

FINANCIAL COMPLIANCE INSTRUCTIONS

I. Introduction

The following procedures relate to the financial compliance requirements of the Pennsylvania Film Tax Credit Law and Guidelines and the Contract between the Production Company and the Department of Community and Economic Development (the "Department"). The Production Company may submit, through an Independent Certified Public Accountant (the "CPA"), an audit or a report on agreed upon procedures to fulfill its financial compliance requirements. The audit or report on agreed upon procedures must be submitted within 120 days after completion of production unless a written request for an extension has been submitted to and approved by the Film Office.

II. Guidelines for Project Audits

A. Selection of an Independent Certified Public Accountant:

The audit must be performed by a properly licensed CPA. The Department encourages a competitive bid process in selecting a CPA. Further, the Commonwealth encourages the use of small firms and firms owned and controlled by socially and economically disadvantaged individuals.

Prior Department approval of the CPA selection is not required unless the Production Company is specifically notified in writing.

B. Scope of the Project Audit:

The Project Audit must include all funds expended on the Project under the Department contract, and must encompass the entire contract period.

Other periods may also be specified at the discretion of the Department and the Department reserves the right to designate additional compliance factors.

C. Components of the Project Audit:

The Project Audit must be done in accordance with the standards set forth in the Generally Accepted Government Auditing Standards (GAGAS), current revision, and must include, **as a minimum**, the following:

1. Accountant's Report
2. Financial Statements, including:

- Statement of Total Qualifying Pennsylvania Expenses and Total Production Expenses
 - Notes to the Financial Statements
3. Report of Estimated Pennsylvania Sales Tax and total Pennsylvania individual gross income taxes withheld related to the Project
 4. Internal Control Report
 5. Compliance Report: including all findings (i.e., instances of non-compliance or deficiencies in the internal control structure), along with all attendant costs.

D. Submission of the Project Audit Report and Technical Assistance:

Three (3) copies of the audit, application, engagement letter and award letter or contract are required to be submitted to the Film Office within 120 days after the completion of the production unless a written request for an extension has been submitted to and approved by the Film Office.

The Pennsylvania Film Office
Department of Community and Economic Development
Commonwealth Keystone Building
400 North Street, 4th Floor
Harrisburg, PA 17120

Questions regarding the performance or submission of the Project Audit should be referred to the Audits & Compliance Office at (717)720-7348.

III. Guidelines for Agreed Upon Procedures Engagements

If the Production Company chooses a CPA to perform a Report on Agreed Upon Procedures, the engagement letter between the Production Company and the CPA must include the procedures detailed in subsection C below. The engagement letter must be approved by the Department ahead of time and included with the Report on Agreed Upon Procedures to the Film Office. Any changes in procedure must be approved in writing by the Audits & Compliance Office.

A. Selection of an Independent Certified Public Accountant:

The Report on Agreed Upon Procedures must be performed by a properly licensed CPA. The Department encourages a competitive bid process in selecting a CPA. Further, the Commonwealth encourages the use of small firms and firms owned and controlled by socially and economically disadvantaged individuals.

Prior Department approval of the CPA selection is not required unless the Production Company is specifically notified in writing.

B. Scope of the Agreed Upon Procedures Engagement:

The Agreed Upon Procedures Engagement must include all funds expended on the Project under the Department contract, and must encompass the entire contract period.

Other periods may also be specified at the discretion of the Department and the Department reserves the right to designate additional compliance factors.

C. Components of the Agreed Upon Procedures Engagement:

The Agreed Upon Procedures Engagement must be done in accordance with the attestation standards established by the American Institute of Certified Public Accountants, and must include, **at a minimum**, the following:

1. Accountant's Report on Agreed Upon Procedures
2. Statement of Total Qualifying Pennsylvania Expenses and Total Production Expenses and computation of Pennsylvania Film Tax Credit.
3. Report of Estimated Pennsylvania Sales Tax and total Pennsylvania individual gross income taxes withheld related to the Project.
4. Report containing an attestation that the Production Company met the conditions set forth in the Pennsylvania Film Tax Credit Law, Guidelines and the Award Letter.

