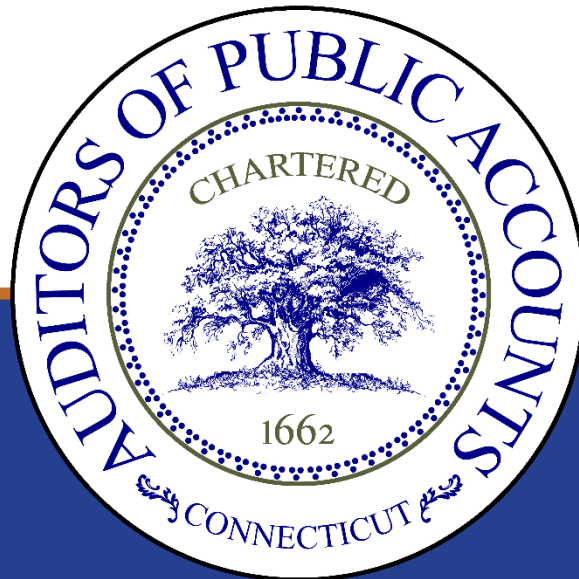


AUDITORS' REPORT

PERFORMANCE AUDIT

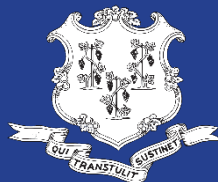
Administration of the Department of Economic and Community Development's Media Tax Credits

FISCAL YEARS ENDED JUNE 30, 2019, 2020, 2021, AND 2022



STATE OF CONNECTICUT
Auditors of Public Accounts

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January 10, 2024

INTRODUCTION

We are pleased to submit this performance audit of three media-related tax credits (Film, Television, and Digital Media, Film Infrastructure, and Digital Animation Production Company) administered by the CT Department of Economic and Community Development (DECD). For the purposes of this audit, we will refer to these credits as media credits. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2019, 2020, 2021, and 2022. Our audit identified internal control deficiencies; instances of noncompliance with laws, regulations, or policies; and a need for improvement in practices and procedures that warrant management's attention.

The Auditors of Public Accounts wish to express our appreciation for the courtesies and cooperation extended to our representatives by the personnel of the Department of Economic and Community Development during the course of our examination.

The Auditors of Public Accounts also would like to acknowledge the auditors who contributed to this report:

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STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

The [Department of Economic and Community Development \(DECD\)](#) administers three tax credits designed to incentivize private spending in film, digital media, and related infrastructure projects. They are the [Film, Television, and Digital Media Tax Credit](#), [Digital Animation Production Company Tax Credit](#), and [Film Infrastructure Tax Credit](#). We provide additional information about these incentives in the [Program Background](#) section.

Our evaluation of the administration of the Department of Economic and Community Development's media credits disclosed the following recommendations.

Finding 1

Lack of Segregation of Duties - Administration of the Media Credits

Criteria

According to Office of the State Comptroller's Internal Control Guide, management is responsible for establishing and maintaining effective internal controls so state agencies can accomplish their objectives.

Segregation of duties is a key internal control intended to minimize the occurrence of errors or fraud by ensuring no employee can initiate, record, authorize, and reconcile a transaction without the intervention of another.

Condition

The Office of Film, Television, and Digital Media (OFTDM) tax credit administrator performed multiple functions that could allow for errors and omissions which would not be detected.

We noted the OFTDM tax credit administrator:

- Received and reviewed application documentation, and qualified applicant projects to receive a credit
- Certified credit voucher amounts and created applicant vouchers
- Authorized transfer of vouchers, created reissue vouchers, and maintained documentation of transfers
- Issued and recorded credit vouchers and transfers

- Maintained all film tax credit records

The tax credit administrator is supervised by the executive director of the Office of Business Development. The executive director is aware of applications in process, provides a level of informal review, and signs vouchers issued.

Context

Credit vouchers are not assets captured and tracked within a traditional accounting system and associated internal controls. Nevertheless, the vouchers create value that could incentivize fraud. The tax credit program warrants a similar set of risk mitigation controls.

Effect

Without proper segregation of duties, there is increased risk of errors and fraud.

Cause

OFTDM has a small staff and management did not make internal controls a priority.

Recommendation

The Department of Economic and Community Development should segregate key aspects of media credit administration. If such segregation is not possible, the department should develop a formalized management review process using reliable records and information.

DECD Response

"While we understand the advantages of the segregation of duties, we respectfully disagree with this finding as appropriate internal controls and managerial oversight are already in place within the office."

Auditors' Concluding Comments

Based on the materials we reviewed, DECD does not have sufficient controls to adequately detect and prevent errors and fraud in the administration of its media credits. DECD did not provide evidence or documentation that it has adequate internal controls or a formal review process using reliable records and information.

Finding 2

DECD has not Developed Written Media Credit Administration Policies and Procedures

Criteria

Organizations should have written policies and procedures to maintain their system of internal controls. Written procedures detail regular work, activities, and authority to assist an organization in

achieving its goals and objectives and ensure compliance with applicable laws and regulations.

Condition

DECD did not have written policies and procedures for the administration of its media credits. While current statutes and regulations provide parameters for the administration of the credits, DECD did not formalize policies with a sufficient level of detail to ensure consistent control and management of the administration of the media tax credit processes.

Context

During our audited period, DECD issued credit vouchers for 142 applications. The review and approval of each application includes numerous statutory and regulatory requirements.

Effect

Internal control was weakened, and there was increased risk of statutory and regulatory noncompliance and errors.

Cause

Management did not prioritize the creation and documentation of written policies and procedures.

Recommendation

The Department of Economic and Community Development should develop written policies and procedures to administer its media credits and should prioritize policies and procedures promoting internal control to ensure statutory and regulatory compliance.

DECD Response

"We agree in part with this finding. While not written, the OFTDM does in fact follow procedure in the administration of the digital media credit programs. Were there a written document it would serve to memorialize the process that is currently place. The OFTDM will seek to reflect procedures in writing."

Finding 3

DECD did not Reconcile Claimed and Issued Transfer Vouchers

Criteria

An organization should reconcile its valuable assets, including comparing transactions and activity to supporting documentation and resolving any discrepancies.

Condition

DECD and the Department of Revenue Services (DRS) did not coordinate or regularly communicate regarding media credits. DECD did not receive information from DRS that would have

allowed it to reconcile credit vouchers issued and credits claimed by companies on their state tax returns. Additionally, DECD did not maintain credit voucher records in a way that would allow for accurate and reliable reconciliations.

Context

We inquired whether DRS and DECD exchanged data and reconciled vouchers to tax data.

Effect

There is increased risk of fraud and errors. There is a decreased likelihood of detecting the issuance of inaccurate or fraudulent vouchers.

