

Audit of FACTOR MUSICACTION CANADA

Foundation to Assist Canadian Talent on Records
(FACTOR)
La Fondation MUSICACTION
(MUSICACTION)

Prepared for
Department of Canadian Heritage

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Executive Summary and Conclusion

FACTOR/MUSICACTION CANADA (FMC) is a non-profit organization dedicated to the development and promotion of Canadian content sound recordings. FMC manages, on behalf of the Department of Canadian Heritage (the Department), under a Contribution Agreement (Agreement), the Audio and Video Production, Marketing and Touring, and Business Development components of the Sound Recording Development Program (SRDP).

FMC consists of the Foundation to Assist Canadian Talent on Records (FACTOR), based in Toronto, and La Fondation MUSICACTION (MUSICACTION), based in Montreal. Applications for financial assistance for English-language vocal music sound recordings are directed to FACTOR, while applications for French-language vocal music sound recordings are directed to MUSICACTION, regardless of where the applicant resides. Artists making “world music” and non-vocal recordings may apply to either organization for financial assistance. FACTOR and MUSICACTION programs are available to all Canadian citizens and landed immigrants residing in Canada.

FACTOR and MUSICACTION provide financial assistance in the form of loans or contributions. To obtain this assistance, applicants are required to meet certain eligibility criteria which FMC established on the basis of the Agreement between the Department and FMC.

For the financial periods ending March 31, 2000 and March 31, 2001, the Department's contribution to FMC, each year, was not to exceed \$8,525,000. This represents approximately 80% of the total budget of MUSICACTION and FACTOR. Private broadcasters' contributions and loan repayments by the recipients account for the remaining 20%. At the time of the audit, MUSICACTION and FACTOR had a total of 1201 active files with a total value of \$10,418,839.

In accordance with our terms of reference, the audit was to provide assurance that:

- the Agreement complies with the objectives of the SRDP;
- FMC, FACTOR and MUSICACTION fulfil their requirements under the terms of the Agreement in an effective and efficient manner;
- due diligence is exercised in the expenditure of program funds;
- financial and performance evaluation information is valid and reliable;
- the governance arrangement between the Department and FMC provides an appropriate level of transparency, accountability and risk management; and
- any other risks to the successful achievement of SRDP objectives have not been overlooked.

To address these criteria, we examined relevant documentation, interviewed key staff, analysed systems in place and conducted a detailed review of 46 recipient files with a total dollar value of \$1,060,681.

Our overall conclusion is that FACTOR and MUSICACTION have generally a satisfactory program management and administrative framework in place for the delivery of the Audio and Video Production, Marketing and Touring, and Business Development program on behalf of the Department.

During the audit field work which took place between October 2000 and January 2001, we identified areas that offer opportunities to enhance certain practices, systems and procedures. While none of these impact on the effective delivery of the program, we are presenting these in this report to assist FMC with improvement oriented activities, where applicable. Matters of a minor, housekeeping nature have been presented to FMC in a separate management letter. To Canadian Heritage we have provided a management letter outlining matters that may be of assistance to the Department as part of its ongoing monitoring of the Agreement.

1. Background

The Sound Recording Development Program (SRDP) was established in 1986 with an initial annual budget of \$5 million. It was the government’s first program directed towards strengthening the infrastructure of the Canadian-owned sector of the sound recording industry and assisting it to produce and, to a lesser extent, market Canadian-content music products. The SRDP budget was raised to \$9.45 million in 1997 in order to provide Canadian-owned and controlled record companies with the means to efficiently promote their products both on the national and international markets.

In accordance with Treasury Board's policy on Transfer Payments, the Department of Canadian Heritage (the Department) provides financial assistance, under a Contribution Agreement (Agreement), to FACTOR/MUSICACTION CANADA (FMC), a non-profit organization dedicated to the development and promotion of Canadian content sound recordings. Under the Agreement ending March 31, 2000, FMC delivered on behalf of the Department four of the six Components of the SRDP as follows:

1. Audio and Video Production
2. Marketing and Touring
3. Business Development and
4. Specialized Music Distribution.

Under the Agreement covering the period April 1, 2000 to March 31, 2003 (2000-2003), FMC no longer delivers the "Specialized Music Distribution" Component.

