requested and received summary-level and detailed information regarding Initial and Final Applications for the Film Production and Post Production Credits for 2019-2020.
- 4.) Obtained and reviewed summary-level and detailed information regarding tax credits issued for the Film Production and Post Production Credits for 2019-2020.
- 5.) Selected a sample of projects issued Film Production and Post Production Credits in 2019-2020.
- 6.) Obtained and reviewed procedures employed by ESD for auditing and approving Final Applications for the Tax Credit(s).
- 7.) Conducted interviews with ESD personnel engaged in the Tax Credit Program administration and audit process.
- 8.) Obtain and review Agreed Upon Procedures and related guidance for CPA Inspection Agreed Upon Procedures initiative.
- 9.) Perform detailed review of sample of projects based on ESD eligibility and audit guidelines to determine:
 - a. Eligibility verified;
 - b. Consistent application of ESD procedures;
 - c. Reconciliation of significant general ledger accounts;
 - d. Sufficiency of ESD procedures applied;
 - e. General accuracy of ESD procedures.

Comments, observations, and recommendations based on the results of the procedures performed have been included in this report in the section titled “Observations and Recommendations”.

PROGRAM ASSESSMENT

As previously noted, the objective of this engagement was to provide an assessment of each program component in several areas. Based on the procedures performed, our assessment is as follows:

Film Production Credit

Efficiency of ESD Operations

The Initial and Final Application processes are appropriately designed and appear to be operating effectively and efficiently. Over the course of the audit period, ESD issued tax credits to 261 productions (157 and 104 in 2019 and 2020, respectively). It should be noted that the processing of Final Applications was slowed over the course of 2020, relative to prior years, due in part to increased call volume and applicant inquiries related to COVID-19 production disruptions.

Accuracy of Tax Credits Issued

Through our review of the Final Applications and related documents provided, it appears that the distribution of program assets and funds, in the form of tax credits is materially accurate. However, it is our recommendation that ESD consider modifying the audit process to further align with the CPA AUP procedures that are employed.

Reliability of ESD's Financial Tracking of Application Data and Tax Credit Amounts

The processes and resources employed by ESD in tracking the Application Data and the corresponding tax credits issued appears adequate. We did not encounter any variances through our comparisons of the information obtained through the Program database maintained by ESD and the underlying Applications and documentation retained or reporting of program activity and tax credits estimated/issued.

Adherence to, and Compliance with, Program Laws and Regulations

It appears that ESD has the appropriate processes in place to ensure compliance with Program Laws and Regulations relating to Applicant eligibility, incorporation of eligible costs and exclusion of ineligible costs and eligibility of the tax credit provided.

Post Production Credit

Efficiency of ESD Operations

Over the course of the audit period, ESD issued post production tax credits to 85 productions (51 and 34 in 2019 and 2020, respectively). The Initial and Final Application processes are appropriately designed and appear to be effective and efficient.

Accuracy of Tax Credits Issued

Through our review of the Final Applications and related documents provided, it appears that the distribution of program assets and funds, in the form of tax credits is materially accurate. The procedures currently employed by the Program, as they relate to the Post Production Credit, appear adequately designed.

Reliability of ESD's Financial Tracking of Application Data and Tax Credit Amounts

The processes and resources employed by ESD in tracking the Application Data and the corresponding tax credits issued appears adequate. We did not encounter any variances through our comparison of the information obtained through the Program database maintained by ESD and the underlying Applications and documentation retained.

Adherence to, and Compliance with, Program Laws and Regulations

Through the procedures performed, it was noted that ESD has the appropriate processes in place to ensure compliance with Program Laws and Regulations relating to Applicant eligibility, incorporation of eligible costs and exclusion of ineligible costs and eligibility of the tax credit provided.