Cause

The General Statutes do not specifically assign reconciliation responsibilities to DECD or DRS. As a result, neither agency has taken responsibility for the reconciliation process.

Recommendation

The Department of Economic and Community Development should enter an agreement with the Department of Revenue Services to obtain data necessary for reconciliation of individual credit vouchers with state tax credits. The department should develop a prompt and accurate reconciliation procedure.

DECD Response

"We disagree with this finding. The OFTDM and the DRS have worked together seamlessly whenever issued tax credit information was requested. It is not in the purview of OFTDM to receive information on tax credits claimed or to reconcile credits issued with credits claimed. It is the responsibility of DRS to ensure credits are not claimed in excess of what was issued and the OFTDM has provided this information in a timely manner whenever requested."

Auditors' Concluding Comments

While we understand DECD's contention that DRS is generally responsible to ensure tax credits are claimed correctly, this does not preclude DECD from reconciling media credits claimed against the vouchers issued. This process would serve as an internal control designed to detect and prevent errors and fraud in the administration of media tax credits.

Finding 4

DECD Lacks Reliable Data to Establish and Monitor Control Activities over Media Credit Administration

Criteria	The State Comptroller's Accountability Directive states that staff members have a duty to produce high quality information to effectively support their agency's internal control system and help it achieve its objectives.
Condition	<p>DECD did not have sufficient and reliable data to support its internal control system.</p> <p>We noted several instances in which reliable data were not available:</p> <ul style="list-style-type: none">• A key records file contained numerous errors and omissions.• DECD did not promptly and consistently update its data sources.• DECD did not maintain a master list of its issued credit vouchers with key data points and a format necessary for control activities. This list should include voucher number, recipient, recipient's federal employer identification number (FEIN), and final dollar amount.• DECD did not consistently maintain a list recording receipt of fees with key information such as check numbers, remitter information, dollar amounts, and application number.
Context	We reviewed the quality of data received from DECD and followed up with DECD staff on specific data-related questions.
Effect	DECD lacked important internal control activities such as reconciliations, accountability reports, and managerial review, which increased the risk of errors and fraud.
Cause	The error-prone manual tax credit administration process contributed to the lack of data reliability. Additionally, management did not monitor the effectiveness of internal controls, contributing to the failure to prioritize the necessary data and records to support control activities.
Recommendation	The Department of Economic and Community Development should obtain information necessary to improve its control activities. The

department should revise its processes to ensure it generates reliable data, which may include the creation of an on-line application system.

DECD Response

"We agree with this finding in part. OFTDM does maintain a comprehensive master list database which presently is administered manually. The database has been updated with all missing information added and we will endeavor to implement a methodology of regular review going forward. The office is developing an on-line application process for roll out January 2024 which should serve to reduce the amount of manual labor within OFTDM processes."

Auditors' Concluding Comments

The finding and recommendation pertain not only to the quality of the information, but its format. While the implementation of an on-line application process would likely address data quality, DECD would still have to identify requisite data and maintain it in a manner that supports internal control functions.

Finding 5

DECD has not Updated its Media Credit Regulations

Criteria

Sections 12-217jj(l), 12-217kk(f), and 12-217ll(h) of the General Statutes require the Department of Economic and Community Development to adopt regulations for the media credits. Once adopted, regulations should be current and consistent with statutory language.

Condition

The Department of Economic and Community Development adopted regulations related to the media credits on February 5, 2009, and June 26, 2009. We noted several instances in which the regulations were outdated or inconsistent with current statute:

Public Act 09-3 of the June Special Session made changes to Sections 12-217jj, 12-217kk, and 12-217ll of the General Statutes to transfer responsibility for the program from the Commission on Culture and Tourism to DECD.

Section 12-217jj only references the use of tax credits against the corporate business, insurance company, and health care center taxes. Public Act 17-2 of the June Special Session and Public Act 21-2 of the June Special Session expanded the use of the tax credit against sales and use, community antenna, and one-way satellite transmission taxes.

Section 12-217kk states a voucher application can be submitted when a state-certified infrastructure project is 60% complete. Public Act 09-3 of the June Special Session increased this requirement to 100%.

Context

We reviewed all media credit regulations and compared them to current statutory language. In the absence of written policies and procedures related to the administration of the media credits, the regulations provide key guidance. There is an established process to amend or revise regulations, which agencies can initiate at any time.

Effect

When regulations are not promptly updated, there is risk for errors in the application process that may require additional staff time, making the process less effective and efficient. There is also a risk of statutory noncompliance.

Cause

DECD did not appear to have a process to regularly review statutory changes and consider their impact on current regulations.

Recommendation

The Department of Economic and Community Development should update its regulations to reflect statutory changes and establish a process to ensure regulations are promptly updated.

DECD Response

"We agree with this finding and will update the regulations."

Finding 6

DECD did not Consistently Provide Accurate, Quality Media Credit Information to Applicants and Stakeholders

Criteria

To deliver services in an effective and efficient manner, users and stakeholders should have access to accurate and current programmatic information.

Condition

The DECD webpage, application forms, and supporting documents contained multiple errors and omissions. We noted inaccuracies in the audit instructions, application, and other guidance.

Context

We judgmentally selected and reviewed a variety of publicly available information sources. We selected these sources based on

their relevance and importance to understanding the credit programs or navigating the application processes.

Effect

The administration of the tax credit process may be less effective and efficient. Businesses may have received incorrect information about the process. This increases the likelihood of misunderstanding and application errors that require additional DECD staff resources.

Cause

DECD did not have a process to regularly review the accuracy of publicly shared information.

Recommendation

The Department of Economic and Community Development should update its website, forms, and policies to reflect statutory, regulatory, and other media credit changes. The department should establish a process to ensure it promptly updates public information.

DECD Response

"We agree in part with this finding. While there may be minor inaccuracies on forms (addresses, titles, etc.), the overall programmatic information is correct. Also, the OFTDM meets directly with applicants initially to walk them through the process and remain readily available to meet or answer any questions regarding applications and/or the program. We will take the development of the application's online version as an opportunity to bring consistency to our materials and to update forms."

Finding 7

DECD did not Collect Accurate Media Credit Application Fees

Criteria

Sections 12-217jj(g)(3), 12-217kk(c)(4), and 12-217ll(c)(2) of the General Statutes state DECD will charge a reasonable administrative fee sufficient to cover the department's costs to analyze media credit applications. OFTDM charges an administrative fee of 1% of the anticipated credit (minimum \$200 and maximum \$5,000) due with the submission of the voucher application.

Condition

A review of the 42 collected media credit fees, totaling \$197,622, revealed the following:

- a. DECD collected \$4,199 in excess fees from three applicants. In each case, the applicant paid the \$5,000 maximum fee. However, in each case 1% of their anticipated credit would have been less than \$5,000.

