

#04-1-006

**MACGILLIVRAY FREEMAN FILMS**

2740 South Coast Highway #F  
Laguna Beach, CA 92651

National Science Foundation Award Numbers

ESI-9896307

ESI-0003650

ESI-0125471

Financial Schedules and  
Independent Auditors' Reports

For the Period August 1, 1998 to September 30, 2003

**CONRAD** AND  
**ASSOCIATES**, L.L.P.

CERTIFIED PUBLIC ACCOUNTANTS

MAR 29 2004

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**CONRAD AND ASSOCIATES, L.L.P.**

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# MACGILLIVRAY FREEMAN FILMS

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**EXECUTIVE SUMMARY**

National Science Foundation  
 Office of Inspector General  
 4201 Wilson Boulevard  
 Arlington, Virginia 22230

**BACKGROUND**

MacGillivray Freeman Films (MacGillivray) is a for-profit organization established in 1972 by two men with the idea of producing a series of films related to surfing. Eventually their work lead to an offer from the Smithsonian Institution's National Air and Space Museum to produce a bicentennial film, *To Fly!*, for the IMAX theater in Washington. Since the premier in 1976, MacGillivray has produced over 29 large format films (IMAX) with four of those films funded with NSF awards. Our audit covers three of the four NSF awards. The organization follows the cost principles specified in Federal Acquisition Regulation (FAR) 48 CFR 31.2 and the National Science Foundation (NSF) General Grants Condition (GC-1). The following summarizes the amounts of the awards and a brief description of the activities associated with each award.

<u>Grant #</u>	<u>Grant Title</u>	<u>Audit Period</u>	<u>Grant Amount</u>	<u>Required Cost Share</u>
ESI-9896307	Caves	08/01/98 – 09/30/01	\$ 1,541,896	\$ 1,500,000
ESI-0003650	Coral Reef	01/01/01 – 05/31/03	1,800,000	7,188,834
ESI-0125471	Greece	05/01/02 – 06/30/03	1,451,250	4,634,190
		Total	<u>\$ 4,793,146</u>	<u>\$ 13,323,024</u>

**Grant Award ESI-9896307** – Financial assistance was granted to MacGillivray to develop, produce, and distribute the IMAX film, *Journey Into Amazing Caves*. The film follows several explorers through caves, canyon walls, glaciers, and beneath the rainforests of Mexico.

**Grant Award ESI-0003650** - Financial assistance was granted to MacGillivray to develop, produce, and distribute the IMAX film, *Coral Reef Adventures*. The film follows the real life expedition of ocean explorers through islands and sun drenched waters of the South Pacific to document the health and beauty of coral reefs.

**Grant Award ESI-0125471** - Financial assistance was granted to MacGillivray to develop, produce, and distribute the IMAX film, *Mysteries of Greece*. The film, currently in production and expected to be released in 2005, documents the history and life of the ancient Greek Islands..

During the grant award, MacGillivray earned income from the Caves and Coral Reef films in the form of licensing and royalty fees. The income, along with NSF funding, assisted in offsetting costs incurred by MacGillivray to produce and distribute the films.

**AUDIT OBJECTIVES, SCOPE AND METHODOLOGY**

At the request of the NSF Office of the Inspector General (OIG), Conrad and Associates, L.L.P., conducted an audit of three NSF awards granted to MacGillivray: ESI-9896307 – Caves, ESI-0003650 – Coral Reef, and ESI-0125471 – Greece. Our audit objectives were to:

1. Determine whether the Schedule(s) of Award Costs of the awardee is presented fairly, in all material respects, the cost claimed on the Federal Cash Transaction Reports (FCTR) – Federal Share of Net Disbursements is in conformity with the terms and conditions of the NSF award(s).

2. Identify matters concerning instances of noncompliance with laws, regulations, and the provisions of the award agreement(s) pertaining to NSF awards and weaknesses in the awardee's internal control over financial reporting that could have a direct and material effect on the Schedule of Award Costs.

To accomplish the objectives of the audit, we:

- Prepared a survey and internal control audit-planning document for OIG review and approval. The document included the proposed audit program and sampling methodology for performing the audit survey, gaining an understanding of the grantee's policies and procedures and financial systems for administering its NSF awards, identifying risks in the grantee's operations for effectively administering its NSF awards, and testing the grantee's significant internal controls to determine whether those controls are operating effectively to mitigate the identified risk.
- Prepared a survey and internal control assessment report for OIG review and approval. The assessment report included a summary of the results of the on-site audit survey and testing of significant internal controls.
- Prepared a substantive audit testing planning document for OIG review and approval. The document included the proposed audit program including sections on tests of compliance with applicable laws and regulations, and substantive testing procedures to determine whether costs charged to the NSF award(s) by the awardee are allowable, allocable, and reasonable in accordance with the applicable Federal cost principles and award terms and conditions.
- Prepared Notification of Findings (NOFs) based on the results of audit fieldwork. The NOFs included detailed information on each finding identified.

Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* (1994 Revision) issued by the Comptroller General of the United States of America. Our audit of the aforementioned awards used non-statistical sampling to test the costs claimed by MacGillivray to test for compliance with Federal laws and the NSF award requirements.

## **SUMMARY OF AUDIT RESULTS**

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Costs charged to the NSF awards by MacGillivray appear allowable, allocable, and reasonable, in accordance with the applicable Federal Cost principles and NSF award terms and conditions. No costs were questioned in the audit.

MacGillivray's systems of internal controls appear adequate to properly administer, account for, and monitor its NSF awards in compliance with NSF and Federal requirements. No compliance or internal control deficiencies that would materially affect the administration of the awards were noted. However, we did note opportunities for MacGillivray to strengthen internal controls in the areas of consulting expense, travel, and cost sharing.

The issues are briefly described below. For the complete findings, refer to the *Independent Auditors' Report on Compliance with Laws and Regulations and Internal Controls*.

**Consulting Expenditures** – A significant portion of MacGillivray's award activities are performed by independent contractors, who may serve as personnel assisting in award performance or consultants who provide professional advice or service. Consultant rates are subject to daily limits established by NSF regulations, making the identification of consultants important. Although we did not determine any of the independent contractor charges to be consultants, which are subject to the maximum rates, MacGillivray's lack of written policies and procedures in place to identify the role and differentiate in the treatment of its independent contractors, risks all consulting costs being mistaken as contractor costs and, therefore exceeding the daily allowable consulting rate on NSF awards.

**International Travel** – MacGillivray incurs substantial international travel in NSF award performance. However, MacGillivray does not have written policies and procedures in place to review international airfare expenditures to ensure costs charged to NSF comply with NSF regulations. Certain NSF rules and regulations apply when international travel is involved, specifically the use of U.S. air carriers when available. Although we did not question any travel cost in this audit, MacGillivray's failure to have proper policies and procedures in place requiring review of international airfare expenditures for compliance with NSF regulations could lead to unallowable costs.

**Cost Sharing** – MacGillivray did not submit annual required cost-sharing certifications. The certification information provides NSF assurance that cost sharing requirements are being met and provides NSF the ability to resolve any potential cost-sharing problems before a particular award expires. We did not question any of MacGillivray's cost sharing, noting that MacGillivray has satisfactorily met the cost-sharing requirement for the two completed awards and that the third award is still in progress. However, MacGillivray needs written policies and procedures to ensure the cost-sharing certification is annually and accurately completed and submitted.

**SUMMARY OF RECOMMENDATIONS**

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To address the internal control issues noted, we recommend that the Directors of NSF's Division of Acquisition and Cost Support (DACS) and the Division of Grants and Agreements (DGA) require that MacGillivray develop and implement written policies and procedures to ensure that: (1) contractors and consultant costs are properly identified and appropriately reviewed for compliance with NSF regulations; (2) travel costs charged to the grant awards are allowable and in compliance with NSF GC-1, Article 10 – Travel; (3) actual incurred cost sharing expenditures are accurately certified and reported to NSF on an annual basis.

**SUMMARY OF AUDITEE'S RESPONSE TO AUDIT RESULTS**

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MacGillivray Freeman Films has agreed with our recommendations to strengthen internal controls in the areas of consulting expenditures, international travel, and cost sharing. MacGillivray has also revised its own written policies and procedures to match our recommendations. See the **Appendix** section of this report for a complete copy of MacGillivray's response to the recommendations.

**EXIT CONFERENCE**

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An exit conference was held on December 3, 2003 at MacGillivray Freeman Films' office located at 2740 South Coast Highway, Laguna Beach, California 92651. Preliminary findings and recommendations noted during the audit were discussed with those in attendance. MacGillivray was informed that the preliminary findings and recommendations were subject to final review by NSF and the report may include additional findings and recommendations and/or omit certain items discussed.

MacGillivray Freeman Film

<u>Name</u>	<u>Title</u>
██████████	██████████
██████████	██████████

Conrad and Associates, L.L.P.

<u>Name</u>	<u>Title</u>
██████████	██████████

**INDEPENDENT AUDITORS' REPORTS**

National Science Foundation  
Office of Inspector General  
4201 Wilson Boulevard  
Arlington, Virginia 22230

**INDEPENDENT AUDITORS REPORT ON  
COMPLIANCE WITH LAWS AND REGULATIONS AND INTERNAL CONTROLS**

We have audited the Schedules of Award Costs as presented in Schedules A-1, A-2, and A-3, which summarize the financial reports submitted by MacGillivray Freeman Films to the National Science Foundation for the awards and periods listed below and have issued our report thereon dated December 3, 2003.