FMC consists of: the Foundation to Assist Canadian Talent on Records (FACTOR), based in Toronto, and La Fondation MUSICACTION (MUSICACTION), based in Montreal. Applications for English-language vocal music sound recordings are directed to FACTOR, while applications for French-language vocal music sound recordings are directed to MUSICACTION, regardless of where the applicant resides. Artists making “world music” and non-vocal recordings may apply to the organization of their choice. FACTOR and MUSICACTION programs are available to all Canadian citizens and landed immigrants residing in Canada.

Of the total funding received by FMC from the Department under SRDP, 60% is allocated to FACTOR and 40% is allocated to MUSICACTION. The Department contributes approximately 80% of the total budget of both organizations while private broadcasters and loan repayments by recipients account for 20%. Each organization has its own board of directors made up of representatives from various sectors of the sound recording and broadcasting industries. Up to 13.5% of the Department’s Contribution can be expended by FMC on administration and communication costs.

According to the Agreement, the Department’s Contribution to FMC for the fiscal years ending March 31, 2001 and March 31, 2000 was not to exceed \$8,525,000 and was distributed as follows:

	<u>March 31, 2001</u>	<u>March 31, 2000</u>
Audio and Video Production (Component 1)	\$3,600,000	\$3,600,000
Marketing and Touring (Component 2)	\$4,250,000	\$4,250,000
Business Development (Component 3)	\$ 675,000	\$ 475,000
Specialized Music Distribution (Component 4)	—	<u>\$ 200,000</u>
	<u>\$8,525,000</u>	<u>\$8,525,000</u>

FACTOR and MUSICACTION provide financial assistance, in the form of loans or contributions, to Canadians, Canadian-owned and controlled companies and associations, and other players in the sound recording industry involved in the production and promotional support of Canadian content sound recordings. To obtain funds, applicants are required to meet a series of eligibility criteria which FMC developed on the basis of certain clauses in the Agreement. Funding provided to an applicant is on a cost-shared basis with the Federal Government's share not normally exceeding the lesser of (i) 50% of total anticipated eligible costs of each eligible project or activity funded under the Program, and (ii) 50% of total actual eligible costs incurred for said project or activity.

Conditions governing payment of the Department's Contribution as well as reporting and audit requirements are described in the Agreement.

As at the time of our audit, FACTOR maintained 819 active files and MUSICACTION had 382 active files.

2. Objectives, Scope and Approach

2.1 Objectives

The objectives for the audit of FMC, FACTOR and MUSICACTION were to provide assurance that:

- the Agreements comply with the objectives of the SRDP;
- FMC, FACTOR and MUSICACTION fulfill their requirements under the terms of the Agreements in an effective and efficient manner;
- due diligence is exercised in the expenditure of program funds;
- financial and performance evaluation information is valid and reliable;
- the governance arrangement between the Department and FMC provides an appropriate level of transparency, accountability and risk management; and
- any other risks to the successful achievement of SRDP objectives have not been overlooked.

2.2 Scope

The scope of the audit included an examination of:

- efforts undertaken by FMC to obtain additional investors or sponsors;
- reasonableness of salaries paid to FMC, FACTOR and MUSICACTION officials when compared to comparable duties and responsibilities of others involved in the cultural and other similar industries;
- the qualifications, training and experience of staff to fulfill expected mandates;
- the effectiveness of monitoring and auditing of the recipients;
- the efficiency, effectiveness and economy of internal systems and controls;
- the clarity of results expected and the capacity to provide reliable performance indicators; and
- the extent of the implementation of the new requirements included in the 2000-2003 Agreement

The field work for this audit took place between October 2000 and January 2001.