PROGRAM ACTIVITY FOR 2019 AND 2020

The following table summarizes the Initial Applications received, the Final Applications received, and Tax Credits issued for the Film Production Credit and Post Production Credit over the period January 1, 2019 – December 31, 2020:

<u>Film Production Credit</u>				
	<u>Initial Applications</u>	<u>Final Applications</u>	<u>Credits Issued</u>	<u>Projects</u>
2019	200	211	\$ 600,431,418	157
2020	112	155	591,615,241	104
<u>Post Production Credit</u>				
	<u>Initial Applications</u>	<u>Final Applications</u>	<u>Credits Issued</u>	<u>Projects</u>
2019	127	51	\$ 29,623,135	51
2020	58	75	14,129,364	34

REVIEW OF PROGRAM COMPONENTS

Through the procedures identified, EFPR documented its understanding of the Film Production and Post Production Tax Credit Program. In addition, we obtained an understanding of the Initial and Final Application processes, as well as the audit process currently employed by ESD. Our understanding was obtained through review of the program information available through the ESD Film and Tax Credit website and augmented through discussion/interview with the ESD personnel identified.

FILM PRODUCTION CREDIT

The Film Production Credit component offers up to a 30% tax credit on qualified costs incurred by a qualified production company that meets the eligibility criteria established by the State of New York. Tax credits through the Program are available to qualified production companies producing feature films, television series, relocated television series, television pilots and films for television. Qualified production costs are generally defined as production costs incurred, or the performance of services within, the State of New York directly and predominantly in the production of a qualified film. As noted, effective April 1, 2020, the Film Production Credit was reduced to 25%. This will impact Initial Applications received subsequent to April 1, 2020.

Eligibility Criteria

Based on our review of the Program Guidelines, eligibility requirements vary based on the type of company and the project/production budget. The general eligibility requirements for the Film Production Credit include:

- Productions with a budget greater than \$15 million, or produced by a company in which more than 5% of the beneficial ownership is owned (directly or indirectly) by a publicly traded entity:
 - 10% or more of total principal photography shooting days must be at a Qualified Production Facility (QPF) in New York State
 - Television pilots are exempt from the 10% requirement. A minimum of one day of principal photography must be shot at a QPF, and at least 75% of total of all expenses must be related to work done at QPF
- Productions with a budget of \$15 million or less, produced by independent companies must shoot at least one day of principal photography at a QPF
- If production costs are incurred at more than one production facility, 75% of all qualified costs incurred at all facilities must be incurred at a QPF
- If a qualified production has met the 75% threshold for QPF expenditures, it may also qualify for the credit based upon qualified expenditures outside the qualified facility that are related to pre-production, location production and post-production if:
 - The production spends less than \$3 million on all costs related to work done at a QPF, then a minimum of 75% of the principal photography days shot on location must be in New York State. This threshold requirement applies to location days only; or
 - The production spends \$3 million or more on all expenses related to work done at a QPF, then all qualified expenditures related to pre-production, location production and post-production in New York State are eligible for calculating the credit.

Upon determination that facility thresholds are met, all qualified costs related to work done at the facility become eligible for the credit.

POST PRODUCTION CREDIT

The Post Production Credit also offers up to a 30% tax credit on qualified costs incurred by a qualified production company that meets the eligibility criteria established by the State of New York. The Credit is limited to the same type of projects as the Film Production Credit. However, the Post Production Credit is available on projects where principal photography/filming occurred outside New York State, but the qualified production company contracts the post-production work to specialized post-production companies within New York State (and to projects which filmed in NYS but did not meet the criteria for the Production Program and applied for the Post-Production Program). As noted, effective April 1, 2020, the Post Production Credit was reduced to 25%. This will impact Initial Applications received subsequent to April 1, 2020. However, a 5% increase to 30% is available for post-production costs incurred in Upstate New York, outside the Metropolitan Commuter Transportation District.

Eligibility Criteria

Based on our review of the Program Guidelines, the eligibility requirements for the Post Production Credit include:

- A qualified post-production facility is any company engaging in providing post-production services to film and television located in New York State
- A qualified production company is eligible for the post-production credit if it meets one or both of the following thresholds:
 - Visual effects (VFX) and Animation – the qualified VFX/Animation costs incurred at a qualified post-production facility in New York State must either meet or exceed:
 - 20% of the total VFX/Animation costs paid or incurred for the qualified film
 - \$3 million in qualified costs
 - Post Production – the qualified post-production costs incurred at qualified facilities in New York State must meet or exceed 75% of the total qualified post-production costs paid or incurred
 - Animation production companies are eligible for both production and post-production VFX/animation costs if the above requirements are met.

