

ALASKA STATE LEGISLATURE

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Division of Legislative Audit



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SUMMARY OF: A Special Report on the Department of Revenue, Alaska Film Production Incentive Program, July 14, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted a performance audit of the Alaska Film Production Incentive Program (film credit program).

This performance audit evaluates the Alaska Film Office's (AFO) compliance with statutes and regulations in conducting the activities of the film credit program from July 1, 2013, through June 30, 2014. The audit also provides the current status of recommendations from the prior two performance audits.

REPORT CONCLUSIONS

The audit concludes:

- Statutory dollar limits for the film credit program were not exceeded.
- Except for the statutory requirement to obtain names of the proposed cast, applications for qualification were approved or rejected in accordance with statutes. The related internal controls were found to be operating effectively.
- Final applications for film tax credits subject to the original statutory framework were approved in accordance with applicable statutes and regulations. The related internal controls were found to be operating effectively.
- Except for the statutory requirement for film productions to include the AFO logo and required verbiage, final applications for film tax credits subject to the new framework were approved in accordance with applicable statutes. The related internal controls were found to be operating effectively.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Department of Revenue's (DOR) AFO executive director should continue efforts to ensure qualification applications contain names of the proposed cast as required by statute.

All 29 qualification applications approved since July 1, 2013, were examined to determine if the applications included names of the producers, directors, and proposed cast. Seven of the 29 qualification applications were incomplete in listing talent or persons highlighted in the film production.

Recommendation No. 2

DOR's AFO executive director and the film commission should ensure that film credit productions include the AFO logo and the required statutory verbiage.

Film productions related to the two final applications approved after July 1, 2013, and subject to the new statutory framework did not include the AFO logo and the words "*Filmed in Alaska with the Support of the State of Alaska*" as required by statutes.

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July 25, 2014

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

DEPARTMENT OF REVENUE ALASKA FILM PRODUCTION INCENTIVE PROGRAM

July 14, 2014

Audit Control Number
04-30076-14

This performance audit evaluates the Department of Revenue, Alaska Film Office's compliance with statutes and regulations in conducting the activities of the Alaska Film Production Incentive Program from July 1, 2013, through June 30, 2014. The audit also provides the current status of recommendations from the prior two performance audits.

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Fieldwork procedures utilized in the course of developing the findings and recommendations presented in this report are discussed in the Objectives, Scope, and Methodology.

A handwritten signature in black ink, appearing to read "Kris Curtis".

Kris Curtis, CPA, CISA
Legislative Auditor

TABLE OF CONTENTS

	<u>Page</u>
Objectives, Scope, and Methodology	1
Organization and Function	3
Background Information.....	5
Report Conclusions.....	11
Findings and Recommendations.....	15
Appendix A.....	17
Agency Response:	
Department of Revenue.....	21

OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with AS 24.20.271(12), we have conducted a performance audit of the Alaska Film Production Incentive Program (film credit program or AFPIP).

Objectives

The audit objectives were to:

- Determine whether final applications for film tax credits with qualification applications approved prior to July 1, 2013, were approved in accordance with the original authorizing statutes and regulations and whether the related internal controls were operating effectively.
- Determine whether applications for qualification and final applications for film tax credits submitted after June 30, 2013, were approved or rejected in accordance with the new statutory framework and whether the related internal controls were operating effectively.
- Provide the current status of prior performance audit recommendations.

Scope

The audit reviewed the film credit program activities from July 1, 2013, through June 30, 2014.

Methodology

During the course of the audit, the following were reviewed and evaluated:

- Alaska Statutes and regulations to identify AFPIP's responsibilities and program requirements prior to July 1, 2013, to identify those under the new statutory framework effective July 1, 2013, and to determine compliance with the applicable statutes and regulations.
- Certified Public Accountant (CPA) expenditure verification procedures to understand the extent of a CPA's review of the qualified expenditures submitted with a final application to be processed under the original authorizing laws and regulations.
- The total amount obligated under the original \$100 million allotment and the new allotment of \$200 million effective July 1, 2013, to determine compliance with statutes.

A random sample of five of the 16 final film tax credit applications approved from July 2013 through February 2014 was selected and assessed for the effectiveness of internal controls and for compliance with laws under the original authorizing statutes and regulations. The examination included review of CPA expenditure verification reports and production cost reports, and recalculating film tax credit amounts. In determining the sample size, the risk of noncompliance was considered moderate due to changes in program management. A sample size of 30 percent was determined sufficient to detect errors.

