



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

**TENNESSEE FILM, ENTERTAINMENT AND
MUSIC COMMISSION**

Performance Audit Report

June 2017

Justin P. Wilson, Comptroller



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June 15, 2017

The Honorable Randy McNally
Speaker of the Senate
The Honorable Beth Harwell
Speaker of the House of Representatives
The Honorable Mike Bell, Chair
Senate Committee on Government Operations
The Honorable Jeremy Faison, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Bob Raines, Executive Director
Tennessee Film, Entertainment and Music Commission
312 Rosa L. Parks Avenue, 27th Floor
Nashville, TN 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Film, Entertainment and Music Commission. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the commission should be continued, restructured, or terminated.

Sincerely,

Deborah V. Loveless, CPA
Director

17260

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit

Tennessee Film, Entertainment and Music Commission

June 2017

OBSERVATION

Commission Oversight of the Film Incentive Has Improved, but Committee Minutes Should Record Contract Approval

The Tennessee Film, Entertainment and Music Commission's film incentive program provides production companies a 25% rebate on qualified expenses (Tennessee Spend) incurred in the production of a film or television program with a Tennessee connection. The January 2013 audit found significant problems with the film incentive audit process. In response to the prior audit findings, the commission contracted with a certified public accounting firm to audit reimbursements in progress and to establish new incentive guidelines. Production companies are now required to have their Tennessee Spend reviewed by a certified public accountant before any incentives are paid. During the current audit, we found that the commission improved its oversight of the incentives awarded. The current audit disclosed that the department and commission have corrected the previous audit findings related to eligible expenses used to calculate incentive payments (page 5).

Performance Audit
Tennessee Film, Entertainment and Music Commission

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Purpose and Authority for the Audit	1
Organization and Statutory Responsibilities	1
AUDIT SCOPE	3
PRIOR AUDIT FINDINGS	3
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS	4
Film Incentive Awards	4
Observation – Commission Oversight of the Film Incentive Has Improved, but Committee Minutes Should Record Contract Approval	5
Film and Television Incentive Fund Reporting and Commission Operational Budget	7
Commission Members’ Conflict-of-Interest Policy and Disclosure	8
Other Work Performed	9

Performance Audit Tennessee Film, Entertainment and Music Commission

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Tennessee Film, Entertainment and Music Commission was conducted pursuant to the Tennessee Governmental Entity Review Law, Title 4, Chapter 29, *Tennessee Code Annotated*. Under Section 4-29-239, the commission is scheduled to terminate June 30, 2018. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the commission and to report to the Joint Government Operations Committee of the General Assembly. This audit is intended to aid the committee in determining whether the Tennessee Film, Entertainment and Music Commission should be continued, restructured, or terminated.

ORGANIZATION AND STATUTORY RESPONSIBILITIES

The Tennessee Film, Entertainment and Music Commission, per *Tennessee Code Annotated*, Section 4-3-5003, is responsible for the economic development of the film, entertainment, and music communities by recruiting business to the state, encouraging increased activities of existing producers within the state, and assisting with resources and professional support. In September 2015, the commission voted to rebrand itself as the Tennessee Entertainment Commission; however, its official name is used in this report.

Membership and Executive Director

The commission was created within the Office of the Governor and is administratively attached to the Department of Economic and Community Development. The Governor appoints the executive director, who is responsible for the administration and marketing of the commission's programs. The commission has nine members appointed by the Governor who have experience and knowledge of the film, television, and music industries. One member is to represent each of the film, television, and music segments of the industry, and membership is to reflect "the racial make-up of the state." In addition, at least one member should be from each grand division. Commission members serve four-year terms and are to meet quarterly, but may meet as often as is necessary.

Members are not compensated but do receive reimbursement for expenses incurred in attending meetings. As of January 2017, all positions were filled, and membership met statutory requirements.

Advisory Council

Since 1987, Section 4-3-5004, *Tennessee Code Annotated*, has provided for a Film, Entertainment and Music Advisory Council to assist and advise the commission. The 2013 performance audit of the commission reported that the council had only one member. The council was inactive until November 2016, when 13 council members, recently appointed, were introduced at the commission meeting.

