Follow-Up on Recommendations from Report No. 16-08, *Audit of Hawai‘i’s Motion Picture, Digital Media, and Film Production Income Tax Credit*

A Report to the Governor
and the Legislature of
the State of Hawai‘i

Report No. 19-14
September 2019

OFFICE OF THE AUDITOR
STATE OF HAWAI‘I

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STATE OF HAWAI‘I

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawai‘i State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor’s position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawai‘i Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

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To improve government through independent and objective analyses.

We provide independent, objective, and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management, and expenditure of public funds.

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We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

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We report our findings and make recommendations to the governor and the Legislature to help them make informed decisions.

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Follow-Up on Recommendations from Report No. 16-08, *Audit of Hawai'i's Motion Picture, Digital Media, and Film Production Income Tax Credit*

Section 23-7.5, Hawai'i Revised Statutes, requires the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited department or agency. We follow up on recommendations in two ways. First, annually, we ask agencies to report the status of their implementation of our audit recommendations. We compile agencies' self-reported implementation status in a consolidated report. Second, we conduct an "active" follow-up two to three years after issuance of the audit report containing the recommendations where we, independently, assess the agency's progress in implementing each recommendation and issue a separate follow-up report. This report presents the results of our follow-up on the Department of Taxation and the Hawai'i Film Office's implementation of the nine audit recommendations made in Report No. 16-08, Audit of Hawai'i's Motion Picture, Digital Media, and Film Production Income Tax Credit, *which was published in November 2016.*

DoTax continues to construe the film tax credit statute to include out-of-state expenditures as "qualified production costs," which is inconsistent with the plain language of the statute and the Legislature's intent that the incentive would stimulate economic growth in Hawai'i.

Hawai‘i's Motion Picture, Digital Media, and Film Production Income Tax Credit

Hawaii's Motion Picture, Digital Media, and Film Production Income Tax Credit (film tax credit) is codified in section 235-17, Hawai‘i Revised Statutes (HRS), and is part of Hawai‘i's income tax law. The film tax credit is based on a production company's expenditures while producing a film, television, commercial, or digital media project in the state. The amount of the credit is 20 percent of the costs incurred by a production on O‘ahu; or 25 percent of the costs incurred by a production on the neighbor islands (i.e., Maui, Kaua‘i, and Hawai‘i counties). The maximum amount of tax credits that a production can claim is $15 million per production per tax year with an annual cap of $35 million, and the credits must be claimed within 12 months following the close of a taxable year.[1]

Productions that qualify for the film tax credit include motion pictures, television shows, music videos, interactive games, and commercials with expenditures in the state. News, sporting events, and pornography do not qualify for the credit. To be eligible for the film tax credit, a qualified production must:

- Have qualified production costs totaling at least $200,000;
- Provide the State a qualified Hawai‘i promotion, which shall be, at a minimum, a shared-card, end-title screen credit, where applicable;
- Provide evidence of reasonable efforts to hire local talent and crew;
- Provide evidence when making any claim for products or services acquired or rendered outside of the state that reasonable efforts were unsuccessful to secure and use comparable products or services within the state[2]; and
- Provide evidence of financial or in-kind contributions or educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, or both, toward the furtherance of the local film and television and digital media industries.

Production costs qualifying for the film tax credit are defined by statute as the costs incurred by a qualified production within the state that are subject to the general excise tax under chapter 237, HRS, or income

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[1] Senate Bill 33, passed in 2019, became law without the Governor's signature and increased the $35 million film tax credit ceiling to $50 million per year.

[2] This requirement was added subsequent to our audit in Report No. 16-08 by Act 143, Session Laws of Hawai‘i 2017, and is codified as section 235-17(d)(5), HRS.

tax under chapter 235, HRS. Examples of production costs identified in section 235-17(m), HRS, include but are not limited to, scouting costs, costs of set construction and operations, wages or salaries of cast and crew, filming and editing costs, rentals and fees, insurance and bonding, and shipping of equipment.

Administration and implementation of the film tax credit

The Department of Taxation (DoTAX) and the Department of Business, Economic Development and Tourism (DBEDT), through its Hawai‘i Film Office (Film Office), are jointly responsible for the administration and implementation of the film tax credit program in the state.

