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Film, Fraud, and Fixes: Choosing film production tax incentives that maximize stakeholders' value while minimizing fraud

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Abstract
The objective of this project is threefold. The first objective is to conduct an analysis of film production tax incentives (Film PTIs) available across all 50 states. Using this information, the second objective is to discern potential frauds for the various types of Film PTIs. The third objective is to then recommend a mix of Film PTIs that: Minimizes the potential for fraud; provides adequate incentives for film production companies; and allows states to promote themselves as supporters of in-state film productions, skilled job creation, and local small businesses.
This graduate research service learning project was conducted at Coastal Carolina University by students in Dr. Maguire's Spring 2015 ACCT 631 Fraud Examination class. The clients for this project operate in multiple sectors of the film industry. They include TLC's Trailer Park: Welcome to Myrtle Manor, A&E's Wild Transport, Jupiter Entertainment, and The Weinstein Company (hereafter "The Clients"). Working in collaboration, this research aims to assist The Clients in their tax planning efforts when evaluating filming locations. Concurrently, this research aims to help South Carolina and other states demonstrate their film industry building efforts, while meeting the commitment to achieve best practices and act in the best interest of their constituents.

Key words: Accounting, Auditing, Fraud, Film, Production Tax Incentives

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With these objectives in mind, we make the following recommendations regarding a Film PTI mix:

- *Offer Film PTIs to all eligible legal production companies, regardless of the market segment (e.g., Video Games, Music Videos, etc.).*
- *No minimum spending cap, however pre-approval from the state is required.*
- *Offer film production companies sales, use, and lodging tax exemptions.*
- *Require project ending audits.*
- *Offer Film PTIs for state specific product placement (e.g., South Carolina license plates, road signs, local businesses, etc.).*
- *Offer Film PTIs for location filming during the off season and/or in smaller towns.*
- *Offer maximum "above the line" salary Film PTIs at $1 million per person (above the line salaries are for screenwriter, producer, director, and principal actors).*
- *Offer Film PTIs for post-production with in-state facilities.*
- *Refundability with a useful life/carry-forward of five years.*
- *State buyback of refundable credits below par or face value.*
- *We do not recommend brick and mortar incentives.*
- *We do not recommend transferability of Film PTIs.*

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INTRODUCTION

"Cinema is the most beautiful fraud in the world."
-- Jean-Luc Godard

The objective of this graduate research service learning project is threefold. The first objective is to conduct an analysis of film production tax incentives (Film PTIs) available across all 50 states. Using this information, the second objective is to discern potential frauds for the various types of Film PTIs. The third objective is to then recommend a mix of Film PTIs that: Minimizes the potential for fraud; provides adequate incentives for film production companies; and allows states to promote themselves as supporters of in-state film productions, skilled job creation, and local small businesses.

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FILM PRODUCTION TAX INCENTIVES

In March 2010, a Massachusetts Department of Revenue inspector deemed the tax returns of the film "The Lightkeepers" as potentially fraudulent. The Department of Revenue referred the case to the Attorney General's Fraud and Financial Crimes Division. The investigation expanded to include the film "The Golden Boys" and the director of both films, Daniel Adams. In 2011 Adams was arrested on multiple fraud charges totaling $4.7 million. His scheme included submitting fraudulent film tax credit applications; claiming inflated expenses; and submitting falsified budgets, bank account and investment documents, and contracts with overstated actor salaries, including that for actor Richard Dreyfuss (Cape Cod Today, 2011). In 2012 Adams pled guilty to ten counts of embezzlement. He was sentenced to up to three years in prison. In addition, he was ordered to pay $4.4 million in restitution and serve ten years on probation at the conclusion of his prison term (Kaufman, 2012).

Adams' fraud provides an example of methods used to exploit Film PTIs. Production tax incentives are temporary financial incentives that attract industries to conduct operations in a particular state (Cambridge University Press, 2015). PTIs in general apply to any production or manufacturing industry. This project focuses on the applicable incentives for the film industry and refers to them as Film PTIs. Film PTIs stem from the economic benefits that the film industry has on job creation, tourism, and sales increases. According to the Motion Picture Association of America (MPAA, 2015), the film and television production and distribution industry employs 1.9 million workers, contributes $40 billion each year to more than 330,000 businesses, and pays $16 billion each year in federal and state taxes.

Film PTIs in the United States became relevant in the 1990s. During this decade, an increasing number of domestic television shows and movies were filmed in other countries. These "runaway" productions became more prevalent in 1997 when Canada adopted the Production Services Tax Credit Program (Canada Film Capital, 2015). According to a study in 1999 by The Monitor Group, while the number of productions per year in the United States remained stable from 1990 to 1998, the number of runaway productions filmed abroad increased from 100 films in 1990 to 285 films in 1998. In 1998 alone, runaway productions accounted for $10.3 billion that was lost to the domestic economy (Monitor Group, 1999). Louisiana was the first state to launch its own Film PTIs in 1991. By 2009, the number of states which offered incentives increased to 44 (Luther, 2010). More recently, Louisiana passed a Film PTI bill in 2005, and reported in December 2006 that the state's film industry grew by 13,445 jobs and $336.3 million when compared to the two years prior to the new Film PTIs (Potter, 2015).