Visual Content Act of 2006

The Visual Content Act of 2006 (Section 4-3-4903, *Tennessee Code Annotated*) authorizes the Department of Economic and Community Development (ECD) to promulgate rules to administer the Tennessee Film and Television Incentive Fund grant program. Eligible productions may receive from the fund 25% of the cost of goods or services used and purchased in Tennessee as an incentive for producing a film or television program with a Tennessee connection. Details of this program are included in a later section of the report.

Interactive Digital Media Program

In March 2016, the commission introduced a new program—the Interactive Digital Media program, with a goal to be the fastest-growing state in the Southeast for interactive digital media jobs, per capita. The program will focus on music technology, digital video and streaming platforms, digital animation, video gaming, education technology, and virtual and augmented reality.

A presentation by the program manager to the commission included a summary of the barriers and the strategies for interactive digital media jobs growth in the state.

Barriers and Strategies for Interactive Digital Media Growth in Tennessee

Barriers	Strategies for Change
Interactive Digital Media community fragmented and largely unorganized	Foster the development of an Interactive Digital Media community, regionally and statewide
Perceptions of the state do not attract the target market	Identify and raise awareness of key Interactive Digital Media assets and brands in the state
Deficiencies exist for skills and experience in fields important to the Interactive Digital Media cluster	Accurately assess and strategically address skills and experience development needs and opportunities to foster Interactive Digital Media career pathways
Absence of tools and resources for Interactive Digital Media industry recruitment	Identify and secure tools and resources for target cluster recruitment

Source: Interactive Digital Media Program Manager.

At the November 2016 commission meeting, the program manager reported that the commission's advisory council will assist the commission with this new program. He also

reported that a new platform to incorporate interactive digital media should be available on the department's website with a target date of June 2017.

AUDIT SCOPE

We audited the commission's activities for the period of January 2013 to December 2016. Our audit scope included a review of internal controls and compliance with laws, regulations, and provisions of contracts or grant agreements that are significant within the context of the audit objectives. Management of the Tennessee Film, Entertainment and Music Commission is responsible for establishing and maintaining effective internal controls and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient, appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

We conducted this performance audit 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.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury actions taken to implement audit recommendations. The Tennessee Film, Entertainment and Music Commission filed a report with the Department of Audit on July 25, 2013, following the January 2013 audit report. We conducted a follow-up of all prior audit findings as part of the current audit.

The January 2013 audit found significant problems with the incentive audit process for qualifying eligible expenses for the Tennessee Spend. The current audit disclosed that the department and commission have corrected the previous audit findings related to eligible expenses used to calculate incentive payments.

A prior audit finding related to a prior executive director's non-disclosure of a conflict of interest has been resolved. Staff and members are required to sign an annual disclosure form stating they will disclose conflicts to the commission.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

FILM INCENTIVE AWARDS

For production companies interested in filming in Tennessee, the Tennessee Film, Entertainment and Music Commission's website includes a description of the application process, information on the film incentive eligibility requirements, the Tennessee production directory (a listing of a local, statewide, industry-related workforce available for hire on the production), and links to the incentive guidelines and required forms. Also available on the website are weather information, a description of the state's geography and potential locations, film and television production higher education programs, labor laws, the music licensing process, and contact information for the executive director.

After contacting the commission, productions interested in incentives submit forms with project information, cast and crew numbers, a production schedule, and names of key persons associated with the project. The commission also requires, in addition to the forms, a preliminary budget and a written description of the project, including script and synopsis, creative elements (producer, director, actors), distribution plans, and financing sources. According to the commission's guidelines, these forms should be submitted at least four months before the start of principal photography, permitting time for the application review and award process. Using the above information, the commission's executive director compiles a summary sheet of pertinent information and presents the project to the Department of Economic and Community Development's (ECD) Grants Committee. The summary sheet includes the project's anticipated Tennessee Spend, defined in the commission's Production Incentive Guidelines as necessary production expenses for products or services used in Tennessee in connection with a production and purchased from a Tennessee vendor or paid to a Tennessee resident. Commission rules and incentive guidelines require approval by the committee. The committee also approves exceptions, if requested by a project, for non-Tennessee resident approval for certain production positions (i.e., director, assistant director, art director, and editor). The committee approved such exemptions for seven projects between January 2013 and December 2016. This means the salaries for certain non-residents were counted as qualified expenditures for the incentive. Section 4-3-4903, *Tennessee Code Annotated*, authorizes the department to award grants in excess of the 25% of Tennessee spend, if deemed appropriate by the department.