DoTAX's responsibilities include adopting administrative rules to implement the credit, reporting on tax credits claimed by Hawai‘i taxpayers, conducting taxpayer audits, and disbursing unused tax credits in the form of refunds.

The Film Office, a unit of DBEDT's Creative Industries Division, promotes and advocates for Hawai‘i's film and television production industry. The Film Office was established within DBEDT in 1978 to recognize the increasing importance and potential of the film industry and serves as a liaison between the state and the industry by providing information and services to filmmakers. The Film Office also operates the Hawai‘i Film Studio, manages the film tax credit in conjunction with DoTAX, and oversees the film industry permit application center, which is the central coordinating entity for processing film permits for the use of state lands and properties.

The Film Office prequalifies productions for the film tax credit based on information contained in a production registration form that a production company must submit at least one week before the date of its first Hawai‘i shoot. Upon project completion, the production company must submit a Hawai‘i production report to the Film Office. The Film Office reviews the production's reported expenditures, then issues a certification letter which the taxpayer submits with its tax forms to DoTAX. The Film Office, with the support of DBEDT's Research and Economic Analysis Division, is responsible for submitting an annual report to the Legislature, detailing the non-aggregated qualified production costs that form the basis of the tax credit claims and expenditures. Costs are itemized by the taxpayer and are presented in a redacted format to preserve the confidentiality of the taxpayers claiming the credit.

Definition of Terms

WE DEEM recommendations:

Implemented

where the department or agency provided sufficient and appropriate evidence to support all elements of the recommendation;

Partially Implemented

where some evidence was provided, but not all elements of the recommendation were addressed;

Not Implemented

where evidence did not support meaningful movement towards implementation, and/or where no evidence was provided;

Not Implemented - N/A

where circumstances changed to make a recommendation not applicable; and

Not Implemented - Disagree

where the department or agency disagreed with the recommendation, did not intend to implement, and no further action will be reported.

Why we did the 2016 audit

Our performance audit of Hawai'i's film tax credit was conducted pursuant to Article VII, Section 10, of the Hawai'i State Constitution and section 23-4, HRS, which require the Auditor to conduct post-audits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the state and its political subdivisions. This was our first audit of the film tax credit. The audit was self-initiated by our office.

What we found in 2016

In Report No. 16-08, *Audit of Hawai'i's Motion Picture, Digital Media, and Film Production Income Tax Credit*, we found that DoTAX had broadened the scope of the film tax credit to include out-of-state expenses subject to tax under chapter 238, HRS, as "qualified production costs" eligible for the credit. We reported that DoTAX's implementation of the tax credit was inconsistent with the plain language of the statute and the Legislature's intent for the incentive to stimulate economic growth within the state and increased the cost of the film tax credit to the state. Expenditures paid to out-of-state businesses and service providers do not infuse money into Hawai'i's economy or provide income for local residents, nor do they create local jobs.

We also found that DoTAX had not adopted administrative rules needed to provide assurance that the film tax credit is properly administered. Without such rules, tax credit qualification requirements were unclear, the Film Office did not have the administrative tools to enforce deadlines and other filing requirements, and there was little assurance that claimed production costs qualified for the tax credit. At the time of our 2016 audit, the film tax credit statute had been in place for over ten years. As part of the audit, we found a number of provisions in the the latest publicly released version of the proposed rules that should be revised to provide greater assurance that the film tax credit is managed in accordance and consistent with the statute's intent.

Finally, we found that the lack of reliable and timely information made it difficult to evaluate whether, from a cost-benefit perspective, the film tax credit is beneficial to the State and for the Legislature to determine whether or not to extend the credit beyond 2018. The Film Office's analysis of film tax credit data did not measure the incentive's true costs and reported economic impacts that were based on incomplete and overstated data. For instance, in its annual reports to the Legislature, the Film Office included an unknown amount of out-of-state expenditures and wages paid to non-residents, as well as inaccurate production expenditure data. Highly paid producers, directors, actors, and crew who are often residents of other states likely spend very little of their Hawaiʻi-earned income in the state. Including these salaries and other out-of-state expenditures in the calculation of the benefits to the state significantly over-inflated the film tax credit's economic impacts.