D. Submission of the Report of Agreed Upon Procedures:

Three (3) copies of the report, application, engagement letter and award letter or contract are required to be submitted to the Film Office within 120 days after the completion of the production unless a written request for an extension has been submitted to and approved by the Film Office.

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Questions regarding the performance or submission of the Report on Agreed Upon Procedures should be referred to the Audits & Compliance Office at (717)720-7348.

E. Sample Agreed Upon Procedures

1. Engagement Purpose

The CPA will apply the agreed-upon procedures noted below to the expense accounts of the Production Company for the pre-production, production and post-production

periods of the Project in accordance with the standards established by the American Institute of Certified Public Accountants.

2. Agreed-Upon Procedures

- a. The CPA will read the Film Tax Credit Law and Guidelines and any other materials provided by the Film Office.
- b. The CPA will test, on a sample basis, payments to individual talent, whether they were made to an individual or a loan-out company, and verify the agreement of: the date the expense was incurred, the vendor/individual and the amount of the expense. The CPA will also inspect the invoice/documentation for evidence of the expense being incurred in Pennsylvania if such invoice has been included in the report as a Qualified Pennsylvania Expense in accordance with the Film Tax Credit Law and Guidelines.

The criteria for determining the sample size for this procedure will be as follows: The CPA will select all individuals whose total earnings were in excess of \$100,000. The number of individuals, whose total earnings were less than or equal to \$100,000, to be randomly selected by the CPA shall be proposed to the Department in the engagement letter.

- c. The CPA will ascertain whether all loan-out companies are registered to do business in the Commonwealth of Pennsylvania.
- d. The CPA will test, on a sample basis, all expenses other than payments to individual talent from the list included in the Report of All Production Expenses and All Qualifying Pennsylvania Expenses of the Project and compare to the supporting invoices and verify agreement of: the date the expense was incurred, the vendor and the amount of the expense. The CPA will also inspect the invoice/documentation for evidence of the expense being incurred in Pennsylvania if such invoice has been included in the report as a Qualified Pennsylvania Expense in accordance with the Film Tax Credit Law and Guidelines.

The criteria for determining the sample size for this procedure will be as follows: The CPA will select all expenditures in excess of \$20,000. The number of expenditures which were less than or equal to \$20,000 to be randomly selected by the CPA shall be proposed to the Department in the engagement letter.

- e. In the event that through the agreed upon procedures, outlined in the steps above, the CPA finds a high rate of misclassified expenses (i.e., non-qualified expenses categorized as qualified), the CPA will notify the Department and request that Production Company carefully review and revise the schedules of Qualified Expenses. The CPA will then select a new sample, as outlined above, and perform the above agreed upon procedures again.
- f. "High rate of misclassified expenses" - If the extrapolated error for all sample strata is equal to or greater than the greater of \$50,000 or 1% of total Qualified Expenses submitted, the Production Company will have the option to submit the expense classification again and the CPA will create a new sample selection and perform the

testing process again or as an alternative, the Production Company can elect to accept the results of the initial testing and accept the resulting Film Credit reduction adjustments as calculated by the CPA as a result of extrapolating the errors initially identified.

- a. For example, if the total Qualified Expenses submitted equals \$2,000,000 and, as a result of the sample testing, \$100,000 of expenses, after extrapolating errors, were determined to be non-qualified, the Production Company can either:
 - i. perform the Qualified Expense analysis again and the CPA will then select an entirely new sample selection, or
 - ii. opt to accept the findings of the initial sampling errors and agree to submit a request for a reduced credit for a net credit of \$475,000 as detailed in the following equation: $[(25\% \times \$2,000,000 = \$500,000) - (25\% \times \$100,000 = \$25,000) = \$475,000]$.
- b. To the extent that errors of non-compliance are found that are not subject to a reclassification as discussed above, the errors found in each sample strata will be extrapolated to arrive at a revised amount for Pennsylvania Qualified Expenses.
- g. The CPA will calculate the amount of the credit at 25% of the Qualified Pennsylvania Expenses.
- h. The CPA will review categories of expenses and payroll reports and prepare an estimate of sales taxes and individual gross income taxes related to the Project.