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
ESI - 9896307	08/01/98 - 09/30/01	08/01/98 - 09/30/01
ESI - 0003650	01/01/01 - 05/31/03	01/01/01 - 05/31/03
ESI - 0125471	05/01/02 - 06/30/05	05/01/02 - 06/30/03

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards (1994 Revision)*, issued by the Comptroller General of the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedule is free of material misstatement.

**COMPLIANCE**

Compliance with applicable Federal laws, regulations, and the NSF award terms and conditions is the responsibility of MacGillivray Freeman Films' management. As part of obtaining reasonable assurance about whether the financial schedules were free of material misstatement, we performed tests of MacGillivray Freeman Films' compliance with certain provisions of laws, regulations, and the NSF award terms and conditions. However, providing an opinion on overall compliance with such provisions was not an objective of our audit of the financial schedules. Accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of MacGillivray Freeman Films is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial schedules in accordance with accounting principles prescribed by the National Science Foundation. Because of inherent limitations in any internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of Schedules A-1, A-2, and A-3 for the period August 1, 1998 to June 30, 2003, we obtained an understanding of MacGillivray Freeman Films' internal control over financial reporting. With respect to internal control, we obtained an understanding of the design of relevant policies and procedures and whether the procedures have been placed in operation. Furthermore, we assessed control risk in order to

determine our auditing procedures for the purpose of expressing our opinion on the financial schedules and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

Our consideration of internal control would not necessarily disclose all matters related to internal control over financial reporting that might be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data in a manner consistent with the assertions of management in the financial schedule.

A material weakness is a condition in which the design or operation of one or more of internal control elements does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of the inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

We noted no matters involving the internal controls over financial reporting and its operation that we consider to be material weaknesses. However, we did note the following matters where internal controls could be strengthened to further improve MacGillivray Freeman Film's ability to monitor and administer NSF grant awards.

**Finding No. 1 – Consulting Expenditures** – NSF normally expects grantees to use their own staff to carry out award activities. However, film production requires individuals who possess highly specialized skills in areas such as underwater or aerial photography, special effects, and film narration. Maintaining a full-time staff with these varied and highly technical skills is usually not cost effective. Therefore, MacGillivray subcontracts a significant portion of its award activity to independent contractors. MacGillivray also obtains the services of consultants who provide professional advice or services.

MacGillivray's written policies and procedures for determining the allowability of costs in accordance with the terms and conditions of its awards did not differentiate in the treatment of independent contractors and consultant services. Differentiation is important because NSF regulations set specific limits on the daily rate of pay for consultants, which are not applicable to independent contractors.

NSF GC-1, Article 5 – Consultants, states: "Payments to individuals for consultant services under this grant shall not exceed the daily equivalent of the then current maximum rate paid to an Executive Schedule Level IT Federal employee (exclusive of indirect cost, travel, per diem, clerical services, fringe benefits and supplies)."<sup>1</sup>

MacGillivray's lack of procedures for identifying and distinguishing between an individual or company that is performing as a subcontractor as opposed to consultant that provides professional advice or services may lead to NSF funding consultant expenditures that exceed the NSF established daily limit. MacGillivray stated that they were not aware that a distinction between consultant and independent contractor was necessary.

We did not question any of MacGillivray's consulting costs, as inquires with personnel and additional review of documentation led us to conclude that the transactions charged to the grants were independent contractor costs, which are not subject to the daily maximum limit. However, the current policy should be strengthened to provide MacGillivray the ability to identify and differentiate consultant and independent contractor costs by requiring appropriate institutional review and approval of each transaction for compliance with NSF policy before any actual costs are incurred.

**Recommendation No. 1 – Consulting Expenditures** - We recommend that NSF's Directors of DACS and DGA ensure that MacGillivray Freeman Films develop and implement written policies and procedures to ensure that subcontract and consultant costs are properly identified and appropriately reviewed for compliance with NSF grant policy.

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<sup>1</sup> The current rate (as well as prior archived rates) is available on the NSF Web site at: <http://www.nsf.gov/bfa/cpo/policy/faqs.htm#cons>.

### **Awardee Comments**

MacGillivray's has revised its policies and procedures and have stated that in the future, the accounting system job cost production sub code, "0007," will constitute the designation for consultants subject to NSF daily cost limits. Also, to ensure further compliance with the NSF daily cost limits prevailing for the then current maximum rate paid to an Executive Schedule Level IT Federal employee, daily rates will be incorporated in the consultants' deal memos or contracts. These daily cost limits will be reviewed for compliance prior to the execution of the deal memo or contract by MacGillivray's general manager and are monitored for ongoing compliance by the MacGillivray accounting department by referencing the NSF Web site. (See the **Appendix** section of this report for a complete copy of MacGillivray's response to the recommendations.)

**Finding No. 2 – International Travel** - MacGillivray films are known for subject matter based in remote and international locations such as the South Pacific for the *Coral Reef Adventure*. As such, MacGillivray incurs substantial international travel costs on most of its films including the three NSF awards within the audit's scope.