What we found in 2019

Since our audit, DoTAX promulgated temporary administrative rules relating to the film tax credit, pursuant to section 231-10.7, HRS[3], which took effect on October 20, 2016, and expired on April 20, 2018. On April 10, 2018, DoTAX issued Tax Information Release (TIR) No. 2018-04, which extended the period during which taxpayers could rely on the temporary rules until December 31, 2018. On January 25, 2019, DoTAX then issued TIR No. 2019-01 to provide advance notice of the proposed administrative rules relating to the film tax credit under section 235-17, HRS, as amended by Act 143, Session Laws of Hawaiʻi (SLH) 2017 (Act 143). TIR No. 2019-01 and the proposed administrative rules[4] are effective from January 1, 2019, until the effective date of the administrative rules adopted in final form.

Act 143, which was signed into law on July 10, 2017, amended section 235-17, HRS, effective December 31, 2018, and generally applies to taxable years beginning after December 31, 2018. The act extended the film tax credit for an additional seven years until January 1, 2026, at which time the law is set for repeal or reenactment. The purpose of the act's extension is to provide stability and economic incentive predictability for the film industry, so Hawaiʻi remains competitive and comparable to other jurisdictions in attracting qualified productions, which generate additional revenue, jobs, and tourism marketing exposure. The act also amended the qualifications that a production must meet in order to claim the credit.

Our follow-up on DoTAX's and the Film Office's implementation of recommendations made in Report No. 16-08, conducted between February and June 2019, included inquiring with select personnel, examining relevant documents and records, and evaluating whether DoTAX and the Film Office have addressed our recommendations. We found that DoTAX and the Film Office have fully implemented one recommendation and have partially implemented six of the nine recommendations. Two recommendations have not been implemented and remain open. We also found that DoTAX

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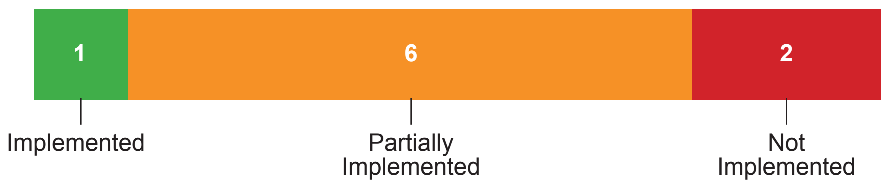
[3] Section 231-10.7, HRS, authorizes DoTAX to adopt any temporary rules that it may deem proper as provided in the section. Temporary rules may include the adoption, amendment, or repeal of any rules concerning any matters that the department is authorized to regulate.

[4] According to sections 231-10.7(d) and (g), HRS, respectively, any temporary rules issued by DoTAX shall also be issued as proposed administrative rules that are subject to the procedural requirements of chapter 91, HRS, and temporary rules shall have the same force and effect as any other administrative rules.

continues to construe the film tax credit statute to include out-of-state expenditures as "qualified production costs," which is inconsistent with the plain language of the statute and the Legislature's intent that the incentive would stimulate economic growth in Hawai'i.

Exhibit 1

Audit Recommendations by Status



Source: Office of the Auditor

Recommendations and their status

Our follow-up efforts were limited to reviewing and reporting on the implementation of audit recommendations. We did not explore new issues or revisit old ones that do not relate to the original recommendations.

Recommendation 1

DoTAX should promulgate administrative rules for section 235-17, HRS, that require all productions to obtain an independent review by a certified public accountant of qualified production costs and provide the report to the Film Office prior to being certified for the tax credit.

Partially Implemented

Comments

According to DoTAX, in TIR No. 2019-01, the department is working with DBEDT on developing proposed administrative rules that are consistent with Act 143. We verified that the two departments are working on the proposed administrative rules for the film tax credit. We also reviewed both the Film Office's and Attorney General's edits made to the draft administrative rules as evidence of both parties' involvement in the drafting process. We further reviewed sample e-mail correspondence between DoTAX and the Film Office as evidence of their collaborative efforts to develop the proposed administrative rules.