DIFFERENT TYPES OF FILM PTIS

Various types of Film PTIs are offered, and in different combinations by participating states. The different types of Film PTIs include Grants, Rebates, Tax Credits, Sales Tax Exemptions, and Fee-Free Locations. These can be subject to Minimum Spending Thresholds, Limitations or Stipulations, Spending Caps, and Carry-Forwards.

Refer to Appendix A (available from the author) for a state to state comparison of Film PTIs offered. Refer to Appendix B (available from the author) to view a detailed description of Film PTIs for each state. The current Film PTIs from each state's film commissions is included, sorted by the categories of Film PTIs discussed in this section. Three sources of state Film PTIs were utilized: The film commission of each state; state profiles provided by Film Production Capital, a production consulting firm; and state profiles provided by the accounting firm of Kevin P. Martin & Associates, P.C. For the purposes of this project, the latter provided the most useful definitions and format to compare states and evaluate potential frauds. Therefore, although all of the information provided was gathered from all three sources, it is presented following the form of Kevin P. Martin & Associates, P.C. (Martin, 2014).

Grants

Grants take the form of an amount of money given to a recipient – in this case the film production company – by a state government to be used for a particular purpose, such as offsetting production expenses. Since it is a grant and not a loan, the funds distributed to the film production companies do not have to be repaid to the state. These grants are accompanied by compliance and reporting requirements that vary by state. Grants are only offered by a few states (Martin, 2014). The North Carolina Grant Program became available in January of 2015. The state's program offers $10 million in grant money to serve as a rebate of up to 25% on qualified expenses. The per project caps are $5 million for feature films, $5 million for video television series per season, and $250,000 for commercials (North Carolina Film Office, 2015).

Rebates

States that offer rebates typically offer these in the form of cash paid directly to the production company. The cash payment is based upon a percentage of the recipient's qualifying expenses. For many states, only qualifying expenses that occurred in-state are eligible. As with grants, rebates are accompanied by compliance and reporting requirements that vary by state (Martin, 2014). The South Carolina Employee Wage Rebate offers rebates based upon the residency of the employees. For South Carolina resident employees, the production company can claim up to a 25% rebate, versus a 20% rebate for nonresident employees. The state sets a per person wage cap of less than $1 million for the project, and the wages must be subject to South Carolina withholding tax in order to qualify for the rebate (South Carolina Film Commission, 2015).

Tax Credits

Tax credits are used to offset or reduce a production company's state income tax liability. Each state defines whether their tax credits will or will not be refundable and/or transferable (Martin, 2014). The Georgia Tax Credit offers a 20% base, transferable tax credit. In addition, production companies with approved projects can earn a 10% Georgia Entertainment Promotion uplift for including an embedded Georgia logo in their film. Production companies must spend a minimum of $500,000 in order to qualify. Georgia does not impose any limitations or caps on in-state spending that qualifies, and the payroll of both resident and nonresident employees qualifies for the tax credits. In addition, they have no sunset clauses, which are dates that the state's Film PTIs will expire if not renewed by the state legislature (Georgia Film, Music & Digital Entertainment Office, 2015). North Carolina's Grant Program began in January of 2015 because their previous set of Film PTIs sunsetted at the end of 2014 (North Carolina Film Office, 2015).

As mentioned earlier, tax credits can or cannot be refundable and/or transferable. Refundable tax credits can be used by the production company to not only reduce their tax liability to zero, but to receive a tax refund for the difference (Martin, 2014). For example, a film production company has a tax liability of

$1,000, but has qualified for $6,000 in tax credits. Table 1 demonstrates how the production company not only reduces its tax liability to zero, but it also receives a tax refund of $5,000.

Table 1 – Refundable Tax Credits Example

Total Tax Due	$1,000
Refundable Credit	($1,000)
Tax Due (Refund)	$0
Remaining Refundable Credit	($5,000)
Tax Due (Refund)	($5,000)

Non-refundable tax credits can reduce a production company's tax liability to zero, but does not allow the firm to receive a tax refund for any remaining credit balance (Martin, 2014). Using the same example as above, Table 2 demonstrates the use of a non-refundable tax credit.

Table 2 – Non-Refundable Tax Credits Example

Total Tax Due	$1,000
Non-Refundable Credit	($1,000)
Tax Due (Refund)	$0
Remaining Non-Refundable Credit	($5,000)
Tax Due (Refund)	$0

The other option on tax credits involves whether or not the state deems them transferable. If a tax credit is transferable, then any production company who earned a tax credit can sell it to a third party, such as another production company filming in the state. This third party can then use the full face value of the purchased tax credit to offset its own tax liability. When a tax credit is transferable, the state's amount of obligation remains the same – only to whom it is owed changes (Martin, 2014).

Sales Tax Exemptions

Some states exempt qualified productions from state sales and use taxes. Another exemption offered is a reduction or elimination of taxes related to the lodging of the cast and crew. States often impose a minimum length of stay, such as 30 days, for the production to qualify (Martin, 2014). Virginia, with a sales and use tax rate of 4%, offers a sales and use tax exemption for qualified activities. These activities include any materials purchased and equipment rented in-state to be used in the production. The exemption is realized at the time of sale when the production company submits paperwork to the vendor. With respect to lodging, Virginia requires a minimum stay of 90 days to qualify for the state's lodging tax exemption (Virginia Film Office, 2015).