If the project is approved, the commission issues a Certificate of Conditional Eligibility to the production company certifying approval and reservation of funds. The department and the production company then enter into a grant contract.

The production company meets with commission staff to discuss the production before principal photography begins. Commission staff review the project time line, Production Incentive Guidelines, and the calculation of Tennessee Spend in the meeting.

Observation

Commission Oversight of the Film Incentive Has Improved, but Committee Minutes Should Record Contract Approval

The January 2013 performance audit of the Tennessee Film, Entertainment and Music Commission found significant problems with the process for determining eligibility for two types of incentives—a film incentive of 17% based on the Tennessee Spend and a 15% franchise and excise tax refund to any production company that established headquarters in Tennessee. The audit found that both incentive programs were subject to lack of oversight and poor management and that further investigation might be needed to determine if any incentives were paid improperly.

Effective July 1, 2012, the General Assembly repealed the franchise and excise tax credit and set the film incentive award at 25% of Tennessee Spend. The commission and the department contracted with a certified public accounting firm with film production experience to audit reimbursements in progress at the time. According to the commission, approximately \$261,000 was recovered through Tennessee Spend audits by this CPA firm. The same firm assisted the commission in establishing new incentive guidelines and audit procedures. In order to resolve the previous audit findings related to non-eligible expenses included in the Tennessee Spend, the commission requires, before any incentive payments are made, that a certified public accountant hired by the production company issue an Independent Accountant's Report on Applying Agreed Upon Procedures using procedures required by the commission's Production Incentive Guidelines and in accordance with attestation standards established by the American Institute of Certified Public Accountants.

While not an audit, an agreed upon procedures engagement involves verifying specific management assertions. In this case, the agreed upon procedures require the accounting firm to read regulations and guidelines, and obtain and test a general ledger listing of all expenditures the production company submits to be qualified Tennessee expenditures. The firm verifies that records support that individuals paid are Tennessee residents, that companies are Tennessee vendors, and that fixed assets used meet requirements for the incentive. The firm is then to recalculate the amount of production incentive by using the amounts verified.

The department's Internal Audit Section uses the report to test a sample of transactions and reports results to the commission. A 2016 report by the National Conference of State Legislatures found that 19 of 41 states with a film incentive program require an assessment of the submitted expenditures.

Review of Commission's Project Documents

Our objective was to determine whether production projects comply with the commission's Production Incentive Guidelines. We reviewed the commission's documentation and the submitted expenses for 3 of 14 productions approved during the audit period and receiving incentives in 2015 and 2016. The three projects received \$7.4 million in incentives and included a production in each of the three categories used by the commission in the biennial reports (feature, feature-independent, and television series). We compared the grant contracts and Grants Committee meeting minutes to information in the December 2016 *Film and Television Incentive Fund Report* about the three productions.

For the three projects reviewed, projects met eligibility requirements and production companies submitted required forms with supporting documentation. The commission issued timely Certificates of Conditional Eligibility and held meetings prior to the start of principal photography. The Agreed Upon Procedures reports from the accounting firms hired by the production companies included a description of the guidance followed, results of the review, and a calculation of the incentive based on the Tennessee Spend. The Internal Audit Section reviewed the reports and reported on their results. We determined that the commission followed the Production Incentive Guidelines and improved its oversight of the incentives awarded.

Review of the Department of Economic and Community Development's Grants Committee Minutes of Commission Projects

Because the commission is administratively attached to ECD, department staff prepare the Grants Committee meeting minutes and required biennial reports, and monitor the fund balance. The fund balance is determined by deducting funds reserved and adding funds recovered, then reporting the amount to the Grants Committee before a project vote. Statute requires the commission to not grant incentives in excess of the amount available in the fund.

According to the commission's rules, the award of a production incentive grant must be approved by the Grants Committee. The commission's Production Incentive Guidelines state that production companies "will enter into a grant contract with ECD upon review and approval from the ECD Grants Committee."