Additionally, we reviewed TIR No. 2019-01 and confirmed that the proposed administrative rules include a section entitled, "Verification review of motion picture, digital media, and film production income tax credit claims," containing the provision specified in this recommendation. According to the section, as required by section 235-17(h), HRS[5], and section 6 of Act 143, a taxpayer claiming the tax credit under section 235-17, HRS, must submit to the Film Office a verification review by a qualified certified public accountant using procedures prescribed by DBEDT, together with a production report as described in section 235-17-03(b) of the proposed administrative rules, no later than 90 days following the end of the taxable year in which the qualified production costs were incurred. The section of the proposed administrative rules further states that "it is the taxpayer's responsibility to provide all relevant information to the taxpayer's qualified certified public accountant." However, based on our review, we found that the proposed rules do not explicitly state that the required provision must be satisfied prior to being certified for the film tax credit, as indicated in this recommendation. Therefore, we recommend that DoTAX consider adding such language to this provision before adopting the proposed administrative rules in order to address the recommendation.

Target Date

Per DoTAX, the estimated adoption date of the proposed administrative rules is November 1, 2019.

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[5] Section 235-17(h), HRS, was amended subsequent to our audit in Report No. 16-08 by Act 143, Session Laws of Hawai‘i 2017, to add the requirement that every taxpayer claiming a tax credit for a qualified production under the section shall also submit a verification review by a qualified certified public accountant using procedures prescribed by DBEDT.

Recommendation 2

DoTAX should promulgate administrative rules for section 235-17, HRS, that specify the reasonable efforts to hire local talent and crew that productions must make to satisfy the statutory requirement to be eligible for the film tax credit.

Partially Implemented

Comments

We verified that the proposed administrative rules contain a section entitled, "Evidence of reasonable efforts to hire local talent and crew," which includes the provision called for in this recommendation.

Section 234-17(d)(4), HRS, requires that a production provide to DBEDT evidence of reasonable efforts to hire local talent and crew. The proposed rules define evidence of reasonable efforts to hire local talent and crew as "documentary evidence of having contacted State chapters of industry unions or guilds, including the date and time of any telephone calls, e-mails, or other contact; the name of the union or guild representative contacted; the name of the production representative initiating contact; and the name of the union or guild contacted." Such evidence also includes "documentary evidence of the specific means of notifying the public of the production's desire to hire local talent and crew, including copies of any press releases; solicitations; requests for proposals; bids; local newspaper ads; trade journal ads; flyers posted; open casting calls; radio spots; Hawai‘i film office website or other internet posting; or engagement of local production professionals as references for local talent and crew hires."

Target Date

Per DoTAX, the estimated date of adoption of the proposed administrative rules is November 1, 2019.

Recommendation 3

DoTAX should promulgate administrative rules for section 235-17, HRS, that require a more reasonable minimum financial or in-kind contribution and educational or workforce development contribution of productions and consider basing the amount of such contributions on the amount of a production's qualified production costs.

Partially Implemented

Comments

We noted that the proposed administrative rules include a section entitled, "Evidence of financial or in-kind contributions to educational or workforce development for the local film, television, and digital media industry," which includes the provision identified in this recommendation.

Section 235-17(d)(6), HRS, requires that a production provide to DBEDT "evidence of financial or in-kind contributions or educational or workforce development efforts, in partnership with related local industry labor organizations, educational institutions, or both, toward the furtherance of the local film, television, and digital media industries." The proposed rules state that "only one contribution is necessary to satisfy the requirement under section 235-17(d)(6), HRS. However, a production may make multiple contributions." The proposed rules list the following contributions that qualify for purposes of section 235-17(d)(6), HRS:

- Financial contributions to state public or charter schools totaling at least 0.1 percent of a production's qualified production costs or $1,000, whichever is higher;
- In-kind contributions to state public or charter schools totaling at least the equivalent value of 0.1 percent of a production's qualified production costs or $1,000, whichever is higher;
- Educational programs provided to state public or charter schools consisting of at least one on-set or post-production internship arrangement with a state public or charter high school or post-secondary school, preferably in the same community in which the production takes place;
- Educational programs provided to local labor union chapters consisting of at least one on-set craft apprenticeship arranged with one of the local labor union chapters;
- Hawai'i Film seminar participation with the Film Office consisting of participation as a speaker in two or more Hawai'i Film seminars; and

- Any other financial or in-kind contributions or any other educational or workforce development approved by the Film Office.