A random sample of eight of 18 qualification applications approved from July 2013 through February 2014 was selected and assessed for the effectiveness of internal controls and for compliance with the laws under the new statutory framework. A random sample of two of 11 applications from March 2014 through June 2014 was selected for testing. The examinations included review of productions' estimated budget, recalculating the estimated film tax credits, and confirming the Alaska Film Incentive Review Commission's (film commission) application approvals. In determining the two sample sizes, the risk of noncompliance was considered moderate to high due to the changes in program management and statutes. An overall sample size of 34 percent was determined sufficient to detect errors. Additionally, all 29 qualification applications were tested for compliance with the statutory requirement that applicants include the names of the producer, director, and cast.

The three applications denied from July 2013 through June 2014 were examined to determine the reasonableness of the decision and if the applicant was properly notified.

The two final film tax credit applications approved after July 1, 2013, were selected and assessed for the effectiveness of internal controls and for compliance with the laws under the new statutory framework. The audit examined AFO staff's review of reports, recalculated tax credit amounts, and confirmed the film commission's application approvals.

The tracking of application activity from February 2012 through June 2013 by Department of Commerce, Community, and Economic Development (DCCED) was reviewed for reasonableness. The tracking of application activity by Department of Revenue (DOR) since July 1, 2013, was also tested for accuracy.

Additionally, inquiries were made of DOR and DCCED management and staff to gain an understanding of AFPIP activities and records.

ORGANIZATION AND FUNCTION

The film credit program is an economic incentive program to encourage film industry growth in Alaska. Chapter 51, SLA 2012 transferred the Alaska Film Production Incentive Program (film credit program or AFPIP) from the Department of Commerce, Community, and Economic Development (DCCED) to the Department of Revenue's (DOR) Tax Division, effective July 1, 2013. Subsequent legislation¹ clarified guidance for how the program should transition. As a result, productions with qualification applications that were approved prior to July 1, 2013, continued through the final application and tax credit issuance process under the statutes in effect prior to July 1, 2013. Productions not issued a notice of qualification prior to July 1, 2013, were subject to the new statutes effective July 1, 2013. As of the date of this report, DOR had not completed drafting new AFPIP regulations.

Alaska Film Office

The Alaska Film Office (film office or AFO) administers the film credit program, issues transferable film tax credit certificates (film tax credits), and monitors film tax credit redemptions. Alaska Statutes 44.25.100-190 govern the film credit program administration, and AS 43.98.030 governs the film tax credit issuance and use.

The film office is staffed with an executive director, a tax auditor, and an accounting technician. According to DOR management, AFPIP personal services budgets were approximately \$308,000 for FY 14 and \$326,000 for FY 15. Per AS 44.25.105-110, AFO duties include:

- Making a report of film office activities available to the legislature within 30 days after the start of each regular session;
- Designing a logo that represents the film office and must be included in a film qualifying for a film tax credit;
- Administering the film credit program to provide a tax credit for certain film production expenditures incurred in the State; and
- Providing an on-site liaison for any film production subject to the maximum application fee. The liaison helps producers meet statutory requirements and ensures that a production, as described in the approved qualification application, is in the State's best interests.

¹Chapter 21, SLA 2013 (Senate Bill 7).

Alaska Film Incentive Review Commission

Statutory changes effective July 1, 2013, created the Alaska Film Incentive Review Commission² (film commission) within DOR. The film commission is responsible for approving or rejecting film tax credit applications; this includes determining whether a production is not contrary to the State's best interests. The film commission also approves, adjusts, or denies the final credit amount recommended by the AFO executive director.

²Film commission membership consists of commissioners from DCCED, DOR, the Department of Natural Resources, and the Department of Labor and Workforce Development.

BACKGROUND INFORMATION

The Alaska Film Production Incentive Program (film credit program or AFPIP) is an economic incentive program created by the legislature in 2008 to encourage film industry growth in Alaska. This program provides production companies with transferable film tax credit certificates (film tax credits) that can be offset against state tax liabilities. Tax credits may also be sold by production companies – usually for less than the value of the credit. The purchasing entity may redeem the credit when filing its state tax return, or under the new statutory framework, the credit may be purchased by the Department of Revenue (DOR) for 75 percent of the credit amount.

As discussed in the organization and function section of this report, the film credit program was transferred from the Department of Commerce, Community, and Economic Development (DCCED) to the DOR, effective July 1, 2013. The film credit program, as administered by DCCED, was authorized to issue up to \$100 million in film tax credits. This funding expires June 30, 2015.³ Legislation reauthorizing the film credit program provides up to an additional \$200 million for film tax credits to be issued. Subsequent legislation⁴ provides December 31, 2018, as the AFPIP’s expiration date, subject to legislative review.