2.3 Approach

We conducted our audit in the offices of FACTOR and MUSICACTION located in Toronto and Montreal, respectively. Our work included the following:

- i. Review a sample of 46 application files (22 FACTOR files and 24 MUSICACTION files). While the focus of the audit was the 2000-2003 Agreement, the bulk of the sample was drawn from applications received in 1999, to allow us to audit the entire cycle from receipt of an application to the final

payment to the recipient. We selected a representative sample of applications for the period March 31, 1999 to September 30, 2000 based on the following criteria:

- SRDP Components under the administration of FACTOR and MUSICACTION;
 - funding allocations for the programs of FACTOR and MUSICACTION; and
 - the various applicant groups who received funding.
- ii. Review documentation, including:
- Treasury Board's Transfer Payment Policy ("A Governing Framework for New Arrangements") dated June, 2000;
 - Chapters 11 and 14 of the Auditor General of Canada Report, dated October, 2000;
 - MUSICACTION's documents entitled *Examen du cadre de gestion de MUSICACTION*, and FACTOR's Management Framework, Corporate Review Branch, both dated February, 1997; and
 - the Final Evaluation Report of the Sound Recording Program, dated April 2000.
- iii. Obtain management's concerns and key issues.
- iv. Review internal practices, processes and controls.
- v. Review and examine documentation supporting FMC's administration and communication expenses.

3. Observations and Recommendations

3.1. Projects funded under Audio and Video Production (Component 1) and Marketing and Touring (Component 2) are clearly related to the objectives for these components as stated in the Agreement, while for Business Development (Component 3), this may not be completely the case.

Based on our review of the numerous programs put in place by both FACTOR and MUSICACTION, we conclude that they meet the objectives of the Agreement with respect to the programs and projects funded under the Audio and Video Production Program and under the Marketing and Touring Program. These two programs represent 94% of the total funding received from the Department.

For the Business Development Component (Component 3), which for the fiscal period ending March 31, 2000, represented approximately 6% of the total funding received from the Department, Appendix A of the Agreement indicates that: *“FMC, FACTOR and MUSICACTION will support projects, preferably of a collaborative nature, that benefit the growth and strengthening of the Canadian-owned and Canadian-controlled sectors of the Canadian sound recording industry. Eligible projects will notably include the following: the linkages between sound recording companies and training institutions, training and development of Canadian artist managers, promotion campaigns for Canadian products, development of plans and expansion strategies, improvement of business management and marketing activities, adaptation to new technologies as well as research on the current state and the trends in sound recording industry.”*

A review of the projects funded by FACTOR and MUSICACTION in the 1999-2000 fiscal year indicated that most of the projects only address the aspect related to “promotion campaigns for Canadian products” such as festivals and award events. This aspect is already addressed by Component 2 (Marketing and Touring).

Recommendation

Projects funded under the Business Development Component (Component 3), should be reviewed by MUSICACTION and FACTOR to ensure that they reflect the objectives stated in the Agreement. Alternatively, the objectives stated in the agreement may have to be re-examined and modified, as appropriate. In this event, MUSICACTION/FACTOR should bring this to the attention of the Department of Canadian Heritage

Management Response

Components 2 & 3 have been redefined in the new CMF. The new CMF CA will clearly outline the mandates and criteria of the two programs; And the CMF Council will ensure that the programs are administered as detailed in the CA.

Also the TB submission for the new CMF allows the Department some flexibility to adjust the government’s contribution to a given program if necessary.

Staff notes MA’s commitment to review the programs & FACTOR’s desire to discuss the objectives of the programs with the Department.

No further action is required.

3.2. Opportunities for best practice exchanges between FACTOR and MUSICACTION have not been fully explored.

FACTOR/MUSICACTION CANADA (FMC) was created in 1986 to incorporate two organizations which already existed at that time: FACTOR was founded in 1982 by a group of Ontario broadcasters in conjunction with the Canadian Independent Record Producers Association (CIRPA) and the Canadian Music Publishers Association (CMPA). MUSICACTION was founded in 1985 by Quebec broadcasters.

Both FACTOR and MUSICACTION are required to pursue the same mission, must comply with terms and conditions of the same Agreement and are overseen by the FMC board of directors. Both organizations have similar requirements for systems, processes and procedures.

In our opinion, opportunities exist for increased collaboration between FACTOR and MUSICACTION through the sharing of best practice exchanges in such areas as:

- File documentation
- Tasks performed by employees
- Approach to Project Management
- Activities by the board of directors
- Hardware and software (computers)
- Development of Conflict of Interest guidelines
- Documentation of systems, processes
- Documentation of administrative procedures relating to employer-employee relationships

To some extent this was recognized by both organizations in a joint board of directors meeting in September 2000. The minutes from this meeting indicate that, as a first step, harmonization relative to the Instrumental Music Program is scheduled for implementation in April 2001.