After completing our review of the commission's documentation, we obtained and reviewed Grants Committee meeting minutes to determine the results of the vote for the three projects in our sample. Meeting minutes for two of the three projects recorded a vote for approval of reservation of funds for the projects. For the other project, minutes recorded a vote for approval of reservation of funds **and** contract approval.

We then compared meeting minutes for the 29 film projects presented by the commission to the Grants Committee from January 2013 to December 2016. In those minutes, the committee voted to reserve funds for a commission project, increase the amount of funds previously reserved for a project, table a project, approve a project for contract, and approve recovery of funds when a project did not use the full amount of its contracted incentive. The Grants Committee meeting minutes for 19 of 29 projects recorded a vote to reserve funds, or revise a

prior reservation of funds, and contract approval. We asked the commission's executive director about the ten projects for which the minutes did not state a vote for contract approval; the executive director stated that a vote to reserve funds is also considered contract approval.

The Grants Committee meeting minutes are the formal record of discussion approving any production incentive. The October 2016 Sunset audit of the Department of Economic and Community Development included a similar finding that the committee meeting minutes did not include contract approval for FastTrack grants. The department concurred and said contract approval was inadvertently excluded from the minutes and that measures were implemented to accurately reflect Grants Committee actions in the future. We recommend that the department and the commission ensure that meeting minutes correctly reflect all actions taken regarding a project, especially the vote to approve a project's contract.

Comment from the Tennessee Film, Entertainment and Music Commission:

In response to the recommendation, commission management will work with the department to ensure that meeting minutes correctly reflect all actions taken regarding those projects and/or programs associated with the Tennessee Entertainment Commission. It should be noted that commission management does not have direct authority over the meeting minutes, their completeness, and how they might be worded.

FILM AND TELEVISION INCENTIVE FUND REPORTING AND COMMISSION OPERATIONAL BUDGET

Because the Tennessee Film, Entertainment and Music Commission is administratively attached to the Department of Economic and Community Development (ECD), the commission's operational budget is included in the budget of the Business Development division of the department.

The Visual Content Act of 2006 (Section 4-3-4903, *Tennessee Code Annotated*) created the Film and Television Incentive Fund, through which the Department of Economic and Community Development may provide incentive grants to production companies. The department may use up to 5% of the annual appropriated amount for administrative expenses of the fund. Statute requires the Tennessee Film, Entertainment and Music Commission executive director to report biennially to the commissioner of the Department of Finance and Administration on the Film and Television Incentive Fund's status, including the amount of each grant awarded since the previous report, the name of the production company receiving each grant, the total amount of outstanding grants, and the total unobligated amount in the fund.

The incentive fund program is the commission's major program and provides production companies a 25% rebate on qualified expenses (Tennessee Spend) incurred in the production of a film or television program with a Tennessee connection (defined as script content, principal actors, producer/executive producer, production company, music/musician, writer, distribution, or distinguishable Tennessee location). The production company must provide production

credits to the Governor, the State of Tennessee, the commission, and ECD. Production companies are required to have a minimum Tennessee Spend of \$200,000.

The following table depicts recent funding to the Film and Television Incentive Fund:

Film and Television Incentive Fund Actual Funding by Fiscal Year			
Year	2014	2015	2016
Actual	\$10,700,400	\$1,999,900	\$13,382,200

Source: State of Tennessee Budget.

* Both 2014 and 2016 include funding for the television series *Nashville*.

The commission provides assistance, other than the incentive, per its statutory authority in Section 4-3-5005, *Tennessee Code Annotated*. According to the commission’s executive director, the commission sponsors events (music and film festivals) and works with production companies to assist them in finding locations, obtaining the necessary permits, and locating a workforce. These can be music video productions or commercials.

Our objectives were to review internal controls over the biennial reporting of fund balance and sponsorship expenditures. To obtain an understanding of the process used to prepare the biennial report and the commission’s operating budget and sponsorship payments, we obtained and reviewed 2013-2016 ECD Grants Committee Meeting minutes, the December 2016 Film and Television Incentive Fund report, 2016 revenues and expenditures from the Film and Television Incentive Fund, 2016 sponsorships paid and documentation, and grant contracts. We compared information from Grants Committee meeting minutes to information in the report and reviewed dollar amounts for accuracy.