Fee-Free Locations

A minority of states offer to waive fees or taxes for use of state-owned properties for a qualified production. State-owned locations include state parks, buildings, and universities. South Carolina is one of the few states to offer this Film PTI (Martin, 2014).

Minimum Spending Thresholds

States can impose a minimum in-state spending threshold for Film PTIs to take effect. South Carolina requires qualified productions to spend $1 million in-state to be eligible for rebates, but only $250,000 in-state to be eligible for fee-free locations and sales, use, and lodging tax exemptions (South Carolina Film Commission, 2015).

Limitations/Stipulations

A number of the limitations and stipulations that states can impose have been discussed in the examples above. Minimum spending thresholds exclude smaller productions and target productions with larger budgets. Whereas South Carolina sets a $1 million in-state minimum spending threshold for rebate eligibility, Oklahoma sets the minimum in-state expenditures at $25,000 (Oklahoma Film & Music Office, 2015). Hawaii sets their minimum in-state spending threshold at $200,000, but also requires production companies to provide evidence of contributions to the development of the state's film production industry in order to be eligible for Film PTIs (Hawaii Film Office, 2015).

States can choose to exclude certain types of productions from eligibility. South Carolina excludes reality television series from all Film PTIs, whereas in Louisiana reality television series are eligible for Film PTIs (Louisiana Film Commission, 2015). South Carolina is one of the states that requires approval by the Film Commission prior to the beginning of filming for a production to be eligible for state Film PTIs. Also, many states require an audit at the completion of production. South Carolina requires an audit at the completion of production for cash rebates to be paid (South Carolina Film Commission, 2015).

Caps

Caps are maximum amounts of earnings or other amounts that are eligible to qualify for a rebate. For example, in South Carolina the wage rebate is capped at the first $1 million of earnings taxed in South Carolina per individual. Another type of cap is when a state allocates a certain amount of funds to be used for Film PTIs per fiscal year. South Carolina allocates $15 million per year by replenishing the rebate fund. Funds left over in the fund from previous years roll over and remain in the rebate fund (South Carolina Film Commission, 2015). North Carolina's new grant program caps grants at $10 million per year with lower per project grant caps (North Carolina Film Office, 2015). Georgia sets no limits or caps on qualified in-state expenditures (Georgia Department of Economic Development, 2015).

Carry-Forwards

A credit carry-forward is a tax rule that allows a taxpayer to save an unused credit and use it in future years (Fowler, 2015). States often allow credits to be carried forward for a maximum number of years before they expire. For example, Nevada has a rule in which credits can carry forward but expire after four years (Nevada Film Office, 2015). Missouri has a rule in which credits can carry forward but expire after five years (Missouri Film Office, 2015).

ADVANTAGES AND DISADVANTAGES OF FILM PTIS

Proponents of Film PTIs contend that the incentives serve a key role in states' strategies for economic development. They assert that the Film PTIs increase spending in the production locations, promote skilled job creation, benefit small businesses, and increase tax revenue, all of which increase economic growth and improve the lives of constituents (Goodman, 2012). In addition, states reap further benefits from film-induced tourism, where fans of movies or television shows visit the filming locations (Carnwath, 2014). For example, Asheville, North Carolina businesses have created vacation packages and host tours of the nearby locations where *The Hunger Games* movie was filmed (Asheville Area Chamber of Commerce, 2015).

Opponents of Film PTIs contend that the state funds should be allocated to improvements in health care and education, or use the savings to lower tax rates for residents. They assert that the Film PTIs and their assorted features create short term indicators of economic success and do not provide incentives for sustainable and prolonged film production. Opponents also view Film PTIs as a political tool with high costs and only localized benefits (Goodman, 2012; Luther, 2010). Other disadvantages put forth include potential censorship by state film commissions and potential conflicts with the state's communities and constituents (Andress, 2015). Any recommended mix of Film PTIs should consider concerns expressed by both proponents and opponents.

FILM PTIS BY STATE

The film production economy in the United States offers 302,000 direct jobs, wages of $47 billion, and 358,000 related distribution jobs (MPAA, 2015). Appendix A (available from the author) presents a map created by Cast & Crew Entertainment Services, a payroll and film production accounting firm. It displays a map of the United States with Film PTIs' strength for each state (Cast and Crew Entertainment Services, 2015). Table 3 presents the contribution of the film industry for five highlighted states (MPAA, 2015).