Recommendation

FACTOR and MUSICACTION should continue to seek out opportunities for harmonizing approaches and sharing best practices and, where practicable, undertake concrete measures to that end. The Department should be kept informed of such initiatives as they are agreed to by FACTOR and MUSICACTION.

Management Response

While both FACTOR and MA agree about the merits of harmonization and sharing best practices, the Department recognizes that differences exist between the English- and French-language markets and that a degree of flexibility is needed by both organizations to administer the program efficiently and effectively.

In recognizing these differences, the two organizations will have separate CAs with the Department.

The CMF Council and the Department, however, will require the organizations to harmonize activities where necessary.

No further action is required.

3.3. The board of directors of MUSICACTION does not request all relevant information to enable them to review programs and monitor the operations.

The board of directors of an organization generally assumes two main responsibilities. It identifies the direction that the organization should take in terms of mission and objectives, and it monitors the work performed by the organization's officers to ensure that appropriate actions are taken towards realizing the stated mission and objectives.

In organizations such as FACTOR and MUSICACTION, the board of directors has a broader mandate, as it includes determining program guidelines and authorizing financial assistance. This task is demanding, as the Board has to deal with many issues and details. The organization benefits from the special expertise that Board members can offer.

In our review of the MUSICACTION board meeting minutes held during fiscal years 1999/2000 and 2000/2001, we found no indication that the Board examined fundamental aspects such as objectives of the programs and program evaluation and relevant guidelines. Additionally, few questions are asked of the General Manager about operational activities and results. No reporting is requested from the General Manager.

The review of the FACTOR Board minutes indicates that the Board is proactive and requests, from management, relevant and sufficient information about the operations.

Recommendation

The board of directors of MUSICACTION should request all relevant information to enable them to review the programs, monitor the operations, and ascertain that guidelines are followed and corrective action is taken, where appropriate.

Management Response

Staff notes that MA's Board has adopted a number of changes in the criteria and formulation of its programs and that all decisions will now be reflected in the minutes.

No further action is required.

3.4. Minutes of the MUSICACTION Board meetings do not always contain all important information.

A review of the Board meeting minutes indicate that the minutes provide few details regarding important discussions by the directors and the rationale behind critical decisions that were made. This includes matters relating to conflicts of interest, and exceptions to program guidelines granted by the Board.

We were informed that a director leaves the Board meeting when projects are submitted that place a director in a conflict of interest situation. However, in the minutes covering the 1999/2000 and 2000/2001 fiscal years, we noted only one occasion where the withdrawal of a member was specifically recorded. Since the appearance of conflict of interest could be as damaging as an actual conflict, each and every withdrawal should be recorded in the minutes.

Decisions by the Board with respect to “exceptions” to program guidelines were properly noted in the minutes. However, the rationale behind the decisions was not always explained.

Recommendation

MUSICACTION should consistently document conflict of interest situations and deviation from program guidelines.

Management Response

MA will ensure that all conflict of interest situations and deviation from program guidelines are noted in the minutes.

No further action is required.

3.5. Project selection and approval procedures are generally sound with some selective opportunities for improvement

Project Selection and Approval constitute key activities in all funding decisions and therefore sound standards based upon which projects are selected and approved, are essential.

The project selection and approval phase, at MUSICACTION and FACTOR, include the following steps:

- Receipt of the application form;
- Evaluation by a program administrator with a resultant evaluation report ;
- Approval by a jury (when applicable);
- Approval by a manager; and
- Approval by the board of directors.

Based on our analysis we conclude that both FACTOR and MUSICACTION have in place appropriate guidelines to select and approve projects. However, we also noted some opportunities to enhance certain aspects of the Project Selection and Approval process, as follows:

- Program guidelines for applicants do not provide sufficiently detailed information and Program administrators are not provided with sufficiently detailed procedures on the relevance of and analysis to be carried out on information submitted by the applicant. For example, there is a lack of emphasis on criteria that should be followed during the review process of budgets and objectives included in the application forms.
- The only written document that emanates from the analysis conducted by program administrators is the “summary sheet” (“grilles d’évaluation” at MUSICACTION). In essence, this document states that the file has been reviewed and that it meets the program eligibility criteria. Often, it highlights items which the program administrator wants to bring to the attention of the manager. Both at FACTOR and MUSICACTION, we did not find in the audited files any conclusions as to the expected benefits from the projects.