National Science Foundation Grant General Conditions (GC-1), Article 10 – Travel, Section C, Paragraph 2, states: "Any air transportation to, from, between, or within a country other than the U.S. of persons or property, the expense of which will be assisted by NSF funding, must be performed by or under a code-sharing arrangement with a U.S.-flag air carrier if service provided by such a carrier is available (see Comp Gen. Decision B-240956, dated September 25, 1991). Tickets (or documentation for electronic tickets) must identify the U.S. flag carrier's designator code and flight number."

MacGillivray's procedures for determining the allowability of costs in accordance with award terms and conditions did not provide for a review of international air carriers to ensure compliance with the award conditions. While MacGillivray makes extensive searches for air travel to minimize the costs and length of flight, it does not ensure international travel is by or under a cost sharing agreement with a U.S. carrier which may led to NSF funding unallowable airfare costs.

We did not question any travel costs as our review found them to be reasonable, allowable, and allocable per NSF regulations. However, MacGillivray could strengthen internal controls by developing and implementing policies and procedures requiring an institutional review of international air carriers for compliance with the foreign-flag carrier restrictions before any actual costs are incurred.

**Recommendation No. 2 – International Travel** - We recommend that NSF's Directors of DACS and DGA ensure that MacGillivray Freeman Films develop and implement written policies and procedures to ensure that international travel costs charged to the grant awards are allowable and in compliance with NSF GC-1, Article 10 – Travel.

### **Awardee Comments**

MacGillivray has stated that it has revised its policies and procedures to be compliant with NSF GC-1 Article 10 – Travel. Additionally, at times it may be necessary to use international carriers as described in the NSF Travel Conditions, paragraph 10 c 4 (b) and (c); and 10 d 1 (a) (b), 2 (a) (b) (c) and 3. In order to document these circumstances and the selection of international carriers over U.S. air carriers, as part of its travel and cargo expense policies and procedures, MacGillivray will retain in its files the appropriate explanation and underlying documentation for the selection of international carriers versus U.S. air carriers. When the use of international carriers is clearly the first choice for cost, safety or efficiency reasons and is outside the NSF Travel Conditions, MacGillivray will solicit a waiver of the NSF Travel Conditions from the NSF while providing airfare/cargo charge and schedule comparisons between international and U.S. air carriers, to support the selection of international carriers based on lower cost and/or efficiency. (See the **Appendix** section of this report for a complete copy of MacGillivray's response to the recommendations.)

**Finding No. 3 – Cost Sharing** - The three NSF awards under audit required cost sharing of \$1.5 million, \$7.2 million, and \$4.6 million, respectively, and were each subject to NSF's annual cost sharing certification requirement.

National Science Foundation Grant General Conditions (GC-1), Article 22 – Cost Sharing and Costs Sharing Records, Section D states in part: “Unless otherwise required by the award or requested by NSF, the actual cost participation by the awardee, while subject to documentation and audit, need not be reported to NSF. In cases, however, **where the cost sharing amount reflected on Line M of the cumulative award budget is \$500,000 or more, the amount of cost sharing must be documented (on an annual and final basis), certified by the Authorized Organizational Representative, and reported to the NSF Program Officer.**”

Prior to our audit, MacGillivray had not submitted cost sharing reports for any of its three awards to NSF. At the time of our audit, MacGillivray should have submitted a total of 5 cost-sharing reports under the three grants within the audit scope. Although MacGillivray submitted annual progress reports, which included the original proposed amount of cost sharing, the status of MacGillivray's actual contributions was not reflected in the report.

MacGillivray's failure to submit annual cost sharing certifications reduces NSF's assurance that cost-sharing requirements are being met and limits NSF's ability to resolve any potential cost sharing problems before a particular award expires.

This problem occurred because MacGillivray was not aware of the requirement to annually submit cost-sharing certifications. Further, because NSF did not request the grantee to provide any additional information regarding the financial data, MacGillivray assumed that all required reports were being properly completed and submitted to NSF.

We did not question any of MacGillivray's cost sharing, as we found that requirements were properly satisfied for two of the three awards, with the third grant still in progress. However, internal controls should be strengthened to better ensure MacGillivray's consistent completion and submission of annual cost sharing certifications and improve NSF's ability to track and monitor cost sharing obligations.

**Recommendation No. 3 – Cost Sharing** - We recommend that NSF's Directors of DACS and DGA ensure that MacGillivray Freeman Films develop and implement written policies and procedures to ensure actual incurred cost sharing is accurately certified and reported to NSF with the annual progress report.

### **Awardee Comments**

MacGillivray has been working with NSF as the recipient of several grants since 1997. MacGillivray had believed that it was in compliance with regards to cost sharing certification, as it was never notified by NSF, that in fact it was not. MacGillivray believed the annual report served as the cost sharing certification.