Film Tax Credit Rates

Exhibit 1 (following page) shows the film tax credit rates effective through June 30, 2013, and the rates effective beginning July 1, 2013, for the reauthorized film credit program. In general, rate changes effective July 1, 2013, encourage Alaska hire and expenditures in rural Alaska. For productions qualified for a film tax credit after July 1, 2013, the credit for Alaska resident wages which is added to the base rate increased from 10 to 20 percent, and the extra credit rate for expenditures incurred in rural Alaska increased from two to six percent. DOR uses the Alaska common law definition of *Alaska residency* for production cast and crew (except for producers, directors, writers, and principal actors)⁵ which defines *residency* as maintaining a place of abode in the State for at least 30 days or more with the intent to remain living in the State indefinitely.

Tax rate changes discourage nonresident hiring by limiting nonresident compensation for producers, directors, writers, and principal actors to a five percent base credit which is increased by an amount equal to 50 percent of qualified expenditures paid to Alaska residents for services and to Alaska businesses for certain costs as noted in Exhibit 1. To be considered Alaska residents and, therefore, eligible for the higher base rate, producers, directors, writers, and principal actors must meet Alaska Permanent Fund Dividend (PFD) eligibility requirements.

³Qualification applications approved prior to July 1, 2013, fall under the former statutory framework and have a consecutive 24-month period to incur qualified expenditures.

⁴Chapter 61, SLA 2014 (House Bill 306).

⁵Alaska Statute 44.25.125(k) defines *principal actors* as the five highest compensated actors or entities representing the five highest compensated actors in the production.

Exhibit 1

Alaska Film Production Tax Credit Rates

Credit Type	Rate through June 30, 2013	Rate Effective July 1, 2013	Description:
Base Rate Applied to Category of Eligible Expenditures			
Base Rate	30%	30%	A base rate of 30% is applied to production expenditures incurred in Alaska excluding nonresident compensation for directors, writers, producers, and the five highest compensated actors.
or			
Base Rate for Nonresident	30%	5%	A base rate of 5% is applied to compensation paid to directors, writers, producers, and the five highest compensated actors not meeting PFD eligibility requirements. The amount of this credit may be increased as discussed below.
Additional Credit Applied to Subcategories of Eligible Expenditures			
Alaska Hire	+10%	+20%	Wages paid to Alaska residents qualify for an additional credit.
Rural Location	+2%	+6%	Qualified expenditures made in a rural area receive an additional credit.
Seasonal	+2%	+2%	Qualified expenditures made between October 1 st and March 30 th receive an additional credit.
Special	+0%	+6%	First episodic scripted television production receives a one-time additional credit.
Range of Available Credit from Above Categories	30-44%	30-64%	

Additional Amount Added to Nonresident Base Rate

Amount equivalent to 50% of qualified expenditures paid (1) to Alaska residents for services provided in the State, including salaries, wages, compensation, and related benefits; (2) to Alaska businesses for payroll and related services, music, and intrastate travel; and (3) for state or municipal taxes levied in Alaska on rental/lease of vehicles and room rentals or other lodging.

Film Tax Credit Eligibility and Qualification Process

To be eligible for a tax credit under the current program structure, a producer must have \$75,000 or more in qualified expenditures⁶ over a consecutive 36-month period. Additionally, the production must not be contrary to the State’s best interests as determined

⁶Alaska Statute 44.25.130 defines and provides a list of qualified expenditures.

by the Alaska Film Incentive Review Commission (film commission). Exhibit 2 provides a list of best interest considerations.

Production activities not eligible for tax credits include: news and weather; political, infomercial, and other advertising (except for commercial television advertisements produced for national distribution); productions for private or internal use; and productions deemed sexually explicit.

The film tax credit process begins when a film producer submits a qualification application along with an application fee⁷ to the Alaska Film Office (film office or AFO). The application must include:

- A detailed budget of all production costs with identification of expenditures to be made in Alaska;
- A distribution plan that outlines where the film will be distributed and its intended audience;
- A production script or synopsis;
- Names of the producer, director, and proposed cast;
- Estimated production start, completion, and filming dates;
- An Alaska business license number; and
- Proof of registration with the State for out-of-state limited liability corporations or other corporations.

Film office staff reviews each application to ensure all statutory requirements are met. Additionally, staff calculates an estimated film tax credit based on the estimated qualified expenditures. Based on this review, the AFO executive director makes a recommendation for approval or denial to the film commission.

Exhibit 2

**Film Tax Credit
Best Interest Considerations**

In determining whether a production is not contrary to the State's best interests, the film commission must consider the effect of the production on:

1. The film industry in Alaska.
2. Alaska employment.
3. The state economy.
4. The public perception of state policy with respect to natural resources of the State.
5. The fiscal health of the State.

Source: Alaska Statute 44.25.115(b)

The film commission examines the AFO executive director's recommendation along with supporting documentation and determines whether the production is not contrary to the State's best interests as described in Exhibit 2. Each commission member has approximately three weeks to review and approve or reject an application.