Recommendations

FACTOR and MUSICACTION should enhance program guidelines for applicants and procedures for program administrators to ensure that all relevant information is obtained and analyzed.

The result of the evaluation of the projects by FACTOR and MUSICACTION should include comments relative to the benefits expected from the projects.

Management Response

The Auditor’s overall assessment is that both FACTOR and MA have in place appropriate guidelines as pertains to project selection and approval. Accordingly, the proposed enhancements and the responses by both organizations are considered as pragmatic and reasonable.

The new CMF CA will require FACTOR and MA to undertake all appropriate operational procedures and require beneficiaries to identify precisely how outcomes will be identified and measured.

No further action is required.

- Article 9 of Appendix A of the Agreement indicates that: “*FMC, FACTOR and MUSICACTION agree to carry out credit checks on any companies or individuals receiving more than \$25,000 in one fiscal year*”. This requirement was also included in the previous Agreement (article 17 of Appendix A).

In the case of MUSICACTION, we found that this requirement is referred to in the program guidelines. For 16 of the 24 projects audited at MUSICACTION, the amount granted in the current year was greater than \$25,000. Credit checks were not carried out for 12 projects.

At FACTOR, the program guidelines or the contracts signed with recipients do not contain any provision regarding credit checks. There was no evidence of credit checks for the 22 projects reviewed at FACTOR.

MUSICACTION always engages the same Chartered Accounting firm to conduct the credit check on its behalf. Based on our understanding, the firm relies solely on discussions with recipients. We believe that the credit check should include an external evaluation (suppliers, financial institutions). This type of credit check, we believe, could also be performed, when judged appropriate, by employees of MUSICACTION (or FACTOR).

Recommendation

FACTOR should modify its program guidelines and contracts signed with recipients to take into consideration the credit check requirement in the Agreement.

Management response

The new CMF CA defines “default” and will require that applicants attest to not being in default, as a precondition of having their applications considered by FACTOR and MA.

FACTOR has indicated that it will insert a clause into its contribution agreements with recipients to take credit checks into consideration.

No further action is required

3.6. At MUSICACTION, certain Policies, Procedures and Guidelines require clarification and documentation.

As part of our audits, we reviewed relevant documented procedures and guidelines to ensure they can meet the organizations' need, and assist in maintaining consistency and continuity in the daily activities. The following was noted:

Employer-Employee Relationships

Procedures covering employer-employee relationships should describe employee duties and responsibilities as well as the responsibilities of the organization towards its employees.

We determined that FACTOR has a reasonable set of administrative procedures. They are comprehensively described in an employee handbook addressing numerous topics such as employee responsibilities, confidentiality of information, conflicts of interest, benefits, probation period, performance review, and internal communications.

At MUSICACTION, most administrative procedures are not documented. Also, many of the current practices were modified during the 18 month period preceding the date of this audit.

Recipients in Default

The loan and contribution contracts signed between FACTOR and MUSICACTION and their recipients cover events of default such as failure to comply with any provision of the contracts, misrepresentation or insolvency. These contracts state that, in the event of default, all financial assistance received by the

recipient under the terms of the contract shall become immediately due at the sole discretion of FACTOR and MUSICACTION.

The results of our tests indicate that MUSICACTION has not consistently exercised its rights in events of default. Among the projects we tested at MUSICACTION, seven recipients were in default for failing to make repayments on loans by the due date. We also found that in such circumstances, MUSICACTION does not exercise its right to charge interest fees on unpaid repayments as provided for in contracts signed with borrowers.

Recipients not meeting Deadlines

FACTOR and MUSICACTION indicate in their contracts that the non-compliance of time limits constitutes an event of default. FACTOR sends letters to recipients reminding them of their requirements and, if necessary, asks them to send a written request for a deadline extension. We found that in most cases deadlines were respected.

At MUSICACTION, our review identified two projects that took an extensive period of time to complete. For a sound recording project, four years elapsed between the acceptance of the project in October 1995 and the receipt of the completion certificate by MUSICACTION in September 1999. In another project, the production of a demo album, two years elapsed between the acceptance of the project in December 1997 and the receipt of the completion certificate by MUSICACTION in January 2000.