- b. In one case, it is not clear whether DECD ever received a \$5,000 voucher application fee. The application file had no record of a deposit or a copy of a check.

Context	During our audited period DECD collected approximately \$654,520 in voucher application fees. We reviewed the fees collected from approximately 43 of 142 (30%) of the applications for which media credits issued during our audited period. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions.
Effect	Some applicants paid higher fees than required and DECD may have underbilled others.
Cause	DECD did not have adequate internal controls to track whether it accurately collected application fees.
Recommendation	The Department of Economic and Community Development should develop internal controls to ensure it consistently and correctly collects media credit fees. The department should document a clear record of applications and related receipts.
DECD Response	"We agree in part with this finding. OFTDM relies on applicants to estimate the correct payment. To date the OFTDM has not increased the amount requested by an applicant whereas we have disallowed certain claimed expenditures resulting in decreasing the credit issued. The online application will allow for the calculation and electronic payment of fees."
Auditors' Concluding Comments	The instances in which we identified overpayment of application fees did not include disallowed expenditures. DECD should have internal controls to prevent, detect and correct incorrect application fees. The department should not rely on applicants to estimate the payments.

Finding 8

DECD's Spending of Revenue from Media Credits Fees did not Conform with Statutes

Background

Public Act 09-3 of the June 2009 Special Session introduced administrative fee requirements for the film and digital media tax credits. This act requires OFTDM to collect a \$200 fee and a 1% fee based on the anticipated credit value (up to \$5000). OFTDM deposits fees in a restricted fund. These fees are the only source of revenue in that fund.

Criteria

Sections 12-217jj(g)(3), 12-217kk(c)(4), and 12-217ll(c)(2) of the General Statutes state DECD will charge a reasonable administrative fee sufficient to cover its costs to analyze applications.

Condition

DECD used voucher application and eligibility fees to cover a variety of OFTDM expenses including the cost of social media advertising, website hosting, travel to trade shows, training, and supporting local film festivals.

Fifty of the 57 expenditures reviewed were not clearly connected to application processing. While these expenditures may have been reasonable as costs associated with OFTDM's operation, they did not comply with the narrowly defined statutory purpose.

Context

We judgmentally selected fiscal years 2021 and 2022 to review. We reviewed all 57 expenditures from these two fiscal years, totaling \$429,944. During the audited period there were 104 expenditures totaling \$660,022.

Effect

OFTDM did not appear to comply with statute. Application fees directly funded its general operations.

Cause

OFTDM management does not believe that it can only use these fees to cover application review costs.

Recommendation

The Department of Economic and Community Development should expend all application fee revenue to review associated applications or seek legislation to allow fees to be used for general Office of Film, Television, and Digital Media operational costs.

DECD Response

"We agree in part with this finding. Training of staff, fostering the industry, etc. are all supportive of the Office's work to analyze applications, but agree they are not explicitly enumerated in the

statute. Going forward we will advocate for those activities to be explicitly included as permitted expenses in the statute.”

Finding 9

DECD Accepted Incomplete External Audit Reports when Processing Media Credit Applications

Criteria	DECD has detailed instructions prescribing all the elements to be included in the audit report submitted with voucher applications.
Condition	We found that 35 of 43 (81%) audit reports reviewed failed to meet at least one of the requirements in the audit instructions. Nineteen were missing affidavits for related party transactions, five were missing explicit real property disclosures, and eight were missing tangible personal property disclosures.
Context	We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions. DECD issued \$214,620,041 in credits for the applications selected. The department issued \$558,267,980 in credits during the audited period.
Effect	DECD issued credit vouchers without ensuring that it only used qualified expenses to determine voucher amounts. This increased the risk that DECD may have issued excess credit vouchers.
Cause	OFTDM did not have proper internal controls to ensure complete audit documentation.
Recommendation	The Department of Economic and Community Development should develop internal controls to ensure all applicant audits include items and notes required by its instructions. The department should update its instructions if necessary.
DECD Response	<p>“We disagree with these findings.</p> <p>Regarding missing “affidavits for related party transactions”, while not an affidavit, every audit report includes a statement on related party transactions that discloses any such transactions and the</p>

relationship between parties. The OFTDM closely reviews all related party transactions. Additionally, each application includes an affidavit from the applicant stating that applicant has read and understood the audit instructions and has presented all supporting documentation as required in the audit instructions to the auditor. Specifically, the audit instructions state the following: (c) *Collaborating evidence of related party transactions shall include an applicant's signed affidavit representing that the applicant has properly disclosed all parties and transactions that meet the definition of a related party. The affidavit must be included as an attachment to the notes to the independent auditor's report.*

The presently required affidavit of understanding and compliance is testament that the applicant has disclosed all related parties. Mandating a second affidavit would be redundant. Furthermore, several of the audits that were found to be incomplete were in fact for infrastructure projects, which have no audit instructions. Therefore, these audits were incorrectly judged against the audit instructions for 217jj.

Missing "explicit disclosures related to real property and tangible personal property" was due to there being no such property to disclose. GAAS strongly recommends not disclosing something that does not apply to the financial statements as presented. There were no material effects on the review of these applications and no excess credits were issued therefore the stated effect of "risk that OFTDM may have issued credit vouchers in excess of the amount warranted by qualified production expenses increased" is not justified."

Auditors' Concluding Comments

In evaluating the completeness of audit reports, we used DECD's audit instructions available on its website. The audit instructions indicate the independent audit report submitted with the credit voucher application shall include "Notes to the Independent Auditor's Report, Exhibit III." The Notes section stipulates the audit report will include a "signed affidavit representing that the applicant has properly disclosed all parties and transactions that meet the definition of a related party." The affidavit of understanding and compliance is listed as an additional requirement. The Notes to the Independent Auditor's Report also includes sections on Real Property and Tangible Personal Property. While we do not contest DECD's assertion regarding GAAS guidance about disclosures, we will point out that some of the audit reports we reviewed disclosed that there was no Real Property and Tangible Personal Property in the financial statements. DECD's audit instructions may be leading to confusion on this point.

We recognize that the audit instructions specifically reference Section 12-217jj. However, since the statutory and regulatory language requiring the audit is the same for all three media credits, we believe that it is reasonable that the audit reports would be held to the same standard. In practice, it seems that audit firms are using the instructions for audits submitted with all media credits. The three

audits we reviewed for the infrastructure credit applications followed the same format as the other reports. Nevertheless, if DECD wishes to maintain that the audit instructions do not apply to audits submitted in support of the infrastructure and digital animation company credits we would emphasize that this reinforces our concerns regarding insufficient controls related to its administration of media credits.