⁷The application fee is equal to 0.2 percent of the estimated total qualified expenditures expected to be incurred in the State (except the fee cannot be less than \$200 or more than \$5,000).

If a qualification application is approved, the film office issues a notice of qualification to the producer that includes the estimated film tax credit. The letter also communicates to the producer that qualification does not guarantee a tax credit will be issued, and it establishes the 36-month period in which qualified expenditures must be incurred. If an application is rejected, film office staff sends the applicant an explanatory letter.

Final Tax Credit Application Procedures

As discussed previously, a production must first qualify for film tax credits. Producers must then incur \$75,000 or more in qualified expenditures within the consecutive 36-month qualifying period before a final tax credit application may be submitted. A final application must include:

- A completed final application form for a film tax credit signed by an authorized individual;
- A production cost report detailing qualified expenditures made in Alaska;
- Verification by an independent Alaska-licensed certified public accountant (CPA) that the costs claimed in the production report are qualified expenditures under AS 44.25.130 and no person in Alaska is owed money for those costs;
- A detailed budget that identifies total expenditures and total expenditures made in Alaska;
- A list of all personnel and cast working in Alaska, including dates worked and salaries earned;
- Residency affidavits for wages paid to Alaska residents and claimed as part of a credit;
- A list of tangible personal property for which costs were claimed that were not transferred or otherwise disposed of at the end of production;
- A list of all Alaska principal photography days including dates and locations;
- Rough assembly of the production;
- Evidence that the production included the AFO logo and the words, “*Filmed in Alaska with the Support of the State of Alaska,*” in the end credits or on each DVD or other media produced for distribution, a short Alaska promotional video, or advertisement approved by the review commission;
- A final distribution plan; and
- A sworn certification that the producer and production have fully complied with all applicable state and federal laws and regulations.

Film office staff reviews final applications for compliance with the aforementioned requirements, and ensures final applications are supported by a production cost report and a

CPA expenditure verification report. Film office staff reviews work performed by the CPAs to determine if additional adjustments to the qualified expenditures are required which may result in an adjustment in the proposed tax credit. Similar to the qualification process, the AFO executive director drafts a recommendation to the film commission and presents the recommendation at a commission meeting. The film commission approves, adjusts, or denies each tax credit.

Film office staff prepares the tax credit certificate for the amount approved by the film commission. The tax credit certificate is reviewed and signed by the AFO executive director and the certificate is mailed to the producer or production company.

Exhibit 3 (following page) summarizes the AFPIP tax credit process.

Tax Credit Certificate Transfers and Redemption

Tax credits issued for productions that qualified under the former statutory framework may only be used by a corporation with an Alaska corporate income tax liability. Under new statutes, a tax credit may be used by any taxpayer with an Alaska tax liability under the following statutes:

- AS 43.20 *Alaska Net Income Tax Act;*
- AS 21.09.210 *Tax on Insurers;*
- AS 21.66.110 *Annual Tax on Title Insurance Premiums;*
- AS 43.55 *Oil and Gas Production Tax and Oil Surcharge;*
- AS 43.56 *Oil and Gas Exploration, Production, and Pipeline Transportation Property Taxes;*
- AS 43.65 *Mining License Tax;*
- AS 43.75 *Fisheries Business License and Taxes; and*
- AS 43.77 *Fishery Resource Landing Tax.*

Tax credit certificates are transferable and may be used for a tax period that occurred, in whole or part, on or after the date the original credit certificate was issued or the date the transferred credit certificate was issued. A tax credit expires three years after its original issue date under the original statutory framework and six years under the new statutory framework. If the expiration occurs during a tax period, the credit may still be used on the taxpayer's tax return for that tax period which is submitted in the next year.