Not meeting deadlines could have multiple negative impacts on the organization. Firstly, additional costs are incurred in managing significantly delayed projects. Secondly, the longer a project remains outstanding, the less the likelihood that it will be completed or finalized. Finally, when it becomes evident that a project will not reach its completion, which also constitutes an event of default, repayments by recipients of financial assistance already received is not likely.

Based on an analysis of outstanding commitments at MUSICACTION as at March 31, 43% of all projects included in the outstanding commitments were older than one year, representing 151 projects with a total value of \$692,829.

Recommendations

We recommend that MUSICACTION conduct a comprehensive review of all its procedures pertaining to employer-employee administration and document these in an employee handbook.

MUSICACTION should clarify its policies and procedures for handling recipients in default and document these and prepare relevant administrative guidelines.

MUSICACTION should tighten its policies and procedures to ensure that proper actions are taken for projects where recipients do not meet agreed to deadlines.

Management Response

MA will establish a formal contract with employees outlining the terms of employment.

As respects program specific issues such as beneficiaries in default and meeting deadlines, MA has already undertaken a full review of its contracts with beneficiaries for the past 5 years and will enforce its procedures accordingly.

No further action is required.

3.7. Project Results and Completion Certificate

The completion certificate is a report that each recipient must submit upon project completion. This report allows FACTOR and MUSICACTION to be informed on the results of the project. It includes:

- the recipient's report on a form provided by FACTOR and MUSICACTION (called the *completion certification form*) which includes a description of the way the project was carried out, and the *cost summary report*; and
- the documentation in support of the costs actually incurred is presented in the *cost summary report*.

The following was noted:

3.7.1 At FACTOR and MUSICACTION, the narrative description about project results is often incomplete and performance achieved by projects funded is not assessed.

A narrative description of a project's results is essential to evaluate how this project was successful in achieving its objectives in an efficient manner. We understand that it may take several months to determine if a project actually succeeded in meeting its objectives. However, this should not limit the recipient from describing, in the completion certificate, how the project was carried out and the future steps to be taken.

For Audio and Video Production projects, included in Component 1, the results tend to be obvious. As for Marketing, Touring and Business Development Projects (Components 2 and 3), an in-depth description of the project and its impact should always be available. This information is useful in evaluating the adequacy and performance of the programs, and to allow for adjustments to the program, where appropriate.

Recommendations

FACTOR and MUSICACTION should improve their program guidelines for recipients relative to the description of results and the performance of projects; and

FACTOR and MUSICACTION should assess the performance of all projects to enable them, where applicable, to adjust programs.

Management Response

MA will now request a description of the results in its completion certificates.

FACTOR indicates that it reviews and assesses its programs on an annual basis.

No further action is required.

3.7.2 The cost report section of the completion certificate obtained by FACTOR and MUSICACTION and the analysis of the reports need improvement.

The cost report includes the cost summary report, part of the completion certificate, as well as relevant support documentation such as invoices, cancelled cheques, money order receipts, bank draft receipts, credit card receipts, etc. The assessment of this report is particularly significant because it allows the program administrator to measure the actual financial results of the project, based on which the second payment of the financial assistance by FACTOR or MUSICACTION is made. The following was noted in the files examined:

Information Provided to FACTOR and MUSICACTION

- Where funding relates to an activity that is part of a larger, complex project, we noted that at FACTOR, invoices were missing for a significant percentage of the incurred costs. We were informed that they do not request copies of all invoices pertaining to this type of file given the magnitude of the event, and the related administrative costs for obtaining this information.
- FACTOR and MUSICACTION program guidelines require that all cancelled cheques be provided by the recipients with each completion certificate. For some projects, cheques were missing. In other situations, cancelled cheques were the sole support for expenditures and in other instances, while invoices were available, they did not provide sufficient relevant information.
- Some of the projects funded generate revenue. This is the case for projects related to Tours, Showcases, and Marketing Initiatives. The primary objective of these projects is to promote artists. These projects often produce a shortfall. The financial assistance provided helps to reduce this shortfall, but is limited to the lesser of 75% of the shortfall or the cap according to program guidelines in place at FACTOR and MUSICACTION (“75% rule”). Therefore, on occasion, revenues constitute a significant amount. We noted that it is FACTOR's and MUSICACTION's policy to accept revenues as reported. No further action is taken to validate the revenue generated by a special event (for example, confirmation from a third party, such as a promoter).
- For projects that cannot easily be segregated from other projects by the recipient, FACTOR and MUSICACTION do not obtain sufficient information in order to effectively assess costs claimed. This was noted in three projects at MUSICACTION and two at FACTOR. Consequently, the eligibility of expenses cannot readily be determined. A significant part of these expenses represent salary costs. To assess the number of hours claimed by the recipient, FACTOR and MUSICACTION need relevant budget information (hours worked) and time sheets.