When MacGillivray submitted an annual report for NSF Award #0125471 via Fastlane in January 2004, an email was automatically forwarded to MacGillivray requesting that it complete a cost sharing notification form via Fastlane and through the newly updated Research Administration area of Fastlane. The note indicated that until MacGillivray completed and submitted that cost sharing form, the annual report would be deemed unsubmitted. This is a new feature of Fastlane and will, in the future, guarantee that on an annual basis, MacGillivray declares its cost sharing for each project for which it is required.

### **Revised MacGillivray Policy and Procedure**

After review for NSF compliance by the MacGillivray accounting department and approval by the MacGillivray director of finance, the annual submission of the MacGillivray cost sharing declaration via Fastlane shall hereby constitute MacGillivray's formal policy and procedure for compliance with the NSF annual cost sharing certification requirement.

We considered these internal control deficiencies in forming our opinion of whether Schedules A-1, A-2, and A-3 were presented fairly in all material respects, in conformity with National Science Foundation policies and procedures, and determined that this report does not affect our report dated December 3, 2003 on the financial schedules.

This report is intended solely for the information and use of the MacGillivray Freeman Films' management, the National Science Foundation, the Office of Management and Budget, and the Congress of the United States of America and is not intended to be and should not be used by anyone other than those specified parties.

*Howard Lind Associates, L.L.P.*

Irvine, California  
December 3, 2003

**FINANCIAL SCHEDULES AND  
SUPPLEMENTAL INFORMATION**

National Science Foundation  
Office of Inspector General  
4201 Wilson Boulevard  
Arlington, Virginia 22230

**INDEPENDENT AUDITORS REPORT ON FINANCIAL SCHEDULES**

We have audited the costs claimed by MacGillivray Freeman Films to the National Science Foundation (NSF) on the Federal Cash Transactions Reports – Federal Share of Net Disbursements for the NSF awards listed below. In addition, we have also audited the amount of cost sharing claimed on the awards. The Federal Cash Transactions Reports - Federal Share of Net Disbursements, as presented in the Schedules of Award Costs (Schedule A-1, A-2, and A-3), are the responsibility of MacGillivray Freeman Films' management. Our responsibility is to express an opinion on Schedules A-1, A-2, and A-3 based on our audit.

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
ESI – 9896307	08/01/98 – 09/30/01	08/01/98 – 09/30/01
ESI – 0003650	01/01/01 – 05/31/03	01/01/01 – 05/31/03
ESI – 0125471	05/01/02 – 06/30/05	05/01/02 – 06/30/03

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards (1994 Revision)*, issued by the Comptroller General of the United States of America, and the *National Science Foundation Audit Guide (September 1996)*. These standards and the *National Science Foundation Audit Guide*, require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe our audit provides a reasonable basis for our opinion.

The accompanying financial schedules were prepared in conformity with the requirements of the *National Science Foundation Audit Guide* as described in the Notes to the Schedules, and are not intended to be a complete presentation of financial position in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the costs claimed on the Federal Cash Transactions Reports - Federal Share of Net Disbursements as presented in the Schedules of Award Costs (Schedule A-1, A-2, and A-3), for the period August 1, 1998 to June 30, 2003 in conformity with the *National Science Foundation Audit Guide*, terms and conditions of the NSF awards and on the basis of accounting described in the Notes to the Financial Schedules.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 3, 2003 on our tests of its compliance with certain provisions of laws, regulations, the provisions of the *National Science Foundation Audit Guide*, and the awards applicable to MacGillivray Freeman Films and our consideration of MacGillivray Freeman Films' internal control over financial reporting. That report is an integral part of an audit

performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of MacGillivray Freeman Films' management, the National Science Foundation, the Office of Management and Budget, and the Congress of the United States of America and is not intended to be and should not be used by anyone other than these specified parties.

*Conrad and Associates, L.L.P.*

Irvine, California  
December 3, 2003

**SCHEDULE A-1**

**MACGILLIVRAY FREEMAN FILMS**  
 National Science Foundation Award Number ESI-9896307  
 Schedule of Award Costs  
 August 1, 1998 - September 30, 2001  
 Final

Cost Category	Approved Budget	Claimed Costs (A)	Questioned Costs
<b>Direct costs:</b>			
Salaries and wages	\$ ██████████	██████████	-
Travel	██████████	█	-
<b>Other direct costs:</b>			
Material and supplies	██████████	█	-
Consulting	██████████	█	-
Subcontractor	██████████	█	-
Other direct costs	██████████	██████████	-
<b>Total direct costs</b>	<b>1,540,560</b>	<b>1,541,896</b>	<b>-</b>
<b>Indirect costs</b>	<b>1,336</b>	<b>-</b>	<b>-</b>
<b>Total</b>	<b>1,541,896</b>	<b>1,541,896</b>	<b>-</b>
<b>Cost sharing</b>	<b>\$ 1,500,000</b>	<b>5,493,210</b>	<b>-</b>

(A) - The total claimed costs agree with the total expenditures reported by MacGillivray Freeman Films on the Federal Cash Transaction Report - Federal Share of Net Disbursements as of the quarter ended September 30, 2001. Claimed costs reported above are taken from the awardee's books of accounts.