Our finding states that DECD accepted audit reports not meeting its own documented instructions. If DECD believes its audit instructions create unnecessary or redundant documentation, or are open to differing interpretations, it should revise its instructions. Barring revisions, DECD should only accept audit reports that comply with its instructions.

Finding 10

DECD did not Consistently Collect all Required Statutory, Regulatory, or Administrative Media Credit Application Information

Criteria

Sections 12-217jj, 12-217kk, and 12-217ll of the Regulations of State Agencies require companies to submit specific financial, company, and project information at defined points of the application and voucher transfer process.

Condition

A review of the selected application files revealed DECD:

- Issued credit vouchers to 35 companies (77% of all applicants) with application files missing at least one required document.
- Accepted incomplete forms from tax credit applicants and voucher recipients. Seven out of 43 application forms reviewed contained at least one field left blank by applicants. Three out of 43 applications reviewed contained at least one incomplete transfer notification.
- Did not collect some information required by statute or regulation, such as application year and business type, for any of the 40 Digital Media and Motion Picture Tax Credit applications reviewed.

- Did not collect two certifications required at the eligibility application until later in the process for all 40 Digital Media and Motion Picture Tax Credit applications reviewed.
- Accepted a variety of documents as evidence applicants were qualified to engage in business in Connecticut. Some of these documents did not sufficiently demonstrate this standing.
- Did not collect copies of loan commitment letters, investor agreements, contact information for lenders, copies of contracts, or copies of licenses and permits as required by regulation for the three Film and Digital Media Infrastructure Credit applications reviewed.

In many cases the documents and information omitted from applications was explicitly required by statute or regulation.

Context

We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions.

Effect

DECD provided credit vouchers to companies that did not supply required documentation and information or did not supply it on time.

Cause

In some cases, DECD failed to collect data due to omissions in its application forms. The application forms did not have a corresponding field to record certain required information.

DECD also had two versions of the transfer voucher form, only one of which had fields to collect all the required information. DECD did not appear to have any controls to ensure the completeness of applications prior to issuing credit vouchers. In addition, the department does not have policies to clearly define documentation acceptable to meet its requirements.

Recommendation

The Department of Economic and Community Development should establish sufficient controls to ensure it collects all required information and documentation during the media credit application process. Additionally, the department should revise its forms to provide fields for all required information.

If certain documentation or information is no longer relevant to the application review process, or to satisfying statutory requirements, DECD should amend the regulations to eliminate the requirements.

DECD Response

"We disagree with these findings.

A review of the findings indicates that many of the "missing items" are provided within the submitted documentation, self-evident or extraneous, such as;

- the type of business entity (self-evident, and also contained in the company's submitted business registration)
- length of production (self-evident and contained in other fields)
- post-production distribution plan (not always in place at time of application and not statutorily required)
- applicant's income year (has no relationship to the year in which the credit is certified.)

Documents identified as collected "later in the process than required by statute or regulation" were collected at the time that is appropriate. It is not possible for an applicant to certify that it has maintained books and records and supplied them to the auditor, and is in compliance with 18 U.S.C. § 2257, prior to the commencement of production and subsequent audit. To compel the collection of these documents at the time the state auditors have identified as appropriate would negate their veracity as they would amount to false statements made under oath.

As far as transfer notifications, the primary "missing field" is the date of transfer, which we have established with the state auditors as the date the last party signs the agreement. The other missing field, "tax identification number" of transferor, has already been collected numerous times in the application process. All notices of assignment contain the tax ID of the transferee."

Auditors' Concluding Comments

The examples cited in DECD's response do not impact our findings. We did not include business entity type, length of production, or applicant's income year when calculating the percentage of incomplete applications. In cases in which we deemed an application incomplete, it was missing additional required information and documentation.

We used statutes or DECD regulations to establish required documentation and deadlines. If the regulatory deadlines and documentation are no longer appropriate, DECD should update its regulations.

Finding 11

DECD Issued Credits to Projects that did not Meet Statutory Production Thresholds

Criteria

Section 12-217jj(c) of the General Statutes establishes production thresholds for an otherwise eligible production to meet to qualify for a credit voucher. An applicant must:

- Conduct not less than 50% of principal photography days within the state, or
- Expend not less than 50% of postproduction costs within the state, or
- Expend not less than one million dollars of postproduction costs within the state.

Condition

In our review of four interactive website production credit vouchers totaling \$8,579,758, we noted that in all four instances DECD issued vouchers that did not meet the criteria in Section 12-217jj(c).

Context

We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions. Four applications in the selection were for interactive website productions. DECD issued \$214,620,041 in credits for the applications selected. The department issued \$558,267,980 in credits during the audited period, \$90,262,162 of which were issued for 23 interactive website productions.

Effect

DECD was not in compliance with Section 12-217jj(c) of the General Statutes.

Cause

The statutory language is not consistent. In 2007, Public Act. 07-236 amended Section 12-217jj(a) to include interactive websites within the definition of qualified production. However, the act did not amend the language related to the thresholds. Since websites do not have post-production expenses, and in some cases, do not engage in principle photography, they cannot meet the statutory thresholds despite being included in the definition of qualified production.

The OFTDM credit administrator appears to be avoiding this inconsistency by interpreting general website production costs as meeting the statutory thresholds.

Recommendation

The Department of Economic and Community Development should seek legislation to amend Section 12-217jj(c) of the General Statutes to include interactive website productions.

DECD Response

"We disagree with this finding.

Interactive websites have their own criteria in the statute: (8) *"Interactive web site" means a web site, the production costs of which (A) exceed five hundred thousand dollars per income year, and (B) is primarily (i) interactive games or end user applications, or (ii) animation, simulation, sound, graphics, story lines or video created or repurposed for distribution over the Internet. An interactive web site does not include a website primarily used for institutional, private, industrial, retail or wholesale marketing or promotional purposes, or which contains obscene content.*

All other production types must meet one of the three criteria mentioned above under Section 12-217jj(c). Additionally, they must spend a minimum of \$100,000 in order to qualify. Websites, however, have their own threshold of \$500,000 in minimum expenditures. By definition they are not bound by the same criteria as other production types."

Auditors' Concluding Comments

We disagree with DECD's interpretation of the statutory language. Section 12-217jj(c) explicitly states "No eligible production company incurring an amount of production expenses or costs that qualifies for such credit shall be eligible for such credit unless" they meet one of the three thresholds described above. The passage identified by DECD is from 12-217jj(a)(8) and establishes the definition of an interactive website under the statute. It does not exempt interactive websites from the eligibility requirements in subsequent sections. The inconsistency in statutory language needs to be resolved.