Table 3 – Film Production Economy

Economy	Direct Jobs	Wages	Related Distribution Jobs
United States	302,000	$47 B	358,000
California	186,853	$18.2 B	129,789
Georgia	23,480	$1.6 B	8,188
Louisiana	9,939	$433.2 MM	5,263
North Carolina	11,680	$572.6 MM	2,957
South Carolina	4,460	$138.9 MM	1,070

California, the home of Hollywood, has Film PTIs that are currently rated three stars out of a possible five by Film Production Capital, a film production location consulting firm and tax credit brokerage company (Film Production Capital, 2015). California offers tax credit benefits that are non-refundable. With the exception of tax credits for independent films, these tax credits are also non-transferable. Benefits for qualified productions include a 20% tax credit for nonresident employees and 25% for resident employees. Projects may earn an additional 5% credit on qualified expenditures. The minimum spending threshold for all productions is $1 million, with the exception of miniseries and movies of the week, which is $500,000 (California Film Commission, 2015).

Georgia – South Carolina's next door neighbor – has Film PTIs that earn the highest rating of five stars out of five (Film Production Capital, 2015). Georgia describes itself as "America's Top State for Business," offering PTIs in multiple industries, including film. The "Camera Ready Community" offers a 20% base tax credit that is transferable, and a 10% Georgia Entertainment Promotion tax credit, which is an additional credit if the Georgia logo is embedded in the film. The minimum spending threshold is $500,000 on either a single or a combination of multiple projects. There are no caps, be they per project or per year. Finally, Georgia is a state that does not require an audit and the end of film production (Georgia Department of Economic Development, 2015).

Louisiana, the first state to adopt Film PTIs, is the only other state that currently has a rating of 5 stars out of five (Film Production Capital, 2015). They provide transferable tax credits of 30% for in-state expenditures that relate to film production. Another 5% tax credit can be earned on resident employees' salaries for qualified productions. The minimum spending threshold is $300,000, and there are no per project or annual caps. Unlike its five star counterpart, Louisiana does require an audit at the conclusion of film production (Louisiana Economic Development, 2015).

As is evident in Table 3, North Carolina developed a strong film production economy. However, the Film PTIs that helped create this economy sunsetted, or expired, at the end of 2014. With the new grant program that took effect in January of 2015, North Carolina's rating fell from five stars to one (Film Production Capital, 2015). The sunsetted Film PTIs included a 25% tax credit for qualified expenditures, a minimum spending threshold of $250,000, no annual cap, a per project cap of $20 million from which television series are excluded, and fee-free location shooting. This earned the moniker "Hollywood East" for the city of Wilmington. The current grant program offers up to $10 million in grant money that can be allocated to up to 25% of qualified expenditures, a $5 million cap for movies and television projects, and a cap of $250,000 for commercial projects. Fee-free location shooting is still offered. In both sets of Film

PTIs, an audit is required at the end of production. However, the sunsetted PTIs stated that the state of North Carolina would pay for the audit. Now with the grant program, the production company must pay for the audit (North Carolina Film Office, 2015).

South Carolina Film PTIs earn three stars from Film Production Capital, the same rating earned by California. Until the end of 2014, both Georgia and North Carolina ranked higher in benefits than South Carolina. Now South Carolina surpasses North Carolina, but still lags behind Georgia (Film Production Capital, 2015). Cash rebates are employed by South Carolina for wages and qualified production expenditures. South Carolina offers a 20% rebate for nonresident employees, 25% for resident employees, and 30% for in-state qualified expenditures. Fee-free location shooting is available, as are sales and use tax exemptions. Minimum spending thresholds include $1 million to qualify for rebates, but only $250,000 to qualify for sales and use tax exemptions. South Carolina does not impose a per project cap, but it allocates $15 million per year for Film PTIs. If not all of the funds are spent in one year, the balance rolls over to the next year and is added to the annual replenishment of $15 million. Additionally, a $1 million per person cap applies to wage rebates. South Carolina performs an audit at their own expense. The state does limit the types of eligible productions in that reality television series are not eligible for any Film PTIs (South Carolina Film Commission, 2015).

FILM PTI FRAUD – THE FRAUD TRIANGLE

Fraud is defined as:

"A generic term, and embraces all the multifarious means which human ingenuity can devise, which are resorted to by one individual, to get an advantage over another by false representations. No definite and invariable rule can be laid down as a general proposition in defining fraud, as it includes surprise, trickery, cunning, and unfair ways by which another is cheated. The only boundaries defining it are those which limit human knavery" (Albrecht , Albrecht, Albrecht , & Zimbelman, 2012, p.38).

The Association of Certified Fraud Examiners (ACFE, 2015) utilizes the definition of fraud provided by Black's Law Dictionary (2004): "A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." The ACFE estimates that 5% of all annual revenues are lost to fraud. For a fraud to be committed, three elements must be present, and these three are illustrated in the fraud triangle. Created by Dr. Donald Cressey, the three elements of the fraud triangle include Perceived Pressure, Perceived Opportunity, and Rationalization. Appendix C (available from the author) provides an illustration of the fraud triangle (ACFE, 2015).

Both Perceived Pressure and Perceived Opportunity are internal to the fraudster. For a potential fraudster, Perceived Pressure is also referred to as an unshareable financial need. The majority of pressures are vice related. A small, sad percentage of fraudsters have a financial need because of illness or death of a loved one. Perceived Opportunity is the extent to which a person believes they can commit fraud in their current position and not be detected. For example, an accounts payables clerk may have a greater Perceived Opportunity to commit fraud than a receptionist, given that the clerk has access to the funds of their employer. Rationalization is how an honest person justifies committing fraud (Albrecht et al, 2012). The two most common Rationalizations are "I'm just borrowing the money" and "I don't earn what I deserve" (ACFE, 2015).