Qualification requirements for each of the listed contributions are also provided in the proposed rules. For example, financial cash contributions and contributions of in-kind property or services must be made specifically to an arts program at a state public or charter elementary, middle, high, or post-secondary school, preferably to a school in the same community in which the production takes place. Additionally, in-kind contributions must include production-related property or services, such as cameras and sound equipment, editing/post-production equipment, grip/electric equipment, computer hardware/software, props/set dressing, costumes, or other property or services previously agreed to by school administrators.

During our audit, we reviewed the proposed rules in TIR No. 2009-05 which define the monetary amount of the financial or in-kind contributions required under the film tax credit law to be "at a minimum, equal to the lesser of 0.1 percent of a production's qualified production costs or $1,000." TIR No. 2018-04 and TIR No. 2019-01 now require productions to provide financial or in-kind contributions "totaling at least 0.1 per cent of a production's qualified production costs or $1,000, *whichever is higher* (emphasis added)." However, in our audit, we noted that when compared to the amount of the film tax credit awarded, the State is not receiving sufficient benefit by allowing a production to fulfill its workforce development requirement by merely providing "*one* on-set or post-production internship" through a local public or charter school or "*one* on-set craft apprenticeship" through one of the local labor unions, neither of which seemed likely to help meaningfully develop the local film industry. We confirmed that the proposed rules regarding the workforce development requirement continue to allow productions to meet the requirement by merely providing at least one on-set or post-production internship or apprenticeship.

Target Date

Per DoTAX, the estimated date of adoption of the proposed administrative rules is November 1, 2019.

Recommendation 4

DoTAX should adopt administrative rules for section 235-17, HRS, that require productions to provide proof of the shared-card, end-title screen credit to the Film Office prior to being certified for the tax credit.

Partially Implemented

Comments

We verified that the proposed administrative rules contain a section entitled, "Hawai‘i promotion; shared-card, end-title screen credit," with the provision specified in this recommendation.

Section 235-17(d)(3), HRS, requires that a production "provide the State a qualified Hawai‘i promotion, (which shall be) at a minimum, a shared-card, end-title screen credit." The requirements are detailed in the proposed rules section as follows: (1) including in the end credits of each qualified production the phrase, "Filmed on location on the Island of __________ in Hawai‘i with the assistance of Hawai‘i Production Tax Credits administered by the Hawai‘i Film Office and the Department of Taxation" and a logo provided by the Film Office; and (2) including in each qualified production distributed by digital video disc, Blu-ray disc, digital download, or other media for the secondary market, a Hawai‘i promotional video approved by the Film Office. The proposed rules also require a production to submit a still shot, frame grab, finished copy of the qualified production in a media format acceptable to the Film Office, or other documentation that the Film Office may require.

However, based on our review, we found that the proposed rules do not explicitly state that the required provision must be satisfied prior to being certified for the film tax credit, as indicated in this recommendation. Therefore, we recommend that DoTAX consider adding such language to this provision before permanently adopting the proposed administrative rules in order to completely address the recommendation.

Target Date

Per DoTAX, the estimated date of adoption of the proposed administrative rules is November 1, 2019.

Recommendation 5

DoTAX should adopt administrative rules for section 235-17, HRS, that require all productions to provide the following information as part of submitted post-production reports: (1) the number of Hawai‘i resident and non-resident hires by category, such as above-the-line, below-the-line, and extras; (2) salary and wage information for resident actors, producers, directors, and other hires; (3) salary and wage information for non-resident actors, producers, directors, and other hires; and (4) any other information that DBEDT determines necessary to estimate the benefits of the tax credit.

