

**Before the
UNITED STATES COPYRIGHT OFFICE
Washington, D.C.**

In the Matter of:

Mechanical and Digital Phonorecord Delivery
Compulsory License

Docket No. 2012-7

REPLY COMMENTS OF MUSIC REPORTS, INC.

Music Reports, Inc. (“Music Reports”) hereby submits these Reply Comments in response to the Copyright Office’s Notice of Proposed Rulemaking (“NPRM”) in the above-captioned proceeding.

Music Reports’ sole purpose in submitting these Reply Comments is to highlight and seek the Copyright Office’s input on certain narrow areas of disagreement between Music Reports, on the one hand, and the National Music Publishers’ Association, Inc. (“NMPA”) and The Harry Fox Agency, Inc. (“HFA”) with respect to certification requirements for statements of account under 37 C.F.R. Section 201.19 (the “Reporting Regulations”), as those requirements relate to high-volume copyright users of the statutory license available in 17 U.S.C. Section 115 (“The Statutory License”). NMPA, HFA, The Digital Media Association, The Recording Industry Association of America, Inc., and Music Reports are referred to herein as “the Joint Commenters” The Joint Commenters are otherwise largely in agreement as to these issues.

I. Music Reports and its Interest in this Matter

A. Music Reports’ Background in Processing Statements of Account

Music Reports is a music rights administration firm which has been providing high-volume music licensing and royalty accounting services to copyright users for almost 20 years. The company performs these services as a private enterprise, which requires the company to be

innovative, efficient, and competitive. Although sometimes incorrectly characterized as owned and controlled by copyright users, the company is in fact independent and provides services to both copyright users and copyright owners¹.

In addition to representing broadcasters, major record companies, consumer products companies, mobile carriers, Music Reports represents the majority of “interactive” digital music services in the United States which rely in high-volume administration of the Statutory License.

A Music Reports client list is available at:

http://www.musicreports.com/web_2011/aboutus/clients.php. Music Reports has provided high-volume Statutory License administration services since 2001. As such, without question, the company has the most first-hand experience among the Joint Commentors in day-to-day use of the Statutory License, as well as with the Reporting Regulations.

Without any legal obligation to do so, but in the good faith expectation that such an audit should be required of service providers of Statutory License administration services, the company has twice obtained an opinion, from two separate, independent, third-party CPA firms that its systems for processing statements of account under the Reporting Regulations are subject to internal controls that are suitably designed and have operated effectively, pursuant to two separate audits pursuant to the Statement on Standards for Attestation Engagements No. 16 (SOC 1) Type II, beginning in April, 2011. We are therefore familiar with the AICPA standards and the practical implications of such standards.

B. The Existing Certification Language and the Modern Compulsory License

As noted in the Joint Comments filed today by the Joint Commenters, the current certification provisions at 37 C.F.R. § 201.19(e)(6) and (f)(6) are inconsistent with modern use of

¹ Music Reports is majority-owned by ABRY Partners, LLC, a private equity firm with extensive media holdings.

the statutory license and, in the case of the annual statement certification, modern public accounting practice. In the case of both monthly and annual statements, the certifications assume human review that is impracticable except in the case where a licensee prepares only a handful of statements by a partly manual process.

Some licensees do in fact make only limited use of the compulsory license and prepare their accounting statements that way. The Joint Commenters agree that the statement of account regulations should continue to provide certifications geared to such small-scale use of the compulsory license.

For the most part, high-volume use of the compulsory license is presently limited to interactive music services. Record labels, which have a limited number of releases per year in any event, tend to rely on negotiated mechanical license agreements rather than the compulsory license. Interactive digital music services, by contrast, typically offer catalogs of more than ten million recordings per service. The efficient use of the Statutory License is critical for these services.

Pursuant to the existing and proposed regulations set forth in 37 CFR Section 385, Subchapters B and C, with respect to the various ‘offerings’ for which statutory mechanical rates have been determined, licensees must report monthly to each licensor for each offering of each service. Because their catalogs contain millions of recordings, as noted above, Music Reports typically must report on their behalf to as many as thirty thousand music publishing administrators for each of those services and offerings. For example, one Music Reports client serves as a white-label service provider for three ‘services’, which between them have ten ‘offerings’, some ‘portable’, some ‘streaming only’, etc. Therefore, in any given month, the company will be called upon to generate tens of thousands of statements for that licensee alone.

While this is an enormous number of statements, however, the construction of these statements breaks down into two relatively simple components. First, every statement for a given offering is based on a very small number of discrete data inputs². From this data Music Reports calculates the total pool of royalties to be paid to all publishers in the aggregate by the compulsory licensee engaged in licensed activity pursuant to Subchapter B and the proposed Subchapter C.

Next, the pool of royalties must be allocated to each publisher based on the usage of their particular works . To manage this allocation, Music Reports must generate discrete statements for each of the tens of thousands of publishers whose works may have been used on a given service offering in a given month. Fortunately, computer systems with adequate controls can reliably perform such repetitive tasks without error. All of the Joint Commenters have agreed, therefore, that the process for such allocation should be examined somehow by a CPA to ensure that the controls on such systems are adequately designed and operate effectively.