Each of the three elements must be present for fraud to occur (Albrecht et al, 2012). People who try to prevent fraud work to decrease Perceived Opportunity. Both Perceived Pressure and Rationalization are internal to the fraudster, and the person working to prevent fraud cannot affect those perceptions. However, having good internal controls can decrease both perceived and actual opportunities, so fraud fighters focus all or most of their preventive efforts on implementing controls and ensuring adherence to them. They rarely focus on the pressures motivating fraud or on the rationalizations of the perpetrators (Albrecht et al, 2012).

INCENTIVES AND TYPES OF FILM PTI FRAUD

Film PTIs present to a potential fraudster both the incentive to overstate and understate a financial position, depending upon the fraudster's needs. For example, a company may want to overstate their film production expenses. The enticement to overstate expenses is that by doing so, the company can receive a higher return from their Film PTIs. This is because PTIs generally repay a portion of the expenses that occurred in the host state (Martin, 2014).

If the company decides to understate expenses or overstate revenues, they will also receive a benefit by reporting a higher income. Reporting higher income gives companies many added benefits. One benefit is that it might allow management and other contributors to the film to receive a larger bonus. This higher income will also give the impression that the company is in a better financial position, and thus be able to secure credit at a lower interest rate (Albrecht et al, 2012).

The production company may opt to understate its revenue, thereby reducing its tax liability and any royalties it owes to "above-the-line" individuals involved in a production. These include screenwriters, directors, producers, and principal actors (Film & TV Production Roles and Development, 2014).

While there are many different ways to commit fraud, listed below are some of the common frauds that relate to Film PTIs. Each of these frauds can be committed by individuals, by organizations in the film production industry, by related parties, and in the buying and selling of tax credits.

- Deliberately underreporting or omitting income
- Making false entries in books and records
- Claiming personal expenses as business expenses to make these eligible for Film PTIs
- Embezzlement – taking of money or property entrusted in the person's care (Albrecht et al, 2012)
- Keeping two sets of books – one set includes the actual transactions of the firm; the other also includes false entries that alter the reported financial position
- False submission of documentation that is fraudulent, incomplete, or missing material facts
- Wire fraud – illegally obtaining money and transferring it using an interstate communications device (e.g., computer, telephone, etc); this is a federal crime where each count can result in fines and up to 20 years in prison (ACFE, 2015)
- Related party transactions, specifically false entries and wire fraud (Internal Revenue Service, 2015).

One example of Film PTI fraud involves Peter Hoffman and Michael Arata, a lawyer and producer respectively. Both men were charged with conspiracy, five counts of wire fraud, and false submission. The charges allege that the men created false vendor payments and used misleading bank transfers and related parties to falsely portray a better financial position. Both men have pleaded not guilty to the charges (Sayre, 2014).

In another example, **George Kostuch** was charged with wire fraud in a scheme to falsify and overstate production expenses. Checks totaling more than $500,000 were created, delivered, and used as false documentation in order to garner Louisiana's Film PTIs tax credit. Louisiana's Economic Development Office issued Kostuch $161,850 in tax credits based upon the false documentation. Kostuch has not yet been tried and/or convicted (Department of Justice, 2015).

Another example in Louisiana involves Gregory Walker, the owner of Bishop LLC. Walker claimed his firm owned transferable tax credits for sale, and sold these false credits for over $2 million. Walker forged signatures on tax credit purchase agreements and used interstate wires to complete the transaction (Federal Bureau of Investigation, 2014). Walker pled guilty to wire fraud and was sentenced to 70 months in prison followed by three years of supervised release. He was ordered to pay over $1.8 million as restitution to the 24 victims of his fraud, and over $970,000 to the United States government (Lodge, 2014).

RED FLAGS FOR FRAUD

A red flag is "a set of circumstances that are unusual in nature or vary from the normal activity." (DiNapoli, 2015). Red flags do not necessarily mean that fraud is present. Instead, they provide a "red flag" that further examination is required. Red flags for fraud can fall into one of three categories – employee red flags, management red flags, and accounting red flags (DiNapoli, 2015). Alternatively, the employee and management red flags can be merged and evaluated from a behavioral perspective, while accounting can be a part of an overall business perspective (KPMG, 2015).

Behavioral changes may be an outward manifestation of the stress experienced by fraudsters, or their efforts to conceal their activities (Albrecht et al, 2012). For example, an employee who is always in the office and never takes vacations, holidays, or sick days may be protecting their fraud scheme from the eyes of fellow employees. Staying in the same job can also be a red flag. Many employees have legitimate reasons for staying in a particular job – health, quality of life, family, etc. – but if an employee also isolates themselves and their work from others, this may signal they are concealing and protecting a potential fraud scheme (KPMG, 2015).