Not Implemented

Comments

We reviewed TIR No. 2019-01 and confirmed that the proposed rules do not contain the provision called for in this recommendation. We also inquired with the DoTAX Rules Officer who explained DoTAX did not include the provision in TIR No. 2019-01 because it has no use for the production information that the provision requires, which is not within DoTAX's jurisdiction, since it is not tax-related information. The DoTAX Rules Officer subsequently consulted with DBEDT and verified that DBEDT is interested in obtaining the information required by the recommended provision. Following that exchange, the DoTAX Rules Officer has indicated DoTAX will include the provision in the proposed administrative rules.

Target Date

Per DoTAX, the estimated date of adoption of the proposed administrative rules is November 1, 2019.

Recommendation 6

DoTAX should adopt administrative rules for section 235-17, HRS, that include a penalty for productions claiming the tax credit that do not meet the 90-day filing deadline to submit their written, sworn statements to DBEDT, similar to the stipulation for productions failing to prequalify for the credit by registering with DBEDT currently in section 235-17(f), HRS.

Partially Implemented

Comments

We found that the proposed administrative rules include a section entitled, "Claim for credit; aggregate cap; allocation of credit," containing the provision identified in this recommendation. The proposed rules section states that "the Hawai'i film office shall only allocate credits to taxpayers who have submitted a timely production report as required under section 235-17(h), HRS. Failure to submit a production report in a timely manner shall constitute a waiver of the credit for the qualified production costs reported on that production report." We also reviewed Act 143, SLH 2017, that amended section 235-17, HRS, to add a new subsection (l), which limits the total amount of tax credits allowed in any particular year to $35,000,000 until December 31, 2025.[6] Section 235-17(l), HRS, further states that "if the total amount of credits applied for in any particular year exceeds the aggregate amount of credits allowed for such year under this section, the excess shall be treated as having been applied for in the subsequent year and shall be claimed in such year."

According to the proposed rules related to this recommendation, the aggregate cap applies to taxable years beginning after December 31, 2018. The rules further state that "for purposes of applying the aggregate cap and allocating the credit, the Hawai'i film office shall consider the year's claims for credits to be the total amount of credits applied for in timely production reports received by the Hawaii film office from April 1 of that year to March 31 of the following year; provided that credits applied for in production reports that cover tax years beginning before January 1, 2019 shall not be counted against the aggregate cap for any year." If the total amount of credits applied for in any year exceeds the aggregate cap, the credit shall be allocated to taxpayers who have submitted a timely production report to the Film Office on a prorated basis.

Target Date

Per DoTAX, the estimated date of adoption of the proposed administrative rules is November 1, 2019.

[6] Senate Bill 33, passed in 2019, became law without the Governor's signature and increased the $35 million film tax credit ceiling to $50 million per year.

Recommendation 7

DoTAX should request the Legislature to amend the statute to address the above recommendations if the department cannot implement the recommendations through administrative rule.

Not Implemented

Comments

According to DoTAX, the department did not propose any legislation amending section 235-17, HRS, during the 2019 legislative session. We inquired with the DoTAX Rules Officer who stated the department does not believe any legislative amendments to section 235-17, HRS, are required at this time. DoTAX plans to address the above recommendations by permanently adopting its proposed administrative rules.

We are compelled to note that DoTAX continues to construe the film tax credit statute to include out-of-state expenditures as "qualified production costs" eligible for the tax credit. Under TIR No. 2019-01, those out-of-state expenditures are subject to Hawai'i's use tax under chapter 238, HRS. However, as we explained in our 2016 report, DoTAX's implementation of the film tax credit appears contrary to both the plain language of the law as well as its legislative intent. More specifically, section 235-17(m) unambiguously defines qualified production costs, i.e., those costs eligible for the tax credit, as "costs incurred by a qualified production within the State that are subject to the general excise tax under chapter 237 or income tax under this chapter." Moreover, the legislative history reflects that the broad purpose of the tax credit is to stimulate economic growth in Hawai'i. As we noted in 2016, "[c]onstruing qualified production costs to include expenditures subject to the use tax means the State is subsidizing some of a production's out-of-state costs. Expenditures paid to out-of-state businesses and service providers do not infuse money into the Hawai'i economy or provide income for local residents; they do not create local jobs. Instead, those out-of-state expenditures infuse money and jobs into economies of other states, which appears to be neither the intent nor the spirit of the Hawai'i film tax credit." We urge DoTAX to seek an amendment to the statute if it intends to continue allowing out-of-state expenditures subject to chapter 238, HRS, Hawai'i's use tax, to be eligible for the film tax credit.