**MACGILLIVRAY FREEMAN FILMS**  
 National Science Foundation Award Number ESI-0003650  
 Schedule of Award Costs  
 January 1, 2001 - May 31, 2003  
 Final

Cost Category	Approved Budget	Claimed Costs (A)	Questioned Costs
Direct costs:			
Salaries and wages	\$ [REDACTED]	[REDACTED]	-
Other direct costs:			
Other direct costs	[REDACTED]	[REDACTED]	-
Total direct costs	1,800,000	1,800,000	-
Cost sharing	\$ 7,188,834	7,271,915	-

(A) - The total claimed costs agree with the total expenditures reported by MacGillivray Freeman Films on the Federal Cash Transaction Report - Federal Share of Net Disbursements as of the quarter ended June 30, 2003. Claimed costs reported above are taken from the awardee's books of accounts.

**MACGILLIVRAY FREEMAN FILMS**  
 National Science Foundation Award Number ESI-0125471  
 Schedule of Award Costs  
 May 1, 2002 - June 30, 2003  
 Interim

Cost Category	Approved Budget	Claimed Costs (A)	Questioned Costs
Direct costs:			
Salaries and wages	\$ [REDACTED]	[REDACTED]	-
Other direct costs:			
Other direct costs	[REDACTED]	[REDACTED]	-
Total direct costs	1,451,250	365,235	-
Cost sharing	4,634,190	211,100	-

(A) - The total claimed costs agree with the total expenditures reported by MacGillivray Freeman Films on the Federal Cash Transaction Report - Federal Share of Net Disbursements as of the quarter ended June 30, 2003. Claimed costs reported above are taken from the awardee's books of accounts.

**MACGILLIVRAY FREEMAN FILMS**  
 Summary Schedules of Awards Audited and Audit Results  
 From August 1, 1998 to June 30, 2003

**Summary of Awards Audited**

<u>Award Number</u>	<u>Award Period</u>	<u>Audit Period</u>
ESI – 9896307	08/01/98 – 09/30/01	08/01/98 – 09/30/01
ESI – 0003650	01/01/01 – 05/31/03	01/01/01 – 05/31/03
ESI – 0125471	05/01/02 – 06/30/05	05/01/02 – 06/30/03

<u>Award Number</u>	<u>Type of Award</u>	<u>Award Description</u>
ESI – 9896307	Grant	Development, production, and distribution of IMAX film titled, <i>Journey Into Amazing Caves</i> .
ESI – 0003650	Grant	Development, production, and distribution of IMAX film titled, <i>Coral Reef Adventures</i> .
ESI – 0125471	Grant	Development, production, and distribution of IMAX film documenting the Greek Islands.

**Summary of Questioned and Unsupported Costs by Award**

<u>Award Number</u>	<u>Award Budget</u>	<u>Claimed Costs</u>	<u>Questioned Costs</u>
ESI – 9896307	\$ 1,541,896	\$ 1,541,896	\$ -
ESI – 0003650	1,800,000	1,800,000	-
ESI – 0125471	1,451,250	365,235	-

**Summary of Questioned Cost by Explanation**

<u>Category</u>	<u>Questioned Costs</u>	<u>Internal Controls</u>	<u>Non-Compliance</u>
Salaries and Wages	\$ -	No	No
Fringe Benefits	-	No	No
Consulting	-	Yes	No
Subcontractors	-	No	No
Travel	-	Yes	No
Other Direct Costs	-	No	No
Cost Sharing	-	Yes	No

**Summary of Non-Compliance and Internal Control Findings**

<u>Findings</u>	<u>Non-Compliance or Internal Control?</u>	<u>Material or Reportable?</u>
Consulting Expenditures	Internal Control	Reportable
Travel Expenditures	Internal Control	Reportable
Cost Sharing	Internal Control	Reportable

**MACGILLIVRAY FREEMAN FILMS**  
Notes to Financial Schedules  
From August 1, 1998 to June 30, 2003

**Note 1: Summary of Significant Accounting Policies**

Accounting Basis

The accompanying financial schedules have been prepared in conformity with National Science Foundation (NSF) instructions. Schedules A-1, A-2, and A-3 have been prepared from the reports submitted to NSF. The basis of accounting utilized in preparation of these reports differs from generally accepted accounting principles. The following information summarizes these differences:

A. Equity

Under the terms of the awards, all funds not expended according to the award agreement and budget at the end of the award period are to be returned to NSF. Therefore, the awardee does not maintain any equity in the award and any excess cash received from NSF over final expenditures is due back to NSF.