Once discovered, fraudsters are often described by those around them as having a Jekyll and Hyde personality. On one hand the employee or manager is living an extravagant lifestyle and showering coworkers with gifts, while on the other they are defensive and autocratic (Albrecht et al, 2012). Personal financial stress, or an unshareable financial need, creates the Perceived Pressure in the fraud triangle (ACFE, 2015). However, a warning sign can be simple greed. KPMG (2015) suggests that in addition to the fraud scheme, fraudsters also overstate their expenses. Lastly, if a senior manager is overly concerned with decisions that typically occur outside of his duties, an organization should consider it a red flag, and consider why this senior manager would be interested in the transactions of another department (DiNapoli, 2015).

Accounting or business red flags focus on how the fraudster is committing and concealing his crime. From a general business perspective, if a firm's financial results appear far better than its industry as a whole, this is a red flag that warrants further investigation as to the cause. It may be a better business model than competitors, or it may suggest that the financial reports have been manipulated. Also, if a senior manager's timing always keeps him from away from internal reviews, this is a red flag that he does not want his work scrutinized (KPMG, 2015).

From an accounting perspective, the relationships that exist between accounts tend to remain stable unless new policies have altered that relationship. For example, the relationship of a firm's credit sales to total revenue should stay relatively stable. However, if a new credit policy went into effect, this could alter the percentage of sales that are credit sales. If no policy changes have been made and relationships between account balances shift dramatically, this is an accounting red flag (Albrecht et al, 2012). If account balances do not reconcile to their subledgers and supporting documentation, this is an accounting red flag that some transactions may not be legitimate. Lastly, when a fraudster manipulates the accounting records, certain accounts may prove useful to them (KPMG, 2015). This will drive the balance of these useful accounts in relationship to others out of the normal activity level. For example, if an employee wants to abscond with company funds, it is easier to do so with a false journal entry to a service expense account than a cost of goods sold account where the corresponding inventory can be inspected (Albrecht et al, 2012). When managers manipulate the financial statements to improve the firm's financial position, they too will look for accounts to conceal their activity (KPMG, 2015). For example, an increase in revenues without a corresponding increase in bad debt expense is a red flag for fraud that deserves further scrutiny.

EFFECTIVE FRAUD PREVENTION

There are six major factors that increase opportunities for individuals to commit fraud within an organization. These six factors include: lack of controls that prevent and/or detect fraudulent behavior; inability to judge quality of performance; failure to discipline fraud perpetrators; lack of access to information; ignorance, apathy and incapacity; and lack of an audit trail (Albrecht, 2012).

The first step to decreasing fraud opportunities is to recognize that all three elements MUST be present for fraud to occur. An important step an organization can take to prevent the opportunity for fraud is to have an effective internal control framework (Albrecht, 2012). The mission of the nonprofit organization Good Jobs First is to serve as a resource for "groups and public officials seeking to make economic development subsidies more accountable and effective" (Good Jobs First, 2015). Via research into economic development efforts across all 50 states, the organization has identified a set of best practices for economic development policies that involve tax incentives. These best practices aim to improve transparency and accountability (Cafcas, 2015). This in turn will help prevent fraud and abuse (Baker, 2013).

Good Jobs First recommends the following best practices for economic development efforts such as Film PTIs:

- Create local hiring requirements
- Establish job quality standards
- Establish market-based wage standards
- Report projected and actual number of jobs created
- Report projected and actual wages for jobs created
- Create an online database of Film PTIs and their details
- Recapture Film PTIs when firms fail to meet predetermined standards
- Conduct fiscal impact analyses
- Set a debt cap
- Use unified economic development budgets (Cafcas, 2015).

According to Good Jobs First, South Carolina already achieves best practices with respect to establishing job quality standards and establishing market-based wage standards. North Carolina achieves best practices in reporting projected and actual number of jobs created, establishing job quality standards, establishing market-based wage standards, and recapturing PTIs when a firm fails to meet predetermined standards. Louisiana achieves best practices in the creation of an online database, reporting projected and actual wages for jobs created, and recapturing PTIs. Georgia achieves best practices in three areas, including establishing job quality standards, establishing market-based wage standards, and recapturing PTIs. California has not achieved best practices in any of the aforementioned categories (Cafcas, 2015).

RECOMMENDATIONS

Recall that the objective of this project is threefold. The first objective is to conduct an analysis of film production tax incentives (Film PTIs) available across all 50 states. Using this information, the second objective is to discern potential frauds for the various types of Film PTIs. The third objective is to then recommend a mix of Film PTIs that: Minimizes the potential for fraud; provides adequate incentives for film production companies; and allows states to promote themselves as supporters of in-state film productions, skilled job creation, and local small businesses.

Table 4 presents recommendations for the mix of Film PTIs that: Takes into account concerns of proponents and opponents of Film PTIs; assists The Clients in their tax planning efforts when evaluating filming locations for individual or multiple productions; and helps South Carolina and other states demonstrate their film industry building efforts and commitment to achieving best practices.

One disclaimer on the following recommendations from the Fraud Examination class is that these recommendations, for the most part, do not come with fixed thresholds. This was done intentionally. These recommendations represent the incentive concepts that allow states to achieve the defined objectives and best practices for Film PTIs. Any interested states are welcome to use these. The purpose of these recommendations is to choose a Film PTI mix that minimizes financial fraud and abuse concerns, not to spark a political argument and be voted into a bill.