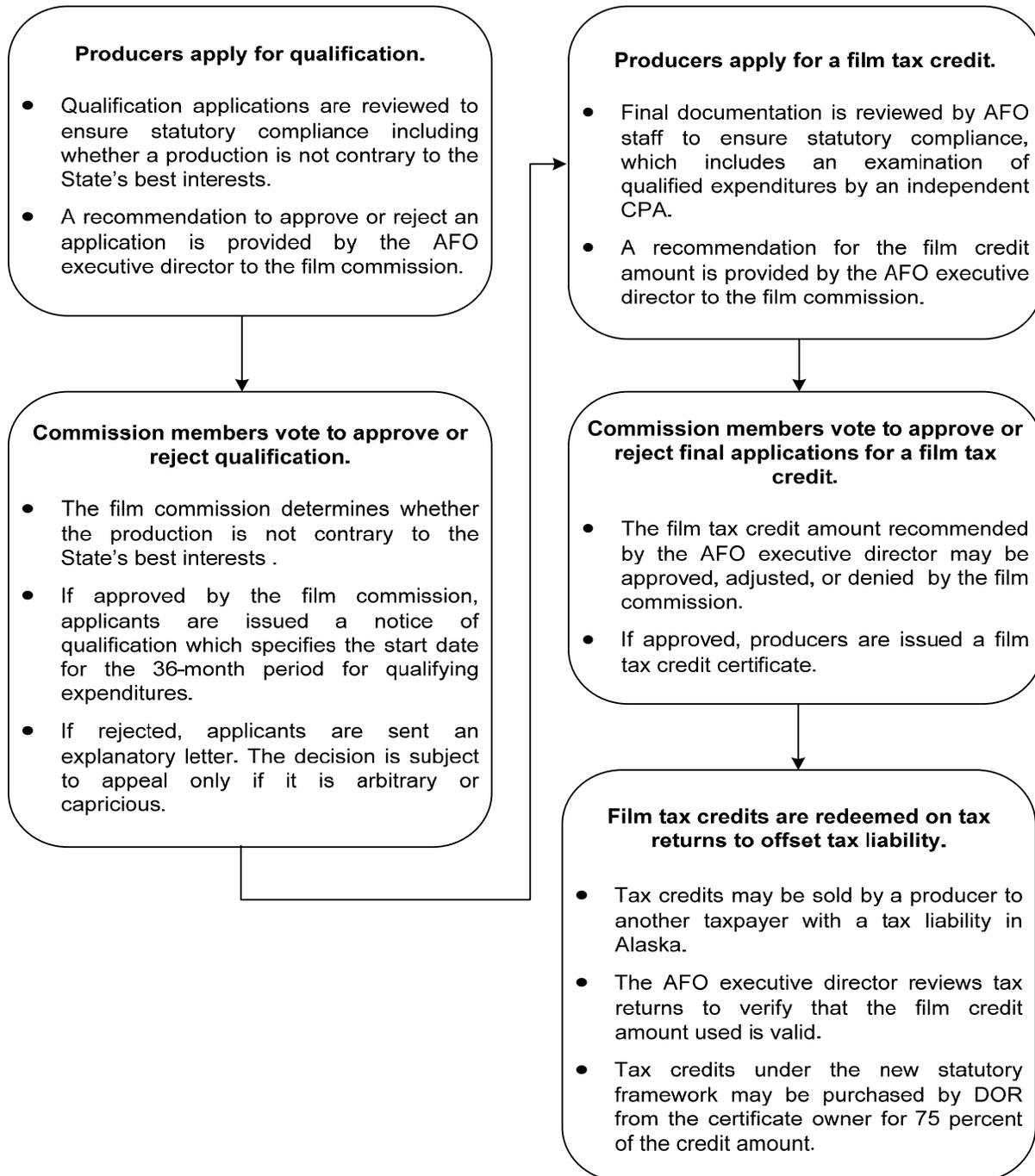
To transfer a film tax credit to a purchaser, the original certificate must be returned to the film office, and a new, transferred tax credit certificate is issued to the purchaser. The original or transferred film tax certificate must be submitted with a taxpayer's tax return. The film tax credit may be used on the taxpayer's tax return for a given year, in whole or part, and any unused balance is tracked by AFO staff until the full credit amount is utilized by a taxpayer.

Additionally, a transferable film tax credit issued with an approved qualification application after July 1, 2013, may be purchased by DOR from the certificate owner for 75 percent of the

credit amount. As of June 30, 2014, no film tax credits had been purchased by DOR under the new statutory framework

Exhibit 3

AFPIP Approval, Issuance, and Redemption Processes



REPORT CONCLUSIONS

The Alaska Film Production Incentive Program (film credit program or AFPIP) was significantly changed during the 2012 and 2013 legislative sessions. Film tax qualification applications approved prior to July 1, 2013, were subject to the original authorizing statutes and a \$100 million threshold. Qualification applications approved after that date were subject to a new \$200 million allotment and different statutory requirements. The most significant changes to the film credit program were: the Alaska Film Office (AFO) transfer from the Department of Commerce, Community, and Economic Development to the Department of Revenue, the addition of the Alaska Film Incentive Review Commission (film commission) to authorize film tax credit certificates (film tax credits), and changes to the film tax credit rates. Additionally, statutes require the Division of Legislative Audit to conduct an audit of the film credit program.