A production company meeting the eligibility requirements for the Film Production Credit can include qualified post-production costs incurred in New York State in the calculation of the tax credit. However, a production company cannot claim the Film Production Credit and the Post Production Credit for the same project and its qualified post production costs.

APPLICATION PROCESS

The application process for the Film Production Credit and the Post Production Credit are essentially the same. The primary difference in the application processes for each relates to the information/documents that are required to be submitted with the Initial and Final Applications and the requirements for submission of Initial Applications. The Initial Applications for the Film Production Credit are required prior to the start of principal and ongoing photography, while the Initial Applications for the Post Production Credit are required prior to incurring any qualified costs in New York State.

The following steps to the Application Process are available to the public via the ESD Film Tax Credit web site. The steps identified were compared to the Application Process defined in Part 170 of the Regulations of the Commissioner of the Department of Economic Development for consistency. In addition, we confirmed the steps to the Application Process through discussion/interview with ESD personnel. Where applicable, we have included additional detail or specific procedures identified through the interview process.

- 1.) The Initial Application process is initiated through the online portal created by ESD.
- 2.) The Initial Application consists of with the following documents:
 - a. Project Summary – Initial

- b. Budget Cost Qualifier
 - c. Production Budget
 - d. Description of project (project synopsis and/or “look book”)
 - e. Employment Practices Form
- 3.) Information included with the Initial Application is populated into an Access database maintained by ESD. Information recorded includes Project Name, budgeted expenditures, projected qualified costs, anticipated tax credit and projected hires.
 - 4.) Upon successful submission, a confirmation is provided to applicants. The initial application is reviewed by the Project Associate, and any corrections or modifications, if necessary, are requested. The Access database is updated to include corrections/changes.
 - 5.) The Final Application is completed through the online portal. The Final Application consists of the following documents/information:
 - a. Project Summary – Final
 - b. Updated Budget Cost Qualifier with final cost information
 - c. General Ledger Detail
 - i. Film Production Credit – the entire project General Ledger must be submitted, along with specific General Ledger reports for each segment of qualified costs indicated in Budget Cost Qualifier
 - ii. Post Production Credit – General Ledger reports for qualified and non-qualified costs
 - d. Employment Report
 - e. Retained Assets Report
 - f. Related Party Transaction Report
 - g. Supplier and Subcontractor Form (Diversity Information)
 - h. Vendor List
 - i. Workforce Utilization Report (Diversity Information)
 - j. End Credit Requirements and Frame Grab of End Credits (showing required text and logo)
 - k. Daily Production Reports – Film Production Credit only
 - l. Shoot Days Summary – Film Production Credit only
 - m. Cast & Crew List – Film Production Credit only
 - 6.) The Final Application is reviewed for completeness by the Project Associate assigned to the Project and the Final Application Checklist is prepared. The Final Application Checklist is utilized to verify that all required documents/information have been submitted. If deemed incomplete, the applicant is notified, and the outstanding information is requested
 - 7.) Upon acceptance of the Final Application and confirmation of completeness, the applicant is notified of acceptance and the Application is queued for audit by ESD.
 - 8.) The Program Director oversees ESD staff in their assignment of Final Application/Projects. The Final Applications on each staff member’s list are audited in order of date of receipt of a complete application.
 - 9.) Final Applications accompanied by a CPA Agreed Upon Procedures Report are reviewed for accuracy and fulfillment of the required procedures by Senior ESD staff.