Finding 12

DECD did not Hold Voucher Applicants to the 90-Day Statutory and Regulatory Deadline

Criteria	Section 12-217jj(h)(2) of the General Statutes and sections 12-217jj-6, and 12-217kk-8 of the Regulations of Connecticut State Agencies require companies to apply for a credit voucher no later than 90 days after incurring the last production cost or expense for a qualified production.
Condition	In our review of 43 credit vouchers totaling \$214,620,041, we noted that DECD issued 30 credit vouchers (70%), totaling \$138,857,361, to applicants who had not submitted their voucher application within 90 days. These companies submitted their applications three to 1,354 days late (median of 132 days).
Context	We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions. The department issued \$558,267,980 in credits during the audited period.
Effect	DECD is not in compliance with statute. Companies that did not meet the 90-day application deadline received production credit vouchers.
Cause	OFTDM did not require applicants to submit voucher applications within 90 days of their last qualifying expense. The office indicated that the 90-day window is not sufficient for most companies to comply with all the necessary steps including the third-party audit.
Recommendation	The Department of Economic and Community Development should hold applicants to the statutorily required deadline or seek legislation to allow applicants more time to submit their voucher application.
DECD Response	<p>"We agree in part with this finding.</p> <p>The legislation states: (2) <i>Not later than ninety days after the end of the annual period, or after the last production expenses or costs are incurred in the production of a qualified production, an eligible</i></p>

production company shall apply to the department for a production tax credit voucher, and shall provide with such application such information and independent certification as the department may require pertaining to the amount of such company's production expenses or costs.

The audit cost is an expense paid by the production company. It is always the last expense incurred by the production company "in the production of the qualified production", as all other costs must have been paid by this point in order to be included in the application. OFTDM will seek to remove the word "production" before "expenses or costs" to bring greater clarity to the language. The cost of the audit is not eligible for the tax credit, but had been at the time the legislation was written and is the ultimate documentation required to substantiate a production's demonstrably incurred Connecticut spend."

Auditors' Concluding Comments

Section 12-217jj(a)(5)(C) of the General Statutes explicitly excludes any expenses or costs related to an independent certification from the definition of production expenses or costs. Section 12-217jj(h)(2) requires companies to apply no later than 90 days after their last production expense or cost. As such, the date the applicant incurs audit cost cannot be used to start the 90-day application deadline.

Finding 13

DECD Improperly Used Audit Expense to Establish the 90-Day Voucher Application Window

Criteria

Section 12-217jj(h)(2) of the General Statutes requires companies apply for a credit voucher no later than 90 days after they incur their last production cost or expense. Section 12-217jj(a)(5)(C)(vi) of the General Statutes stipulates any costs related to the independent verification of production expenses cannot be considered production expenses or costs.

Condition

Contrary to statute, DECD used the audit cost as the final production expense, allowing companies and external audit firms to use the date they incurred the audit cost as the start of the 90-day deadline. In our review of 43 credit vouchers totaling \$214,620,041, we noted that DECD issued 29 credit vouchers totaling \$186,279,335 that used the date of the incurred audit cost to establish the 90-day application window.

Context

We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. We

used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions. The department issued \$558,267,980 in credits during the audited period.

Effect

DECD did not hold 29 companies to statutory requirements. Subsequently, DECD granted \$125,609,099 in production credit vouchers to 25 companies that exceeded the 90-day voucher application deadline.

Cause

DECD allowed audit expenses to be used as the final production cost to make the process more manageable for applicants, audit firms, and the department.

Recommendation

The Department of Economic and Community Development should comply with Section 12-217jj(a)(5)(C) of the General Statutes and not allow audit costs to be considered a production expense for establishing the 90-day application window.

DECD Response

"We disagree with this finding. The audit cost is an expense incurred by an eligible production company that is mandated by the state in order to participate in the tax credit program. While this expense can no longer be counted as a "qualified expense" and included in the tax credit calculation, it is an expense nonetheless.

The ninety-day deadline from last "qualified" tax credit earning expenditure does not allow enough time to close out a production and perform an audit. Though not counted as a qualified tax credit spend, disallowing the audit as the last production expense would create uncertainty around the program and deter productions from locating to Connecticut due to the high risk of not being able to meet this deadline."

Auditors' Concluding Comments

Section 12-217jj(a)(5)(C) of the General Statutes explicitly excludes any expenses or costs related to an independent certification from the definition of production expenses or costs. Section 12-217jj(h)(2) requires applicants to apply no later than 90 days after the last production expense or cost. As such, the date the applicant incurs the audit cost cannot be used to establish the start of the 90-day application deadline. If an application deadline of 90 days from the final production cost is not feasible, DECD should seek appropriate statutory changes.

OBJECTIVES, SCOPE, AND METHODOLOGY

Section 2-90c of the General Statutes provides in part that the Auditors of Public Accounts conduct a performance audit of the Department of Community and Economic Development's (DECD) incentive programs as part of each DECD audit or as a stand-alone audit. We have conducted a performance audit of three media-related tax credits administered by the Department of Economic and Community Development. For the purposes of this audit, we will refer to these three credits as media credits. The scope of our audit included, but was not necessarily limited to, the fiscal years ended June 30, 2019, 2020, 2021, and 2022.

The objectives of our audit were to:

1. Evaluate the efficiency and effectiveness of DECD's administration of its film and media credit programs, including a review of eligibility and voucher applications, and credit transfer processes;
2. Determine whether DECD has sufficient controls to ensure that it appropriately and consistently follows the application, credit certification, and credit transfer processes; and
3. Examine whether the department's administration of the tax credits complies with statutes and regulations.

We did not evaluate the economic impact of the credits as part of this audit.

We obtained information for this performance audit through multiple sources and methods including a review of relevant state statutes and regulations, our and other states' audit reports, economic impact studies, DECD annual reports, news articles, legislative history, and DECD documents and data sets. We also interviewed agency staff, reviewed applications submitted to DECD, and obtained tax claim data from the Connecticut Department of Revenue Services (DRS). We did not audit DRS as part of this engagement. We only used DRS data to evaluate certain aspects of DECD's administration of media credits.

We established evaluative criteria by reviewing relevant Connecticut statutes and regulations, considering inherent risks related to the credit administration and internal controls that would mitigate such risks, and developing an understanding of the processes for administering the tax credits. Our testing was not designed to project to a population unless specifically stated.