In accordance with AS 24.20.271(12), the film tax credit approval and issuance process has been audited for compliance with statutory and regulatory requirements. The audit concludes:

- Statutory dollar limits for the film credit program were not exceeded.
- Except for the statutory requirement to obtain names of the proposed cast, applications for qualification were approved or rejected in accordance with statutes. The related internal controls were found to be operating effectively.
- Final applications for film tax credits subject to the original statutory framework were approved in accordance with applicable statutes and regulations. The related internal controls were found to be operating effectively.
- Except for the statutory requirement for the film production to include the AFO logo and required verbiage, final applications for film tax credits subject to the new framework were approved in accordance with applicable statutes. The related internal controls were found to be operating effectively.

Detailed conclusions that address the audit objectives are presented below.

Estimated and actual film tax credits issued under the prior statutory framework total \$54.4 million which is within the \$100 million statutory limit.

Alaska Statutes in effect prior to July 1, 2013, limited the total amount of film tax credits to \$100 million. Exhibit 4 (page 13) summarizes the total estimated film tax credits outstanding from qualification applications approved prior to July 1, 2013, the total film tax credits issued based on approved final applications, and the total film tax credits redeemed through

application of the credit to a corporate income tax liability.⁸ As of June 2014, for film tax credits subject to the prior statutory language, there were \$10.8 million in estimated qualified film tax credits outstanding and \$43.7 million in film tax credits issued.

Estimated film tax credits from qualification applications approved under the new statutory framework total \$14.2 million which is within the \$200 million statutory limit.

For film tax credits subject to the new statutory framework, there were 29 applications approved with estimated film tax credits totaling \$14.2 million as of June 2014. Two final applications were issued for film credits. The total of the film credits issued is not included in this report because it is statutorily confidential. Exhibit 5 (page 14) summarizes the total estimated film tax credits from qualification applications approved since July 1, 2013.

A review of the two final applications approved after July 1, 2013, under the new statutory framework found that neither film production included the AFO logo and the words “*Filmed in Alaska with the Support of the State of Alaska*” as required by statutes. (See Recommendation No. 2.)

Qualification applications and final applications for film tax credits were generally reviewed and approved in compliance with the applicable statutes.

This audit examined eight of the 18 qualification applications approved from July 2013 through February 2014. Additionally, two of the 11 qualification applications approved from March 2014 through June 2014 were examined. Except for the requirement that producers list the proposed cast names as part of the application, the 10 approved qualification applications reviewed complied with statutes. Three applications were denied, and the basis for the denials was consistent with statutes.

Of the eight reviewed qualification applications approved from July 2013 through February 2014, two did not comply with the requirement to provide cast names. We expanded the audit sample and examined all approved qualification applications for compliance with the proposed cast names statutory requirement. Of the 29 approved qualification applications, seven did not provide the proposed cast names as required by statutes. (See Recommendation No. 1.)

Five of 16 final film tax credit applications approved from July 2013 through February 2014, for which the production was qualified prior to July 1, 2013, were examined as part of this audit and found in compliance with the applicable statutes and regulations.

The two final applications approved after July 1, 2013, and subject to the new statutory framework were examined. Neither film production included the AFO logo and the words “*Filmed in Alaska with the Support of the State of Alaska*” as required by statute. (See Recommendation No. 2.)

⁸Productions, qualified under former AS 44.33.234, that are issued a film tax credit can only use the credit against a corporate income tax liability in accordance with the former AS 43.98.030(c).

Exhibit 4

**Qualification Applications Approved Prior to July 1, 2013, and
Related Film Credits Issued and Redeemed
July 1, 2008 through June 30, 2014**

Tax Credits Qualified

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Estimated Credit</u>
2009 - 2011	64	\$ 53,036,747
2012	40	39,933,936
2013	39	10,594,564
Total Qualification Applications	143	\$ 103,565,247
Less:		
Finalized and Issued	(87)	\$ (53,713,988)
Denied, Expired, or Withdrawn	(26)	(39,092,654)
Net Outstanding Estimates	30	\$ 10,758,605

Tax Credits Issued

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Estimated Credit</u>	<u>Actual Credit</u>
2010 - 2011	21		\$ 6,507,814
2012	24		18,615,847
2013	24		13,001,397
2014	18		5,543,701
Total Issued	87	\$ 53,713,988	\$ 43,668,759
Plus Net Outstanding Estimates	30		10,758,605
Total Issued and Outstanding	117		\$ 54,427,364

Tax Credits Redeemed

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Redeemed Amount</u>
2011	(2)	\$ (193,765)
2012	(8)	(2,702,514)
2013	(18)	(6,011,541)
2014	(18)	(21,478,699)
Total Redeemed*	(46)	\$ (30,386,519)

*Total number includes partial redemptions.
Source: Film tax credit documents.