- 10.) Upon completion of the audit, a Final Review Memo is issued to the applicant, which details specific questions and/or requests for additional information/documentation. This additional information is incorporated into the audit process upon submission.
- 11.) After the audit is completed, the Final Application is reviewed and approved by the Program Director and then forwarded to the Senior VP of Tax Incentives who performs a quality control review. The Senior VP then requests approval to issue tax credit certificates from the Commissioner.
- 12.) Upon approval, a Certificate of Tax Credit is issued to the Applicant. The Certificate of Tax Credit details the completion date of the project and the allocation year of the credit.

AUDIT PROCESS

The audit protocol currently utilized by ESD is designed to focus the review on all above-the-line costs, the major qualified cost items, most frequently disallowed cost items and a sampling methodology for other non-labor cost items. The process and protocol identified through our interviews with ESD personnel is as follows:

1. Final Applications are submitted via the online system and receipt is acknowledged by the Project Manager assigned to that role.
2. Complete applications are dated as received in the Access database, which determines the order of audit for the Final Application.
3. Incomplete and/or inaccurate applications are considered “pending”; and the Project Manager informs applicant of the need for corrected/revised and/or missing documents to be submitted.
4. The date when all revised documentation is received by the Project Manager is when the “Final Rec’d” date is recorded in the Access database.
5. Under oversight of the Program Director via weekly status reports, Project Managers review the list of Final Applications to be reviewed and select projects which they will audit (in the order received by the Department).
6. The audit process begins with verifying that the accuracy and completeness of the Final Application and accompanying documents. If necessary, the Project Manager will contact the applicant for additional revisions.
7. Sampling and detailed testing of expenditures consists of identifying approximately 5-20 “big ticket items” in varying budget categories, including the invoice(s) for stage lease agreement in most instances. The number of items automatically reviewed is tied to the budget range of the project, escalating from approximately 10 for a project less than \$20 million to 20 or more for projects in the \$50 plus million range. Items which are easily identified as non-qualified are not sampled.
8. The separate general ledger report for each BCQ category of qualified costs is reviewed to determine that all costs are qualified and appropriately categorized on the BCQ.
9. Separate general ledger reports for projects should be scrutinized for the following specific non-qualified cost items:
 - a. Above the Line – rights and clearance fees, WGA fees, airfare outside NYS, hotels, per diems in NYC within studio zone, actor salaries, producer and director fees, entertainment, gifts, luxury items, personal assistants.

- b. Below the Line – In Art Department, licenses and fees for artwork, photos, stock footage, legal fees, finance charges, In transportation, deliveries, out of state taxes, out of state repairs, out of state tolls.
 - c. Post Production – License fees, versions beyond primary venue (TV versions of films, international versions, in-flight versions), trailers, promotion, music rights, composer fees, out of state salaries, hotels and per diems in NYC.
10. Additionally, the Project Manager scans the general ledger reports using key words intended to identify a wide range of non-qualified costs that are listed in the Schedule (and Supplement) of Non-Qualified costs, and additional non-codified non-qualified costs.
 11. Production reports are reviewed to determine that stage day threshold requirements were met; employment reports are reviewed to verify conformity with other documentation (Production Summary data).
 12. Final Application reviews are sent to Applicant to provide requested documentation and explanations to clarify items in question.
 13. When all documents have been verified and clarifications provided, requests for tax credit certificates are submitted

In addition to these procedures, ESD performs a review to ensure that New York State registered sales tax vendors are used; any expenses identified that originate from vendors not registered with New York State are disqualified.

Through discussion with ESD Program personnel, it was noted that a manual and primarily judgmental audit process/methodology is employed when performing detailed testing of costs. Generally speaking, specific categories on the general ledgers submitted by the Applicants with Final Applications are manually scanned, and suspect line item entries are selected for further documentation and/or investigation. The separate ledger reports for each category of qualified costs are reconciled to the Budget Cost Qualifier documents submitted in aggregate, but it does not appear that specific accounts are reconciled to the general ledger.