We completed the following to address our audit objectives:

- Reviewed the accuracy and completeness of publicly available documents, webpages, application forms and documentation, audit instructions, and other records
- Reviewed the accuracy and completeness of administrative data and records
- Reviewed and determined the completeness of application files
- Compared the administration of the application and voucher credit processes against relevant state statutory and regulatory requirements

- Compared Connecticut tax filing data against DECD credit vouchers and voucher transfers

We selected applications for review using a modified random approach. We reviewed 43 of 142 of the applications (approximately 30%) for which DECD issued media credits during our audited period. Some of these applicants may have applied before our audit period began. We excluded from consideration any application submitted during our audit period, for which a credit had not yet been issued. We used a stratified random sampling method to identify the reviewed applications. We based the stratification on the fiscal year, selecting 30% of applications in each fiscal year. We replaced one application from the random sample with an application we had already identified with potential exceptions. The application replaced was selected judgmentally from applications in the same fiscal year as the replacement application.

We obtained an understanding of internal controls we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain controls to obtain evidence regarding the effectiveness of their design and operation.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The accompanying program background is presented for informational purposes. We obtained this information from a variety of available sources including, but not limited to, interviews, documents, annual reports, statutes and regulations, and data provided by agency staff. It was not subject to the procedures applied in our audit of the media credit administration. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with laws and regulations; and
3. A need for improvement in management practices and procedures we deemed to be reportable.

PROGRAM BACKGROUND

TAX CREDIT DESCRIPTIONS

The [Department of Economic and Community Development \(DECD\)](#) administers three tax credits designed to incentivize private spending in film, digital media, and related infrastructure projects. They are the [Film, Television, and Digital Media Tax Credit](#), the [Digital Animation Production Company Tax Credit](#), and the [Film Infrastructure Tax Credit](#).

- The Film, Television, and Digital Media Tax Credit offers tax credits for productions with a \$100,000 minimum Connecticut expenditure. The credit issued is a percentage of total production expenses or costs based on the following thresholds:

Production Expenses	Potential Tax Credit
\$100,000 - \$500,000	10%
\$500,001 - \$1,000,000	15%
More than \$1,000,000	30%

To be eligible for the credit, production companies must conduct at least 50% of principal photography days within the state, expend at least 50% of postproduction costs within the state, or expend \$1 million or more in postproduction costs within the state.

- The Digital Animation Production Company Tax Credit offers tax credits to production companies engaged in digital animation production activity in Connecticut. The required spending thresholds and potential credit amounts mirror those of the Film, Television, and Digital Media Tax Credit. In addition to meeting the minimum spending threshold, production companies must maintain studio facilities within the state and employ at least 200 full-time Connecticut employees.
- The Film Infrastructure Tax Credit offers a 20% tax credit to taxpayers investing at least \$3 million in a capital project to provide buildings, facilities, or installations for the digital media and motion picture industry functions in Connecticut.

All three credits are nonrefundable but can be sold or otherwise transferred up to three times. The Film, Television, and Digital Media Tax Credit can be claimed against tax imposed under the corporate business, insurance company, health care center, community antenna television system, one-way satellite transmission, and sales and use taxes for the income year in which the production expenses were incurred, or in the five immediately succeeding income years. The Digital Animation Production Company and the Film Infrastructure tax credits can be claimed against taxes imposed under the corporate business, insurance company and health care center taxes for the income year in which the expenses were incurred, or in the three immediately succeeding income years.

ENABLING LEGISLATION

The Film, Television, and Digital Media Tax Credit, the Film Infrastructure Tax Credit, and the Digital Animation Production Company Tax Credit are described in Chapter 208, Sections 12-217jj, 12-217kk, and 12-217ll respectively of the General Statutes.

Public Act 06-83 established the Film, Television, and Digital Media Tax Credit. Public Act 07-236 establishing the Digital Animation and Public Act 07-4 of the June Special Session establishing the Film Infrastructure Tax Credit.

Public Act 09-3 of the June Special Session raised the qualifying minimum spending for the Film, Television, and Digital Media Tax Credit from \$50,000 to \$100,000 and changed the spending thresholds and potential credit percentages it and the Digital Animation Production Company Credit to their current tiered structure. Public Act 09-3 also established a requirement that at least 50% of principal photography days be conducted in Connecticut, barred any out-of-state expenses from qualifying for a tax credit, further limited the amounts paid for star talent, transferred credit administration authority from the CT Commission on Culture and Tourism to DECD, and introduced the external audit and administrative fee requirements.

Public Act 11-1 of the October Special Session added relocated productions to the list of eligible production types. Public Act 13-184 established a two-year moratorium on motion picture eligibility. This moratorium was extended indefinitely in 2017 with Public Act 17-2 of the June Special Session. Public Act 21-2 of the June Special Session allowed the Film, Television, and Digital Media Tax Credit to be claimed against tax burdens under the sales and use tax under certain conditions beginning January 1, 2022.

TAX CREDIT ADMINISTRATION

The media credits are administered by the Office of Film, TV, and Digital Media (OFTDM) under the Office of Business and Community Development of the Department of Economic and Community Development. The OFTDM application forms and process reflect the statutory and regulatory requirements and support compliance. The application process serves as the key control for ensuring only qualified companies, productions, or projects receive media credits for the statutorily mandated amount based on the actual expenses incurred.

Statutes and regulations provide the framework for the administration of the program, stipulating details related to eligibility and process.

Statutes establish key aspects of eligibility for the media credits including:

- Types of projects and productions to receive a credit
- Deadlines for eligibility, voucher applications, and transfer notifications
- Qualifying credit expenses
- Thresholds for qualified expenses
- Requirement for third-party audits of submitted expenses

Regulations provide additional details regarding the process including:

- Required eligibility documentation and information
- Details and notes required in the audit report submitted with the voucher application
- Documents supporting the certification of qualified expenses and voucher amount
- Information required at the point of credit transfer or sale

There is a two-step process to apply for one of the media credits. Applicants must first apply with OFTDM to determine if their project, production, or company is eligible to receive the credit. OFTDM reviews applications, determines if the applicant qualifies, and certifies eligibility. The initial certification does not guarantee a tax-credit will be issued.

Once companies incur all expenses associated with an eligible project or production, they apply for a credit voucher. Companies must submit an external audit performed by a DECD-approved audit firm with their voucher application. OFTDM reviews voucher applications, certifies the amount of the credit, then issues a voucher to the applicant.

If a credit voucher recipient sells or transfers any part of its credit voucher, both parties must provide written notice of the transfer to OFTDM. OFTDM will reissue the original voucher for the new amount, and issue new vouchers to the new party.

The OFTDM tax credit administrator administers the application process. The credit administrator performs all aspects of the process including communicating with applicants, receiving application materials, certifying voucher amounts, and processing and recording voucher transfers.

An additional OFTDM employee oversees production location and vendor services and manages and facilitates filming permits. The executive director of the Office and Community Development signs credit vouchers prepared by the tax credit administrator.