Exhibit 5

**Qualification Applications Approved after July 1, 2013, and
Related Film Credits Issued and Redeemed
July 1, 2013 through June 30, 2014**

Tax Credits Qualified

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Estimated Credit</u>
2014 Total Qualification Applications	49	
Less:		
Pending Qualified Approval	(16)	
Denied or Withdrawn	(4)	
Total Qualified Applications Approved	29	\$ 14,201,682

Tax Credits Issued

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Estimated Credit</u>	<u>Actual Credit</u>
2014	2	Confidential*	Confidential*

Tax Credits Redeemed

<u>Fiscal Year</u>	<u>Quantity</u>	<u>Redeemed Amount</u>
2014	(0)	\$ (0)
Total Redeemed	(0)	\$ (0)

*Considered confidential by statute.
Source: Film tax credit documents.

FINDINGS AND RECOMMENDATIONS

The 2012 performance audits of the Alaska Film Production Incentive Program (film credit program or AFPIP) under the former statutory framework contained a total of eight recommendations.⁹ One of the prior recommendations is not applicable to the scope of this audit as it relates to the Film Production Promotion Program which did not transfer to the Department of Revenue (DOR). Appendix A of this report provides the status of the seven prior audit recommendations applicable to the scope of this audit.

This audit determined six of the prior recommendations were implemented. The recommendation to ensure that the names of the producers, directors, and proposed cast are included in qualification applications as required by statute was not implemented and is reiterated below as Recommendation No. 1. Additionally, one new recommendation is made to ensure AFPIP productions include the Alaska Film Office (film office or AFO) logo and required statutory verbiage.

Recommendation No. 1

DOR's AFO executive director should continue efforts to ensure qualification applications contain names of the proposed cast as required by statute.

All 29 qualification applications approved since July 1, 2013, were examined to determine if the applications included names of the producers, directors, and proposed cast. Seven of the 29 qualification applications were incomplete in listing talent or persons highlighted in the film¹⁰ production.

Alaska Statutes¹¹ require that qualification applications submitted by film producers include names of the producers, directors, and proposed cast.

The term *proposed cast* is not defined in statute. DOR and AFO management interprets *proposed cast* in the context of the statutory residency requirement (AS 44.25.125(k)) which relates to principal actors who are the five highest compensated actors or entities representing the actors. Therefore, only the principal actors were being required by DOR to be listed on the application. In May 2014, the AFO executive director revised the application form to require unscripted television productions to report cast names. Additionally, management is currently working on promulgating regulations for the film credit program.

⁹Department of Commerce, Community, and Economic Development; Department of Revenue, Alaska Film Production Tax Incentive Program, Financial Compliance, February 29, 2012, Audit Control Number 08-30065-12 and Department of Commerce, Community, and Economic Development, Department of Revenue, Alaska Film Production Tax Incentive Program, Performance Compliance, August 8, 2012, Audit Control Number 08-30066-12.

¹⁰Alaska Statute 44.25.190(2) defines *film* to include television, commercials, and videos.

¹¹Alaska Statute 44.25.120(a)(2).

Qualification applications that do not include all of the statutorily required information impede the review and approval process. Part of the approval process for qualification applications requires a determination by the Alaska Film Incentive Review Committee (film commission) that the production is not contrary to the State's best interests. The film commission considers all the information provided in the application, including who is producing, directing, and being cast in a production.

We recommend the AFO executive director continue efforts to ensure that the proposed cast names are submitted as part of qualification applications as required by statute.

Recommendation No. 2

DOR's AFO executive director and the film commission should ensure that film credit productions include the AFO logo and the required statutory verbiage.

Film productions related to the two final applications approved after July 1, 2013, and subject to the new statutory framework did not include the film office logo and the words "*Filmed in Alaska with the Support of the State of Alaska*" as required by statutes.

Alaska Statute 44.25.105(b) requires the film office logo be included in a film qualifying for a film tax credit certificate (film tax credit). Additionally, AS 44.25.125(i) states that to qualify for the film tax credit, a producer shall include:

- (1) *In the end credits of each qualified film, the film office logo ... and the words, "Filmed in Alaska with the Support of the State of Alaska"; or*
- (2) *On each DVD or other media produced for distributions, a short Alaska promotional video or advertisement approved by the Alaska Film Incentive Review Commission.*

Furthermore, AS 44.25.125(j) states that DOR may not provide a film tax credit to a producer that fails to meet the requirements in AS 44.25.125(i).

The productions for the two film tax credits issued were commercials. DOR and AFO management interpreted AS 44.25.125(i) as not applicable because there were no end credits for the commercials. However, AS 44.25.190(2) defines *film* to include television, commercials, and videos.

The AFO logo and verbiage is a method to publicize the State. Without the publicity of the film credit program, the economic benefits are diminished.

We recommend both DOR's AFO executive director and the film commission ensure that AFPIP productions include the film office logo and the required statutory verbiage.