B. Equipment

Equipment is charged to expense in the period during which it is purchased instead of being recognized as an asset and depreciated over its useful life. As a result, the expenses reflected in the statement of award costs include the cost of equipment purchased during the period rather than a provision for depreciation.

The equipment acquired is owned by MacGillivray Freeman Films while used in the program for which it was purchased or in other future authorized programs. However, NSF has the reversionary interest in the equipment. Its disposition, as well as the ownership of any proceeds there from, is subject to Federal regulations.

C. Inventory

Minor materials and supplies are charged to expense during the period of purchase. As a result, no inventory is recognized for these items in the financial schedules.

The departure from generally accepted accounting principles allows NSF to properly monitor and track actual expenditures incurred by the grantee. The departure does not constitute a material weakness in internal controls.

**Note 2: NSF Cost Sharing and Matching**

The following represents the cost share requirements and actual cost share as of December 3, 2003:

<u>Award Number</u>	<u>Cost Share Required</u>	<u>Actual Cost Share Provided</u>	<u>Over/(Under)</u>
ESI – 9896307	\$ 1,500,000	\$ 5,493,210	\$ 3,993,210
ESI – 0003650	7,188,834	7,271,915	83,081
ESI – 0125471	4,634,190	211,100	(4,423,090)*

\*Grant ESI-0125471 ends 6/30/05. Cost sharing is expected to be fully satisfied at the end of the grant period.

**Note 3: Indirect Cost Rates**

Indirect costs were not approved in the original or amended budgets. Therefore, no indirect costs were claimed on the awards.

**APPENDIX - AUDITEE'S COMMENTS TO REPORT**

# MACGILLIVRAY FREEMAN FILMS

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March 3, 2004



Conrad and Associates, LLP  
Certified Public Accountants  
2301 Dupont Drive, Suite 200  
Irvine, CA 92612

Re: National Science Foundation Draft Audit Report  
ESI-9896307 Caves, ESI-0003650 Coral Reef, ESI-0125471 Greece



We have received and reviewed the National Science Foundation (NSF) Draft Audit Report (Report) covering the above referenced grants. We note that the Report does not identify any Compliance Findings that require a specific response. As requested, we are responding to your recommendations to improve internal control in the areas of consulting expense, travel and cost sharing as follows:

## **Consulting Expenditures**

Conrad Comment- A significant portion of MacGillivray's award activities are performed by independent contactors, who may serve as personnel assisting in award performance or consultants who provide professional advice or service. Consultant rates are subject to daily limits established by NSF regulations, making the identification of independent contractors important. Although we did not determine any of the independent contractor charges to be consultants, which are subject to the maximum rates, MacGillivray's lack of written policies and procedures in place to identify the role and differentiate in the treatment of its independent contractors, leaves all such costs subject to mistaken identify and at risk for overcharging to NSF awards.

MacGillivray Response- MacGillivray Freeman Films employs both independent contractors and specialized consultants. We differentiate between these types of personnel by two means with regard to accounting and production. A consultant is classified as someone who is an expert in a specific subject or field, typically scientific in nature. These individuals are classified most often as educational or science advisors, their contribution to a project being on an "as needed," intellectual basis. These consultants sign specific agreements that state they are an educational or science advisor. The payments are coded to a specific project code and sub code, denoting that the payment is to a Consultant/Expert, i.e. "P" (for production code and the number follows, such as "143") and then sub code "0007."

*Specializing in Film Production and  
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Independent contractors are hired for skills or services with respect to the actual physical production aspects of a film. This would typically be production coordinators and managers that arrange the various aspects of a location shoot for a project. Their contribution to a project is usually in the form of a specific skill set. They sign a more comprehensive deal memo, which states their job title and the time frame for which they have been hired. This usually covers a specific location or occasionally for the project in general. Independent contractors are also coded specifically within the MacGillivray accounting system, to the various areas of production or post production.

## Revised MacGillivray Policy and Procedure

MacGillivray's accounting system job cost production sub code, "0007," hereby constitutes the designation for consultants subject to NSF daily cost limits. To ensure further compliance with the NSF daily cost limits prevailing for the then current maximum rate paid to an Executive Schedule Level IT Federal employee, daily rates are incorporated in the consultants' deal memos or contracts. These daily cost limits are reviewed for compliance prior to the execution of the deal memo or contract by MacGillivray's general manager and are monitored for ongoing compliance by the MacGillivray accounting department by referencing the NSF Web site at: <http://www.nsf.gov/bfa/cpo/policy/faqs.htm#cons>.

## International Travel

Conrad Comment- MacGillivray incurs substantial travel in NSF award performance. However, MacGillivray does not have written policies and procedures in place to review international airfare expenditures to ensure costs charged to NSF comply with NSF regulations. Certain NSF rules and regulations apply when international travel is involved; specifically the use of U.S. air carriers when available. Although we did not question any travel cost in this audit, MacGillivray's failure to have proper policies and procedures in place requiring review of international airfare expenditures for compliance with NSF regulations could lead to unallowable costs.