Table 4 – Film PTIs, Recommendations, and Project Objectives Met

Incentive	**Recommend?**	**Minimizes the potential for fraud**	**Provides adequate incentive to The Clients**	**State supports in-state film production**	**State supports skilled job creation**	**State supports local small businesses**
Offer Film PTIs to all legal production companies, regardless of market segment (e.g., Video Games, Music Videos, etc.)	Yes		X	X	X	X
No minimum spending cap, however pre-approval from state required	Yes	X	X	X	X	X
Offer sales, use, and lodging tax exemptions	Yes		X	X		
Require project ending audits	Yes	X				
PTIs for state specific product placement (e.g., SC license plates, road signs, local businesses)	Yes		X	X		X
PTIs for filming during off season or in smaller towns	Yes		X	X	X	X
Max above the line salary PTI at $1MM per person	Yes	X				

Incentive	**Recommend?**	**Minimizes the potential for fraud**	**Provides adequate incentive to The Clients**	**State supports in-state film production**	**State supports skilled job creation**	**State supports local small businesses**
Tax Rebate for post-production with in-state facilities	Yes	X	X	X	X	X
Refundability with useful life/carry forward of 5 years	Yes		X	X	X	X
State buyback of refundable credits below par value	Yes			X	X	X
Brick and mortar incentives	No	X				
Transferability of Film PTIs	No	X				

We first recommend offering all Film PTIs to all eligible, legal production companies, regardless of market segment. One of the deliverables of this project is to increase the competitiveness of South Carolina and interested states in the film production industry. Allowing all types of projects provides incentives to film production companies that have digital media projects, independent films, and music videos, and makes South Carolina more competitive in the film production industry. These productions still require skilled labor and still need in-state services that can be provided by local small businesses. If the Film PTIs were limited to only production companies specialized in the filming of big-budget movies, the state would prevent its constituents from the additional opportunities provided by these market segments. We recommend for South Carolina to extend these production tax incentives to television shows, reality television shows, music videos, video games, documentaries and all production filming segments not previously listed.

Many states utilize minimum spending thresholds that film production companies must spend in production in order to qualify for incentives. This prevents smaller productions from availing themselves of the states' Film PTIs. This is a disincentive for these productions. When states discriminate between big budget projects and small budget projects, they also do a disservice to their constituents, who could otherwise take advantage of these opportunities. The dollar amount spent in any one production does not matter. Skilled workers enter the economy, and states benefit from the increased demand. We recommend no minimum spending threshold. However, in order to minimize fraud, we also recommend that pre-approval from the state for all productions be required.

Another recommendation that incorporates state pre-approval is giving film production crews tax exempt lodging for those productions that qualify. We recommend these qualifying productions also be eligible for sales and use tax exemptions. This will be one of the easiest recommendations to implement because, as stated above, a pre-approval would be mandatory in this proposed mix of Film PTIs. Therefore, any production company filming in-state would have already met the prerequisite for this incentive. The rationale is to incentivize The Clients, while at the same time allowing the state to demonstrate its support for in-state productions. Without the film crew staying in local hotels, there would be empty rooms that cost the hotels money to the extent of fixed cost per room. By giving a tax exempt lodging incentive, film companies save a large sum of money, especially for long filming projects, and the local hotels are not absorbing fixed costs, but instead making a profit.

To ensure compliance and financial accountability of all production companies filming in South Carolina, we recommend requiring production companies to have an audit after the company has completed its production in the area. This will benefit the companies and the local economy. Both entities can demonstrate their commitment to minimizing fraud and achieving best practices.

Requiring project ending audits will promote awareness throughout the film production company. Once a company knows an audit is required, Perceived Opportunity for fraud will decline, and the production company will be more inclined to keep up to date and accurate records. Required audits will build a company's goodwill with the public. The audits may show the public that the company is not misusing the taxpayer's potential money. Goodwill is an intangible that is not easily measurable. It can impact a company much more than a dollar amount listed on a spreadsheet and companies may be interested to adding credibility to their name.

The local economy will benefit from the audits because it will create more skilled jobs and keep more money in the local economy. The jobs created within the film production industry will be related to in-house accounting jobs and Certified Public Accountants (CPAs). CPAs and their local practices will also experience growth due to the increased demand to conduct the required project ending audits.

The next Film PTI we recommend pertains to state specific product placement in the final product. As discussed earlier, states reap additional benefits from film-induced tourism, where fans of movies or television shows visit the filming locations (Carnwath, 2014). For example, Asheville, North Carolina businesses have created vacation packages and host tours of the nearby locations where *The Hunger Games* movie was filmed (Asheville Area Chamber of Commerce, 2015). The South Carolina product placement can be any of the following: South Carolina license plates; characters in the production wearing South Carolina related clothing; prominent road signs; different towns talked about in dialogue; or local businesses portrayed in the film.