Recommendation 8

The Film Office should collaborate with DBEDT's Research and Economic Analysis Division (READ) to identify the specific production information READ needs to prepare a comprehensive cost-benefit analysis and/or economic output estimates that account for the different categories of jobs created, salaries and wages of resident and non-resident production hires, and any other relevant information.

Partially Implemented

Comments

According to DBEDT, the Film Office, Creative Industries Division (CID), and READ are working together to improve economic output estimates by revising the data collection fields on its Hawai‘i Production Report form to provide more specificity in certain categories as recommended by the State Economist. Based on the State Economist's recommendations, the Film Office has added expense categories to the production report form separated by above- and below-the-line, Hawai‘i vendors and resident expenditures, and goods and services imported to Hawai‘i and for which the use tax is paid. We reviewed a draft copy of the production report form developed in collaboration with READ and noted the expense categories identified by DBEDT under the "Expenditures Breakdown" sections of the form that address this recommendation. DBEDT further stated that READ will provide metrics based on the new production report data collection fields, which are more specific to the different categories of jobs, numbers of jobs created, and the salaries and wages of resident and non-resident hires. The department's reporting will now include other relevant information to remedy the initial audit findings and concerns.

According to DBEDT, while READ will handle the reporting component, the Film Office still needs to expand to obtain the proper accounting expertise, as noted in DBEDT's response to our 2016 audit. DBEDT confirmed that it submitted a request for accounting services during the 2019 legislative session and an accounting position was granted. We reviewed CID's legislative budget worksheets and identified the addition of a permanent Accountant V position. We also reviewed the Film Office's April 10, 2019, "Overview and Instructions" for the film tax credit posted on its website, which includes new policies and procedures on the implementation of Act 143, and the submission of a production report in order to be certified for the credit by the Film Office. The Film Office plans to update these policies and procedures again based on the adoption of DoTAX's draft administrative rules.

Target Date

Per DBEDT, the estimated date of implementation through finalization of its draft production report form is July 1, 2019.

Recommendation 9

The Film Office should improve its reporting to the Legislature on the film tax credit by ensuring that the reported data is accurate, consistent, and timely.

Implemented

Comments

According to DBEDT, the Film Office has improved its reporting process to the Legislature with greater collaboration between CID and READ on all reporting for the film tax credit, and by providing the necessary data sets on jobs, wages, the related economic impacts, state taxes forgone, and other pertinent data to the Legislature. Starting with the calendar year 2017 report to the Legislature, the Film Office and CID provided data sets of the total estimated 2017 expenditures by production type to READ to determine the economic impacts of that spending. We reviewed the Film Office's 2017 and 2018 film tax credit reports to the Legislature, and noted narrative sections and data on the estimated qualified and aggregate production expenditures for the respective calendar years, as well as the resulting economic impacts calculated by READ. Both reports also include narrative sections and data on the actual qualified production expenditures for the previous calendar year, along with the corresponding economic impacts. As part of our review, we verified that both reports contain calculations of the "State tax forgone" identified by DBEDT as the estimated economic opportunity cost of the film tax credit to the state government.

DBEDT further cited a few internal systemic improvements that it will be implementing to address this recommendation. First, the Film Office's leadership will be gathering the final calendar year 2016 production report forms to transmit to READ. READ's designated staff will then develop procedures to convert the production report data from digital and hard copy forms into a searchable format to tabulate the data using statistical packages. Second, for productions with budgets over $1 million, the documentation transmitted to READ will also include the required third-party review by a tax professional as part of the data set for each production. According to DBEDT, READ brings the same robust and vigorous methodology to this process that it employs for its ongoing economic reports. All future reports will include data with more definitive categories, improved accuracy, consistent methodology, and reported on a timely basis.