The department used Film and Television Incentive Funds for administrative expenses such as the development of a new website for the commission in 2014 and for the accounting firm used to audit film incentive payments in process during 2012. The commission provided sponsorship support to various film and music festivals during the 2016 fiscal year from the operating budget. Based on our review, we determined that adequate controls are in place over reporting fund information and operating expenditures.

COMMISSION MEMBERS’ CONFLICT-OF-INTEREST POLICY AND DISCLOSURE

Section 4-3-5006, *Tennessee Code Annotated*, states that no member should use information gained as a member for personal gain or reveal information to any person who is not in connection with the commission. Although the members do not vote to approve projects for incentives, the members are working in the industry, and discussions during meetings could, potentially, affect them at some point.

Our objective was to determine the conflict-of-interest policy requirements for commission members. To gain an understanding of the current policy for commission members, we obtained the Tennessee Film, Entertainment and Music Commission Ethics and Conflict of Interest Agreement forms for calendar years 2016 and 2017.

In 2015, the commission adopted the form; a one-page document the commission requires members to sign at the time of appointment and by the end of January each year during their term. Members acknowledge that per statute, they are not compensated other than reimbursement for travel expenses to attend meetings; they will not use information obtained as a member for personal gain or disclose information to others; and they will disclose as a potential conflict any financial interest or family member's financial interest in a production applying for the incentive. According to the executive director, board members are encouraged to reach out to commission or department staff if they have any questions about the form or disclosing of conflicts.

In 2016, as reported by the department's Internal Audit Section, five commission members filed their disclosures an average of 126 days late, and one member did not date his disclosure. Three board members disclosed potential conflicts connected with their employment. In 2017, all commission members signed disclosures by the end of January as required and one board member disclosed a connection with a project that could apply for an incentive in the future.

OTHER WORK PERFORMED

Return on Investment

The January 2013 Sunset audit of the Film, Entertainment and Music Commission included an analysis of the return on investment the Department of Economic and Community Development calculated based on the commission's production incentive. The audit said that the department should provide information that shows a more complete picture including the fact that the average production time of the film projects reviewed was approximately 47 days. The department said it would develop new performance measures.

In January 2017, the Center for Economic Research in Tennessee (CERT) published the study *Impacts of the Production Industry in Tennessee*. (CERT is the research division of ECD.) The study estimates the economic and fiscal impacts to the state based on an analysis of 50 production projects between 2007 and 2015 that received funding from the commission (referred to as incentivized projects) and on other assistance provided to projects such as location, permitting, etc. (referred to as non-incentivized projects).

Incentivized Projects

According to the study, the commission provided \$37.74 million in reimbursements or rebates between 2007 and 2015 to 50 production projects across Tennessee. CERT analyzed the anticipated economic and fiscal impact of the production projects and reported

- the 50 production projects operated in the state for 7,346 total production days, which includes pre-production, production, and post-production operations;
- an estimated \$228.3 million in new income for Tennessee workers was generated from the 50 incentivized production projects;

- the projects created over 4,000 new full-time equivalent Tennessee jobs while generating \$370.8 million in economic output for the state; and
- the production projects generated taxable sales and purchases in Tennessee, resulting in \$11.1 million in sales tax revenue.

Non-incentivized Projects

The commission provides assistance to production projects that do not qualify for production incentives but receive location, permitting, and other assistance from the state. The CERT report says that between the first quarter of 2014 and the second quarter of 2016, the commission supported 589 projects with non-incentivized assistance, creating 589 Tennessee jobs and \$34.7 million in new income for Tennessee workers.

Other Impact

Based on 2014 interviews of visitors by the Nashville Convention and Visitors Corporation, viewers of the show *Nashville* mentioned that it was a factor in their decision to visit the city and other areas of Tennessee. CERT stated that *Nashville*-related tourism was expected to generate \$34 million in sales tax revenue for the state for the three years following the show's premier in 2012.

The report (found on the department's website) also mentions that Tennessee ranks seventh among all states in the nation for employment in the motion picture production industry.