CPA AGREED UPON PROCEDURES INSPECTIONS

Beginning in 2015, Applicants have had the option of employing the services of a Certified Public Accountant (CPA) to perform an Agreed Upon Procedures (AUP) Inspection and prepare a report summarizing the results of the procedures to include with Final Applications. The cost of the AUP Inspection is the responsibility of the Applicant, but ideally will help to expedite the Final Application review and approval process, and subsequently expedite the issuance of the tax credit. The AUP process was initially only available for Applicants of the Film Production Tax Credit. However, during 2016 the AUP Inspection process was instituted for Post Production Applicants. The Agreed Upon Procedures for Production was revised in October 2019 to include submission of a complete vendor listing, as well as the inclusion of testing related to custom items produced outside of New York State. No modifications were made to the Post Production Procedures.

We reviewed the Agreed Upon Procedures that are currently employed by the approved

CPA firms. The AUPs have been designed to review the following areas:

- Eligibility – The CPA firm reviews all of the final application documents and confirms that the Applicant is eligible for the respective tax credit.
- Expenditures (Excluding Payroll) – The CPA firm reviews/inspects the general ledgers of the Production to identify and remove any non-qualified costs; obtain New York State Registered Sales Tax Vendor certification for certain expenditures; obtain a completed Related Party Transaction Report Form; ensure any insurance claims have been incorporated into the general ledgers; select a sample of expenditures for detailed testing; and obtain a Retained Assets Report.
- Expenditures (Payroll) – The CPA firm compares/reconciles qualified payroll expenditures on the general ledgers to the Employment Report; and select a sample of employees for detailed testing.

The guidance issued with the AUP guidelines includes a sampling methodology based on qualified expenditures and specific items in the general ledger, as well as a sampling methodology designed to test qualified payroll expenditures, and defines procedures for identifying a projected misstatement and for requiring additional sampling. The processes have been updated to specifically incorporate a review of out of state custom-made items to verify that a 60/40 split of non-qualified (labor) and qualified (materials) costs. In addition, the AUPs require a review of vendors to ensure that qualified expenses are coming from registered New York State sales tax vendors. The guidance has defined a general format for the submission of the report supporting the performance of the AUPs. Following the issuance of the AUP Report and required documentation to ESD, the Reports and supporting work papers are reviewed for completeness and accuracy.

Over the course of the audit period, 197 Final Applications (111 in 2019 and 86 in 2020, respectively) for which Production tax credits have been issued elected to employ the services of a CPA firm. This represented approximately 75% of the total Productions Final Applications reviewed and approximately 83% (\$515M) of the total Production tax credits issued. With respect to the Post Production tax credit, 55 Final Applications (32 in 2019 and 23 in 2020, respectively) for which Post Production tax credits have been issued elected to employ the services of a CPA firm. This represented approximately 65% of the total Post Production Final Applications reviewed and approximately 69% (\$8.309M) of the total Post Production tax credits issued.

DETAILED ANALYSIS OF PROJECTS

As part of the procedures performed, EFPR selected a sample of projects for which Tax Credits have been issued. Our sample included 25 projects for the Film Production Tax Credit and 10 projects for the Post Production Tax Credit. Of the selections, 17 of the Film Production selections were CPA-reviewed and 8 of the Post Production selections were CPA-reviewed. The value of the Tax Credits for the selections represents 26% (\$307M) and 43% (\$19M) of the total Tax Credits issued for the Film Production Credit and Post Production Credit, respectively.

For each of the projects selected, EFPR obtained the following information:

- A. Initial Application and Required Information/Documentation
- B. Preliminary Budget(s)
- C. Final Application and Required Information/Documentation
- D. ESD Work papers documenting audit procedures
- E. Tax Credit calculation workpapers
- F. AUP Report and supporting workpapers (where applicable)

Upon receipt of the requested information, we reviewed each of the projects to assess, among other things, compliance with eligibility requirements relating to the production and the costs incorporated in the calculation of the Tax Credit, adherence to the audit protocol established by ESD, compliance with submission of required documents and to identify potential areas of strength and/or weakness. With respect to the CPA-reviewed productions, we reviewed the reports and supporting workpapers for adherence to the AUPs as well as the sampling methodologies defined by ESD.