MacGillivray Response- MacGillivray staff is fully aware of the NSF regulations regarding international air travel expenditures and the requirement to use U.S. carriers in accordance with NSF Grant General Conditions (GC-1), Article 10 - Travel. While it is always MacGillivray's first choice to use domestic U.S. carriers, due to the unique operational characteristics of our industry, we are sometimes required to use international carriers to operate efficiently, successfully, and at ultimate lowest cost. A typical foreign location production shooting lasts several weeks and involves the transportation of crew as well as tonnage of equipment, film, and supplies. It is imperative that crew and equipment/supplies move efficiently through customs, are not exposed to damaging Xray devices, and arrive intact and on time. Sometimes, MacGillivray is able to obtain reduced air fare and cargo rates from international carriers in return for promotional consideration in the film. For these reasons MacGillivray has found that it often makes sense, both operationally and financially, to use a foreign carrier to handle the total round trip from Los Angeles to foreign destination and back. It would make little sense, for

# MACGILLIVRAY FREEMAN FILMS

example, to use domestic flights from Los Angeles to New York, and then transfer tonnage to a foreign carrier to final destination. The risk of loss, damage, additional handling expense, and delays would all add to the final cost of the production. Also, scheduled air service may not be available in some remote international locations, and MacGillivray may be required to use foreign charter air services to move film crews and equipment. It is, and has always been, MacGillivray's policy is to use the most efficient and cost effective methods of moving crew and equipment to locations while giving priority to U.S. air carriers.

## Revised MacGillivray Policy and Procedure

It is MacGillivray's policy, in compliance with NSF Grant General Conditions (GC-1), Article 10 - Travel (NSF Travel Conditions), to use U.S. air carriers (or carriers under a code-sharing arrangement with a U.S. air carrier) if the service provided by such a carrier is available and is in accordance with NSF Travel Conditions. However, at times, it may be necessary to use international carriers as described in the NSF Travel Conditions, paragraph 10 c 4 (b) and (c); and 10 d 1 (a) (b), 2 (a) (b) (c) and 3. In order to document these circumstances and the selection of international carriers over U.S. air carriers, as part of its travel and cargo expense policies and procedures, MacGillivray will retain in its files the appropriate explanation and underlying documentation for the selection of international carriers versus U.S. air carriers. When the use of international carriers is clearly the first choice for cost, safety or efficiency reasons and is outside the NSF Travel Conditions, MacGillivray will solicit a waiver of the NSF Travel Conditions from the NSF while providing airfare/cargo charge and schedule comparisons between international and U.S. air carriers, to support the selection of international carriers based on lower cost and/or efficiency. Tickets and cargo way-bills must always identify the carrier's designator code and flight number (to the extent a flight number is available if a charter service is used).

## Cost Sharing

Conrad Comment- MacGillivray did not submit annual required cost certifications. The certification information provides NSF assurance that cost sharing requirements are being met and provides NSF the ability to resolve any potential cost sharing problems before a particular award expires. We did not question any of MacGillivray's cost sharing, noting that MacGillivray has satisfactorily met the cost sharing requirements for the two completed awards and the third award is still in progress. However, MacGillivray needs written policies and procedures to ensure the cost sharing certification is annually and accurately completed and submitted.

MacGillivray Response- MacGillivray has been working with NSF as the recipient of several grants since 1997. MacGillivray had believed that it was in compliance with regards to cost sharing certification, as it was never notified by NSF, that in fact it was not. MacGillivray believed the annual report served as the cost sharing certification.

When MacGillivray submitted an annual report for NSF Award #0125471 via Fastlane in January 2004, an email was automatically forwarded to MacGillivray requesting that it

# MACGILLIVRAY FREEMAN FILMS

complete a cost sharing notification form via Fastlane and through the newly updated Research Administration area of Fastlane. The note indicated that until MacGillivray completed and submitted that cost sharing form, the annual report would be deemed unsubmitted. This is a new feature of Fastlane and will, in the future, guarantee that on an annual basis, MacGillivray declares its cost sharing for each project for which it is required.

## Revised MacGillivray Policy and Procedure

After review for NSF compliance by the MacGillivray accounting department and approval by the MacGillivray director of finance, the annual submission of the MacGillivray cost sharing declaration via Fastlane shall hereby constitute MacGillivray's formal policy and procedure for compliance with the NSF annual cost sharing certification requirement.

## Conclusion

We trust we have adequately covered Conrad's findings and recommendations for action. We appreciate the recommendations for improvement and found the Conrad staff conducting the audit to be constructive and professional. If we have not responded comprehensively and adequately to the draft audit report, we would appreciate the opportunity to provide further explanations and clarification.

Sincerely,

[REDACTED]

cc:

[REDACTED]

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