Another Film PTI South Carolina and other interested states should offer to film production companies is an incentive for location filming during the off season and/or in smaller towns. A significant portion of South Carolina's economy is seasonal; the closer you go to the coast, the more this is true. During the offseason, many businesses are forced to lay off their employees until the summer. If a film production company were to come into a town during the off season, many of these seasonal businesses would generate more income during the offseason and be able to keep more employees employed. Businesses located in a seasonal economy hire its staff based on the demand in the local area. By increasing the number of consumers in the area, the demand for the business will increase, therefore increasing the overall employment in the area. This type of incentive establishes a partnership between the state and the company, one that can help both tremendously.

One of the largest expenses for film production companies are the salaries paid to employees. We recommend South Carolina offer a cap to above the line workers at $1 million per person in order to minimize fraud. The covered members in the above the line class are the principal actors, screenwriters, directors and producers who gross the top five compensation per production. There are some members in this class with enormous compensation and this cap is to ensure people with large compensation cannot receive large refunds. One example of enormous above the line compensation can be seen with Robert Downey Jr.'s compensation for The Avengers. The actor grossed $50 million (O'Connell, 2013). Without a cap, an unscrupulous above the line employee could file for part of his compensation back.

However, there should be an incentive for production companies who employ in-state residents. A beneficial incentive for production companies is no cap for below the line in-state residents. Below the line members are all the people involved in the production not included in the above the line category (O'Connell, 2013).

There are some states that offer film production film companies "brick and mortar" incentives. This type of incentive states if a film production company builds a post-production facility, the state will give the company a stated tax percentage break for the construction of the building. The first problem with this said tax incentive is who receives the incentive. Many production companies hire an independent contractor for the construction of a post-production facility. It is the independent contractor who receives the break, not the company. The second problem occurs because this incentive does not give film companies an incentive to continue doing business in the current state. This Film PTI is a one-time incentive, so there is not an incentive for companies to continue post-production in the constructed building. We recommend for South Carolina and other interested states to discontinue or not use any "brick and mortar" incentives.

We do recommend, however, for states to offer post-production services, conducted in-state, to be allowable costs. Unlike the "brick and mortar" incentives some states offer that are one time incentives, this Film PTI would bring film companies continually back to the state for post-production. With this incentive, a film company would receive a tax break for either doing its post-production at its in-state facility or renting the space out to another company to use the facility. With either option, there is a surplus on people coming to the state. Going back to the goal of these recommendations, this minimizes fraud and abuse in brick and mortar facilities construction, provides incentives for The Clients to conduct their post-production activities in-state, and allows the state to demonstrate its support for in-state productions, skilled job creation, and local small businesses.

We also recommend states to not offer any type of transferability of Film PTIs between film production companies. This allows companies who have Film PTIs that carry-forward from previous years to sell these to other companies. This does not help out the states who offer the transferability. The goal of Film PTIs should be to generate repeat business from production companies. In addition, eliminating transferability eliminates an entire category of Film PTI fraud.

Instead of offering transferability, states should offer companies refundability with a useful life up to five years. This recommendation of refundability will apply to all the Film PTIs for which the film production company can qualify. Put another way, this means all of the previously recommended Film PTIs a state offers a film production should be refundable and subject to a five year carry-forward.

Another recommendation is for states to offer to buy back the remaining unused Film PTIs of a film production company at a value that is below par or face value. This way the film production company is receiving some money back for its in-state production and the state settles its obligations at a discount. Both of these options have benefits for both parties. Film production companies are still able to use any unused Film PTIs in future years. With the buyback, states ensure film production companies will have an incentive to engage in repeat business within five years. With this the state can demonstrate to its stakeholders that it supports in-state productions, skilled job creation, and local small businesses. In addition, with the buyback of unused Film PTI credits at a value below the par or face value, the state demonstrates its stewardship over taxpayers' funds and its commitment to achieve best practices for all parties involved.

CONCLUSION

Providing the previously listed Film PTIs will enable states to create a lasting partnership with film production companies. The entertainment industry in the United States is one of the biggest industries with a large amount of demand. States should embrace this industry and capitalize on the film production companies' spending. By offering Film PTIs, a state makes itself more attractive to film production companies as a filming location. While the state will lose some tax revenue due to offering Film PTIs, this loss is more than compensated by the increase of money supply the film production companies put into the state's economy. The companies spend money on food, housing, nightly entertainment, etc. that allows businesses to thrive on an increase in consumer base. In addition, the state benefits from any film-induced tourism. The recommended Film PTIs look to create long term incentives for film production companies to stay in a state and create a lasting effect on state economies. The goal is to create a beneficial partnership for both parties, states and film production companies, which will serve both interests for the upcoming years.

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Maryland Incentive: 25% for film, 27% for TV. Minimum spend: $500,000. Massachusetts Incentive: 25%. Minimum spend: $50,000. Minnesota Incentive: 20% (productions under $1 million in metro areas), 25% (above $1 million or at least 60% outside metro areas). Minimum spend: $100,000. Mississippi Incentive: 25% (30% for resident cast and crew), plus 5% for U.S. veterans.Â New Mexico Incentive: 25% for film, 30% for TV, plus 5% for resident crew wages if filming at least 10 days at qualified facilities (15 days if over $30 million). Minimum spend: $0. The upcoming comic book-based series Preacher (AMC) from Seth Rogen is shooting in Albuquerque, also home to Better Call Saul.