Review Conducted by FACTOR and MUSICACTION

- We tested a total of four video production projects at MUSICACTION and FACTOR (two at MUSICACTION and two at FACTOR). For all four projects, the videos were produced by firms specializing in this type of production. The recipient presented only video producer invoices to back costs included in the cost report with the completion certificate. For three of the four projects, only one invoice, summing up all fees of the video production, was presented, and MUSICACTION and FACTOR did not conduct a review of the costs incurred.

Where there is a sole supplier, MUSICACTION and FACTOR rely exclusively on the information presented by the supplier. FACTOR usually asks for a breakdown of the invoiced amount in the cost report for statistical purpose. However, the value of this information is questionable because it comes from the applicant and is not usually supported by proper documentation. In addition, article 10.2.7 of the Agreement indicates that any suppliers or subcontractors, receiving 20% or more of the total value of the financial assistance paid to a recipient, are subject to audit with regard to a funded project except in the case of International Touring and Showcases or for contributions of \$3,000 or less. No audit was carried out on the four projects.

- At FACTOR, we identified a sound recording project where, from the total cost of \$122,000, an amount of \$100,000 was paid by the recipient (the producer) to the artist recording the album. The agreement between the artist and the producer indicates that this amount does not constitute a fee for the recording of the album, but instead is a “master acquisition fee”.

Had this amount been considered a fee for the recording of the album, it would have amounted to approximately \$3,500. This is based on the rate of \$573 per song as set by the *American Federation of Musicians/Canadian office* (6 songs were on the album).

In accordance with the agreement between the producer and the artist, FACTOR accepted the “master acquisition fee” of \$100,000 as an eligible expense. However, FACTOR has no guidelines to address “master acquisition fees” paid in sound recording projects with regard to maximum amounts and conditions upon which they are accepted.

- For the same project, the agreement between the producer and the artist indicated that the “master acquisition fee” was an amount recoverable out of the artist’s royalties and other amounts to be paid under the terms of the agreement.

This amount was considered an eligible expense by FACTOR, even though they were aware that it was fully recoverable as an advance. FACTOR stated that all amounts paid by a record label to an artist for the production of an album are reimbursable against the royalties paid on the sales of an album. In their opinion, this constitutes a standard in the sound recording industry. However, FACTOR does not monitor the album sales of sound recording projects for recoverable amounts.

Recommendations

MUSICACTION and FACTOR, where applicable, should:

- **improve guidelines for the recipients and clarify procedural requirements for their own staff relative to the needs and requirements for support documentation that must be included with the Cost Summary Report to allow for effective monitoring and analysis.**

- whenever they fund projects that include activities that can not be easily segregated from other activities conducted by the recipient, obtain the following documents in order to assess salary costs:
 - detailed budgets, with respect to the numbers of hours to be worked on each aspect of the project, as well as hourly rates;
 - detailed time sheets signed by employees; and
 - employment contracts or pay cheques
- modify their requirements for Video Production projects in which a sole sub-contractor is involved, to ensure access to the sub-contractor's financial records and support documentation. In addition, all supporting documentation relating to claimed expenses should be provided in the completion certificate.
- establish guidelines to address master acquisition fees paid in sound recording projects.
- establish guidelines for the monitoring of recoverable amounts.

Management Response

Notwithstanding the auditor's recommendations, SR supports the fundamental principle that programs be administered as efficiently and effectively as possible within a framework that is both achievable and reasonable, keeping in mind the finite level of human and financial resources. SR considers that the inordinate amount of administrative rigour which would be required to implement the auditor's recommendation would not be appropriate given the way in which the sound recording sector operates (i.e. time sheets are not typically required) nor in keeping with the principles of risk-management.