OFTDM does not have a dedicated information technology system to administer these tax credit programs. During the initial years of our audit period, companies submitted physical applications and supporting documentation. Due in part to the 2020 onset of the COVID-19 pandemic, the application process evolved, and applicants supply much of the documentation electronically.

FEES AND EXPENDITURES

The tax credit application fees are OFTDM's sole source of revenue. Salaries and fringe benefits are funded centrally. OFTDM collects two fees from each applicant: an eligibility application fee, and a voucher application fee. These fees are deposited in a restricted fund and spent on programmatic expenses. During our audit period, OFTDM collected \$653,485 in fees.

OFTDM Fees:	Fiscal Year				
	2019	2020	2021	2022	Total
Eligibility Fees	\$ 10,000	\$ 6,800	\$ 9,400	\$ 10,000	\$ 36,200
Voucher Fees	153,502	178,573	127,016	158,194	617,285
Total Fees Collected	\$ 163,502	\$ 185,373	\$ 136,416	\$ 168,194	\$ 653,485

Major expenditures included event sponsorship, marketing, advertising, and training funds provided to another organization. Expenditures totaled to \$660,022.

OFTDM Fee Account Expenditures:	Fiscal Year				
	2019	2020	2021	2022	Total
Pass thru Grant Non-State*	\$ -	\$ -	\$ 250,000	\$ -	\$ 250,000
Sponsorship	96,500	32,000	22,500	32,500	183,500
Marketing	7,455	46,200	35,650	37,800	127,105
IT Software Maintenance & Support	-	13,842	16,692	16,692	47,226
Out-Of-State Travel	-	8,813	354	9,629	18,796
Online Information Services	10,800	-	-	-	10,800
IT Consultant Services	-	-	5,740	-	5,740
Promotional Supplies	-	4,194	-	-	4,194
Membership Dues	-	1,709	950	950	3,609
Other	3,494	4,717	433	407	9,051
Total Fee Account Expenditures	\$ 118,249	\$ 111,475	\$ 332,319	\$ 97,978	\$ 660,021

* These funds were passed to an external organization for training purposes

PROGRAM ACTIVITY

Value of Tax Credits Issued

The media credits are collectively the largest tax credits administered by DECD. From fiscal year 2019 to fiscal year 2022, OFTDM issued \$555.9 million in tax credits for over \$1.8 billion spent in Connecticut.¹ The number of credits issued varies each year. During fiscal years 2019 - 2022, the credits issued annually have ranged from 30 to 39, averaging 35 per year. The value of credits issued has ranged from approximately \$120 million to \$157 million, with an average of \$139 million per year (see Exhibit 1).

¹ Figures in this section are taken from DECD's publicly available annual reports.

Exhibit 1: Combined Film Tax Credits 4-year Summary

Fiscal Year:	Company Spend	Value of Credits Issued	Number of Credits
2022	\$ 508,438,692	\$ 144,942,201	34
2021	400,545,435	119,894,531	30
2020	447,546,649	133,850,487	37
2019	531,432,154	157,303,414	39
Total	\$ 1,887,962,930	\$ 555,990,633	140

The Film, Television, and Digital Media Tax Credit is the largest media credit. During fiscal years 2019 through 2022, OFTDM issued 134 credits (see Exhibit 2), accounting for approximately 95% of all company spend and 96% of the value of all credits issued during this period.

Exhibit 2: Film, Television, and Digital Media Tax Credit 4-year Summary

Fiscal Year:	Company Spend	Value of Credits Issued	Number of Credits
2022	\$ 432,517,618	\$ 129,757,986	31
2021	400,545,435	119,894,531	30
2020	444,349,678	133,211,093	36
2019	512,180,316	153,453,046	37
Total	\$ 1,789,593,047	\$ 536,316,656	134

The Film Infrastructure Tax Credits accounted for approximately 98 million of company spend and \$20 million of credits issued during fiscal years 2019 through 2022. OFTDM issued six infrastructure credits during this period. In fiscal year 2021, OFTDM did not issue any infrastructure credits (see Exhibit 3).

Exhibit 3: Film Infrastructure Tax Credit 4-year Summary

Fiscal Year:	Company Spend	Value of Credits Issued	Number of Credits
2022	\$ 75,921,074	\$ 15,184,215	3
2021	-	-	-
2020	3,196,971	639,394	1
2019	19,251,838	3,850,368	2
Total	\$ 98,369,883	\$ 19,673,977	6

No companies applied for the Digital Animation Production Company Tax Credit in fiscal years 2019 through 2022.

Tax Abatements

During our audit period, tax credits were claimed against Connecticut taxes by companies under the corporate business, insurance company, health care center, community antenna television system, and one-way satellite transmission business taxes. Claimed credits create tax abatements tracked by DRS. Since the tax credits can be claimed across multiple years, the amounts claimed in any given year do not correspond to the value of issued credits. DRS reported \$380,785,677 in abated taxes during fiscal years 2019 through 2022 (see Exhibit 4).

Exhibit 4: Tax Abatement Amounts from Media Credit Program

Fiscal Year:	Abatement Amount
2022	\$ 83,442,611
2021	107,361,353
2020	101,261,204
2019	88,720,509
Total	\$ 380,785,677

During the years DRS provided disaggregated tax abatement amounts, insurance companies were the largest recipients of tax benefits, accounting for 53% of abated taxes. Credits claimed against taxes filed under the corporate income tax accounted for another 44%, with claims filed against the community antenna television systems and one-way satellite transmission business taxes accounting for the final 3%.

Tax Credits and Recipients

During our audit period, 52 companies received credit vouchers for either the Film, Television, and Digital Media Tax Credit or the Film Infrastructure Tax Credit (two companies applied for both credits during our audit period)². They received 142 credits with a combined value of \$558,267,980. The number of times companies applied for a tax credit varied greatly. Approximately 24 of 52 companies (46%) applied and were issued one tax credit during our audit period. An additional 46% of companies applied for one credit a year for multiple years. Two companies applied for multiple credits per year, for multiple years. The number of credits issued to a company ranged between one and 17 (see Exhibit 5).