APPENDIX

The 2012 financial and performance audits¹² of the Alaska Film Production Incentive Program (AFPIP) under the former Department of Commerce, Community, and Economic Development (DCCED) statutes and regulations contained a total of eight recommendations. One recommendation relates to the film production promotion program which did not transfer to the Department of Revenue (DOR) and, therefore, was not included in the scope of this audit. Appendix A gives the status of seven prior audit recommendations applicable to the scope of the audit.

¹²*Department of Commerce, Community, and Economic Development; Department of Revenue, Alaska Film Production Tax Incentive Program, Financial Compliance, February 29, 2012, Audit Control Number 08-30065-12 and Department of Commerce, Community, and Economic Development; Department of Revenue, Alaska Film Production Tax Incentive Program, Performance Compliance, August 8, 2012, Audit Control Number 08-30066-12.*

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Appendix A

Status of Prior Alaska Film Production Incentive Program Audit Recommendations

Recommendation	Status
DCCED’s Division of Economic Development (DED) director and the Alaska Film Office (AFO) development specialist should develop clear and measurable criteria to support best interest determinations.	This recommendation was implemented. Procedures were developed; supporting documentation was improved; and a film commission was established to assist in the best interest determinations.
The AFO development specialist should ensure that expenditures reported as reviewed by a CPA fall within the 24-month qualifying period.	This recommendation was implemented. Procedures were changed.
The AFO development specialist should ensure that the names of the director and proposed cast are included in the prequalification application as required by statute.	The finding is not resolved and is reiterated as audit Recommendation No. 1 in this report.
The Tax Division director should improve procedures for tracking and reporting the use of tax credits.	This recommendation was implemented. System changes were made and tracking procedures were improved.
The AFO development specialist should strengthen qualified expenditure documentation requirements to ensure film tax credit calculations are adequately supported.	This recommendation was implemented. Forms and procedures were updated.
DCCED’s DED director should consider amending AFPIP regulations to more clearly define Alaska residency and provide CPAs a more effective method of verifying expenditures claimed as resident wages.	This recommendation was implemented. Forms and procedures were changed.
The AFO development specialist should strengthen procedures for collecting and reporting Alaska employment data to ensure reliable information is available for program evaluation.	This recommendation was implemented. Forms and procedures were changed.

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THE STATE
of **ALASKA**
GOVERNOR SEAN PARNELL

Department of Revenue

COMMISSIONER'S OFFICE
Angela M. Rodell, Commissioner

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August 26, 2014

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AUG 26 2014

LEGISLATIVE AUDIT

Kris Curtis, Legislative Auditor
Legislative Budget & Audit Committee
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

RE: Response to Preliminary Report Recommendations, Alaska Film Production Incentive Program

Dear Ms. Curtis:

Thank you for your agency's recent review of the Department of Revenue, Alaska Film Production Incentive Program. We appreciate the opportunity to respond to the proposed recommendations contained in your agency's preliminary report dated July 14, 2014. The recommendations identified in your letter are itemized and addressed below.

Recommendation No. 1:

DOR's AFO executive director should continue efforts to ensure qualification applications contain names of the proposed cast as required by statute.

DOR understands Legislative Audit's position on this issue, and as noted in your report, the Alaska Film Office (AFO) has already taken steps to ensure that the qualification applications contain names of the spotlighted talent. DOR agrees with Legislative Audit that the statutes are not clear in this area, and the AFO will continue to work on regulations to help clarify this issue.

Recommendation No. 2:

DOR's AFO executive director and the film commission should ensure that AFPIP productions include the AFO logo and the required statutory verbiage.

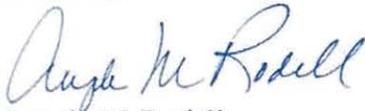
As noted in the report, the AFO had interpreted the statutory language requiring the film office logo in the "end credits" to apply only to productions that had end credits. Since commercial advertisements (commercials) do not have end credits, the AFO did not initially require the logo to be placed in commercials. However, DOR agrees with Legislative Audit that the statutory

language does require the placement of the logo and verbiage to be in each "qualified film" which includes commercials. The AFO has taken immediate steps to ensure that all productions, including commercials, insert the required logo and verbiage.

The AFO has already contacted several film producers with commercial advertisements pending final credits, and informed them that they must insert the required logo and verbiage to qualify for the credit.

We believe that we have addressed all of the findings and recommendations presented in your July 14, 2014 report, and will continue to work on improving in these areas. If you or your staff have additional comments or questions, please do not hesitate to contact us.

Sincerely,



Angela M. Rodell
Commissioner

Cc: Michael Pawlowski, Deputy Commissioner, DOR
Matthew Fonder, Director, Tax Division, DOR
Dan DeBartolo, Director, Administrative Services Division, DOR