OBSERVATIONS/RECOMMENDATIONS

General Observations

- 1) As of December 31, 2020, there are 193 Final Applications for the Film Production Credit either in process or awaiting audit/review and issuance of the credit. There are 83 Final Applications for the Post Production Credit either in process or awaiting audit/review and issuance of the tax credit, including 20 submitted during the 4th Quarter of 2020. As of December 31, 2018, 81 Final Applications for the Film Production Credit were in process, and 36 Final Applications for the Post Production Credit were in process.
- 2) Film Production Tax Credits issued for 2019 and 2020 amount to approximately \$600M and \$592M, respectively. For comparative purposes, Film Production Tax Credits issued in 2017 and 2018 amounted to approximately \$688M and \$729M, respectively. Post Production Tax Credits amounted to approximately \$30M and \$14M in 2019 and 2020, respectively. Comparatively, Tax Credits issued in 2017 and 2018 approximated \$33M and \$28M, respectively.
- 3) In prior years staffing and turnover has been a challenge for ESD, in the context of reviewing Final Applications and processing the corresponding Tax Credits. ESD staff working on the Film Tax Credit program are also involved in the administration of the Commercial Production Tax Credit and Musical and Theatrical Tax Credit programs. It appears that staffing for ESD remained relatively consistent over 2019-2020, and turnover was minimal relative to 2017-2018.
- 4) Through discussion with ESD, it was noted that staff working in Film Tax Credit Program were reallocated to work on Covid-19 related projects by ESD during March and April. This contributed to the delay in the review and processing of Final Applications, and ultimately the issuance of Tax Credits. It was also noted that ESD

staff have been primarily working in a remote capacity for a majority of 2020 with no overall impact on productivity.

Initial and Final Application Processes

- 1) The Initial and Final Application processes appear effective. Through discussion with the Program Director, ESD has effectively dedicated certain staff to the review of Initial and Final Application documentation submitted directly to ESD, and certain staff to the audit/review of the Final Applications submitted both with CPA AUP Reports and without. It was noted that in 2020, nearly 80% of the Initial Applications received for the Production Tax Credit for the year were received prior to April 1, 2020, which reflects the impending decrease in the tax credit rate to 25%. There does not appear to have a similar influx prior to April 1, 2020 with respect to Initial Applications for the Post-Production Tax Credit.
- 2) On an overall basis, the number of days between receipt of a Final Application and issuance of a Production Tax Credit for Projects submitted in 2019-20 has increased to an average of 272 days from 223 days in 2017-18. Final Applications for the Production Tax Credit that included a CPA AUP Report had tax credits issued with 224 days, on average, which is up from 69 days in 2017-18. For Final Applications for the Production Tax Credit that were reviewed exclusively by ESD personnel, the average time between receipt and tax credit issuance approximated 421 days. However, this average appears to be skewed by credits issued for 14 projects from 2013 – 2017 and 25 projects from 2018. For Final Applications received during 2019 – 2020, the average time of issuance for a tax credit approximates 245 days.

Based on our review of the detail of Tax Credits issued, it appears that the increase relative to 2017-18 can be attributed to activity during 2020. For 2019, on an overall basis the average number of days between receipt of a Final Application and the issuance of a Production Tax Credit was 218 days. This increased to an average of 355 days during 2020. As noted, this seems to be a result of the ESD staff being re-allocated to work on Covid-19 projects during 2020.

- 3) On an overall basis, the number of days between receipt of a Final Application and issuance of a Post Production Tax Credit for Projects submitted in 2019-20 was 364 days. This is an increase from 294 days observed for 2017-18. Similar to the Production Tax Credit, it appears the time increased from 302 days in 2019 to 458 days in 2020.