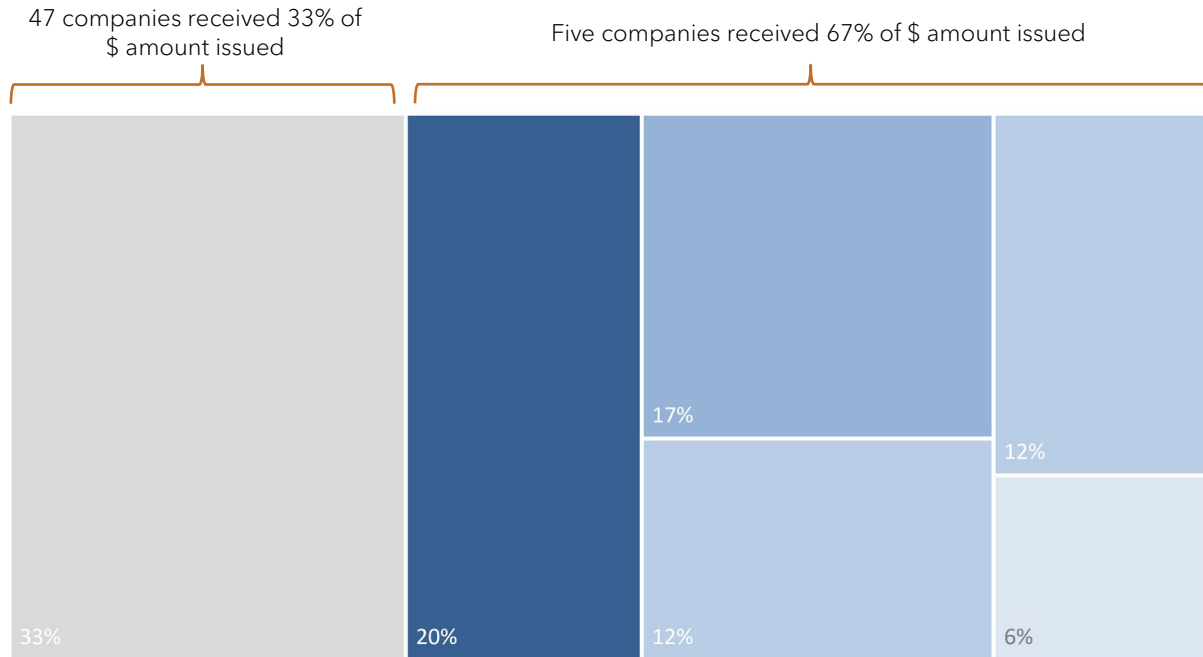
Exhibit 5: Distribution of Credits Issued by # of Credits Received

Credits Received:	# Of Companies	% Of Companies
1	24	46%
2	1	2%
3	12	23%
4	12	23%
5	1	2%
10	1	2%
17	1	2%
Total	52	100%

The total value of credits companies received varied greatly. Five companies received \$374,962,666 (67%) of the value of all credits issued during this period (see Exhibit 6).

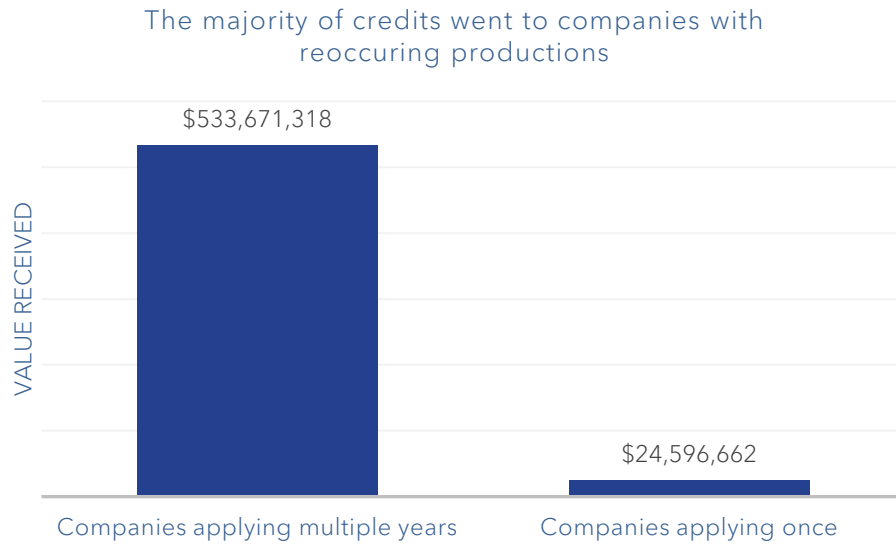
² Figures related to credits, recipients, and sales are approximate. We found multiple errors and omissions in the records related to the media credits provided by OFTDM, including discrepancies with publicly reported data. Additionally, we had to transform the data for purposes of analysis. Nevertheless, the figures can be seen as describing the overall magnitude and direction of observations.

Exhibit 6: Distribution of Credits Issued by Value of Credits Received



In terms of the number of credits and dollar value, OFTDM issued most credits to companies with reoccurring productions in Connecticut (see Exhibit 7).

Exhibit 7: Distribution of Credits Issued by Application Frequency



The average value of credits varied as well. Companies applying across multiple years averaged \$4,522,638 per credit and one-time applicants averaged \$1,024,861 (see Exhibit 8). Additionally, the top five companies' average credit value (\$9,867,439) was significantly greater than the average credit value of all other companies (\$1,762,551) (see Exhibit 8).

Exhibit 8: Average Credit Value by Recipient Rank and Application Frequency

	Dollar Amount	# Credits Received	Average Credit Value
Top Five Credit Recipients	\$374,962,666	38	\$9,867,439
All Other Recipients	\$183,305,314	104	\$1,762,551
Applied Multiple Years	\$533,671,318	118	\$4,522,638
Applied Once	\$24,596,662	24	\$1,024,861

Credit Transfers

Many companies eligible for one of the media credits do not pay Connecticut taxes. Since the tax credit is nonrefundable, incentivization is only effective if these companies can sell their credits. Some states have refundable credits, which simplifies accounting for this process. This is not the case in Connecticut. The revenue from these sales reduces the overall production costs. Transferees are brokers who purchase credits to resell them or companies who operate in Connecticut and have a tax burden under the corporate business, insurance company, health care center, community antenna television system, one-way satellite transmission, or sales and use taxes.

Credits can be sold up to three times and can be sold to multiple transferees. For example, if a company sold its credit to six companies, this would only count as one sale. During the audit period most applicants that received a credit sold all or a portion of their originally issued vouchers. Original recipients sold 130 of the 142 DECD vouchers (92%). Of those vouchers, 61 of 130 (47%) were sold to more than one transferee. Regardless of the number of transfers, the value of subsequent vouchers should equal the originally issued credit.

Voucher sales greatly increased the final number of vouchers issued during our audit period. The 142 vouchers issued during this time grew to 488 vouchers with a non-zero end balance.³ Only 18 out of the 488, were original or original non-zero reissues. The remaining vouchers were issued because of a transfer (see Exhibit 9).

Exhibit 9: Vouchers Resulting from Transfers

Transfer level:	# Vouchers Created	% Of Final Vouchers
Original or Non-zero Reissues	18	4%
First	356	73%
Second	109	22%
Third	5	1%
Total	488	100%

³ If a company transfers the full value of their credit voucher, OFTDM will reissue the original voucher with a zero balance.