No further action is necessary

The new CMF CA will required applicants to identify non-arms-length funding streams and expenses, which will provide FACTOR and MA with the tools to readily identify non-arm's-length transactions.

Also both FACTOR and MA intend to monitor non-arm's-length transactions more closely to ensure that transactions are made at fair market value.

No further action is required.

SR will review the issue of "master acquisition fees paid in sound recording projects" during the next six months and release policy guidelines on the subject upon completion of the review.

As noted in "16" above, under the existing SRDP FACTOR and MA are not required to recoup financial assistance provided to recipients.

The new CMF CA will require beneficiaries receiving more than \$100,000 for a project to reimburse FACTOR or MA.

No further action is required.

3.8. Loan repayment terms have not been revised for some time at FACTOR and MUSICACTION.

Two types of financial assistance are available to recipients: loans, for which the financial assistance must be repaid, and contributions for which there is no repayment. The Agreement does not provide any guidance to FACTOR or MUSICACTION on how the financial assistance should be managed, except for article 4.2.1, indicating that it “...*should take the form of loans or contributions*”.

The following was noted:

- FACTOR and MUSICACTION need to clarify if their current basis of repayment, a flat rate per unit sold, is still acceptable. Another option could be the gross profit per album sold.
- The current rates at MUSICACTION have not been modified since 1992. Taking into account the price increase in compact disks over the past nine years, a new study of the current rates should be conducted.
- Currently, borrowers are freed from repayment obligations after a two-year period following the release of the album, even though the loan may have only been partially repaid.

The above need to be addressed to ensure that FACTOR and MUSICACTION's financial assistance remains in line with the economic environment of the sound recording industry. An efficient framework that would guide the board of directors should support the decision making on these matters.

Recommendations

FACTOR and MUSICACTION should develop and document guidelines to structure the decision making with regard to the means for financial assistance (contributions, loans); and

FACTOR and MUSICACTION should review loan conditions to ensure that they continue to reflect the dynamic environment of the sound recording industry.

Management Response

Under the existing SRDP FACTOR and MA are not required to recoup financial assistance provided to recipients.

The new CMF CA will require beneficiaries receiving more than \$100,000 for a project to reimburse FACTOR or MA.

No further action is required.

3.9 Acknowledgement of financial assistance is not always provided by recipients in projects funded by FACTOR and MUSICACTION

Appendix C of the Agreement states two types of requirements that the recipient should take into consideration for the financial assistance that is being made available by the Department through the SRDP. The first one is related to the audit of books and records by the Department. The second one, found in article 4, is related to the acknowledgement of the financial assistance. Article 4, in conjunction with article 10.1.7 of the Agreement, indicates that FACTOR and MUSICACTION shall:

10.1.7 *“require, as a condition precedent to providing financial assistance to any Recipient, that the Recipient sign and deliver to FACTOR or MUSICACTION an undertaking in the form attached hereto as Appendix C...”*

4 (Appendix C) *“...the Recipient...undertakes...to include the Canada Wordmark logo on all projects funded under the Sound Recording Development Program, as well as the following acknowledgement, in the appropriate language:*

We acknowledge the financial support of the Government of Canada through the Sound Recording Development Program for this program”

The acknowledgement sentence was only added to the Agreement in its current version, which took effect as of April 1, 2000. As for other requirements indicated in the Appendix C, they are the same as in the previous version.

Our review of agreements signed between FACTOR or MUSICACTION and recipients showed that both organizations have included the requirement related to the acknowledgement of the financial assistance, except for Promotion and Marketing projects agreements at MUSICACTION.

We also reviewed the projects themselves to ensure that the financial assistance was actually acknowledged. At MUSICACTION, there were no such acknowledgements in 11 of the 24 projects reviewed, and at FACTOR in 9 of 22 projects reviewed.

Recommendations

FACTOR and MUSICACTION should ensure that, when applicable, all recipients acknowledge the financial assistance of the Department in an appropriate way;

MUSICACTION should modify its model agreements signed with recipients in Promotional and Marketing projects to include the acknowledgement requirement.

Management Response

FACTOR and MA will ensure that projects include the acknowledgement.

No further action is required.