Audit Protocol/Processes

- 1) The audit process currently employed by ESD does not require the detailed testing of qualified payroll expenditures but, payroll expenditures on the general ledger are reviewed for reasonableness and reconciled to the Budget Cost Qualifier and Employment Report. Through review of the Final Applications selected as part of our sample, it was noted that qualified payroll expenditures, as a percentage of total

qualified expenditures, ranged from 42% to 53%. This is inclusive of applicable payroll taxes and fringe benefits and represents a significant amount of a project that is not subject to detailed testing. The CPA AUP incorporates detailed testing of payroll/employees. In several of the CPA reports reviewed, we noted adjustments relating to procedures performed on payroll/employees. It is our recommendation that procedures similar to the CPA AUPs should be incorporated into the ESD Audit Process to test payroll expenditures being incorporated in the calculation of the Tax Credit. This would include the review of timecards, call sheets, production reports and/or other equivalent documentation on a sampling basis to confirm that work was performed in New York.

- 2) Part of the ESD audit process incorporates a reconciliation of the various general ledgers to the corresponding Budget Cost Qualifier (BCQ) categories. To facilitate the reconciliation process, a crosswalk between an applicant's general ledger accounts to the corresponding BCQ accounts is helpful. It seems that some applicants provide this information, but it is our understanding that a majority of applicants do not. We recommend ESD consider updating the Application Materials required as part of the application process to include the provision of a crosswalk between the applicant general ledger accounts and the BCQ accounts.
- 3) As part of the Final Application audit process, ESD auditors will select the largest (dollar value) 5 – 20 transactions identified in the general ledger(s) submitted with the Final Applications. Additional expenditures selected for detailed testing appear to be judgmentally selected by the ESD auditor, following a review of the general ledger(s). Through our review of the final audit testing workpapers for the Final Applications audited by ESD, we noted that the number of expenditures selected for detailed testing varied. The use of a judgmental sampling methodology is appropriate, considering the experience ESD personnel have with the program. However, it is our recommendation that ESD consider updating the Audit Process to incorporate a standardized sampling methodology similar to the one in place for the CPA Agreed Upon procedures.

Analysis of Projects

- 1) We did not encounter any exceptions through our reconciliation of Final Application documents and general ledgers provided for the sample of Film Production and Post Production Credit Applications to the corresponding Budget Cost Qualifiers.
- 2) With respect to the Final Applications submitted for the Production Tax Credit selected for review as part of our sample, ESD performed detailed reviews of the reports and documentation upon receipt for eight of them. The number of expense items reviewed on Final Applications by ESD that were selected ranged from 76 to 265, while the total value of the expenses reviewed ranged from \$1,132,459 to \$2,119,698. It was noted that these Final Applications audited by ESD did not have any adjustments made for non-qualified expenditures. However, the Final Applications for these projects detailed expenditures that were deducted/removed by the production companies prior to submitting their Final Applications.

For the Post-Production audit selections, it was noted that the number of expense items reviewed ranged from 22 to 41, with adjustments ranging from \$0 to \$141,967.

- 3) The Final Applications audited by ESD that were selected for review showed no deductions from the project expenses. As noted above, costs appear to have been deducted prior to submission, and these deductions were provided in the Final Application documentation for review by ESD. Through discussion with the Program Director, it was noted that a New York-based production accountant has been employed by various applicants to pre-audit these application since the inception of the program in 2004. The adjustments made to the Final Applications prior to submission ranged from \$225,439 to \$1,211,758.
- 4) Through our review of the CPA AUP workpapers and documentation provided as part of our Film Production sample selection, it was noted that CPA adjustments ranged from \$170 - \$4,568,473. The Production with the largest net adjustment (\$4,568,473) appears related to an adjustment related to an insurance claim in the amount of \$4,009,770. For the Post-Production Final Applications reviewed by a CPA firm, it was noted that for the samples selected adjustments ranged from \$9,567 to \$134,211.

CPA AUP Inspections

- 1) Through our review of the CPA AUP Reports and supporting workpapers, we did not identify any deviations from the defined AUPs, sampling methodologies or reporting requirements. In addition, it appears that ESD is appropriately reviewing the CPA AUP Reports and supporting workpapers for adherence to the AUPs.
- 2) As designed, the AUPs appear adequately designed to provide reasonable assurance that the Final Applications received relate to qualified projects and materially reflect qualified expenditures.