C. The Disagreement Between Music Reports and NMPA

Where Music Reports and NMPA/HFA differ is with respect to: (a) the standards that should be applied generally to the Annual Statements or the data and processes used to create them; and (b) the form of the certification that should be required in these high-volume statement contexts.

II. The NMPA Proposal

² Depending on the type of service offering involved, these data points include: the number of times each song was streamed or downloaded; the revenue received by the service; the amounts expended to the owners of the sound recordings in connection with the service; the amounts expended for performance rights in connection with the service; and, in some cases, the number of subscribers to the service, or ‘active subscribers’, in the case of so-called ‘bundled services’.

The NMPA/HFA proposal reveals two principal points of disagreement. First, the NMPA/HFA proposal would require, in high-volume reporting contexts, that the data on which each statement is based be examined using a ‘process’ audit. A process audit is a particular auditing procedure, not an auditing standard. Music Reports believes that the auditing procedure to be used in relation to the data underlying any given statement should be left to the professional judgment of the applicable certified public accountant and not dictated in regulations. There is no requirement in the current Reporting Regulations of such a process audit. Second, the NMPA/HFA approach would require the CPA for the statutory licensee (who has retained a third party service provider) to rely on the report and opinion of a second CPA retained by the service provider, before the licensee CPA could certify annual statements of account. Music Reports believes this structure is awkward and, in fact, less transparent than having the CPA for the service provider separately and directly certify each statement of account it generates.

A. Generally Accepted Auditing Standards

Section 115(c)(5) of the Statutory License provides that “[t]he Register shall also prescribe regulations under which detailed cumulative annual statements of account, certified by a certified public accountant, shall be filed for every statutory license under this section.” The Office has previously read that provision to impose ‘generally accepted auditing standards: “Our examination was made in accordance with **generally accepted auditing standards** and accordingly, **included tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.**” 37 CFR 201.19(f)(6)(ii)(A) (*emphasis added*). The current definition of this term is in essence a list of ten standards currently promulgated by the AICPA at AU Section 150 (available at: <http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00150.pdf>).

Importantly, auditing standards should not be confused with auditing procedures, as noted in the first clause of AU Section 150: “**Auditing standards** provide a measure of audit quality and the objectives to be achieved in an audit. **Auditing procedures** differ from auditing standards. Auditing procedures are acts that the auditor performs during the course of an audit to comply with auditing standards,” (*emphasis added*). The current regulations are therefore consistent with the AICPA’s guidance on this issue, as they require a standard, but do not dictate to the CPA the procedures the CPA should use in examining the annual statement or its underlying data, which are left to the professional judgment of the CPA.

B. The NMPA/HFA Proposal

(i) The Requirement of an Attestation Engagement

The current proposal of the NMPA would require that CPAs certifying statements conduct an examination, “in accordance with the attestation standards established by the American Institute of Certified Public Accountants,” in every case. These attestation standards are a set of standards to be used by CPAs in the context of “Attestation Engagements”. See AICPA’s Statement on Standards for Attestation Engagements (available at: <http://www.aicpa.org/Research/Standards/AuditAttest/Pages/SSAE.aspx>).

The NMPA/HFA proposal would require that these attestation standards apply in every situation to every aspect of a statutory licensee’s annual statements of account, whether in relation to low or high-volume accounting situations, and whether in relation to the few discrete data points upon which a pool of royalties is based, or to the process by which that pool is allocated to thousands of publishers. But whether any particular engagement is an attestation

engagement is a question that seems to us best left to the professional judgment of the CPA in relation to each specific engagement, as the current regulations dictate.³

To be clear, however, while Music Reports disagrees with NMPA/HFA that the attestation standards should always and in all circumstances be required in examinations of statutory licensees as to the data underlying high-volume statements, we agree that the attestation standards are appropriate as to the examination of the processes used to generate the statements themselves, for reasons that will be discussed more fully below.

(ii) The Requirement of a ‘Process Audit’ as to Data in High-Volume Contexts

Moreover, the NMPA proposal would require that a CPA examine “the processes, including the calculation of statutory royalties, it operated,” to generate “Annual Statements relevant to such examination that present fairly, in all material respects, both the statutory licensee’s usage of statutory licensors’ musical works...the statutory royalties applicable thereto, and such other data as are relevant to the calculation of the statutory royalties applicable thereto in accordance with 17 USC 115 and 37 CFR parts 210 and 385, as amended or superseded from time to time (collectively, the “Usage and Royalty Data”). This is a roundabout way of saying that it is not sufficient for the CPA to use his or her professional judgment in testing the statutory licensee’s revenues, label payments, performance rights obligations, subscriber counts and play counts, but would instead require that the CPA examine the processes used by the compulsory

³ There may be an additional area of disagreement, as NMPA/HFA reads the attestation standards to require the opinion of an external “independent” auditor, while Music Reports believes the attestation standards may be satisfied by an internal auditor, as long as the internal auditor is exercising “independent” judgment. Music Reports would appreciate the Copyright Office’s view of what “independent” means in the attestation standards in this context.

licensee to determine those values. In other words, the NMPA would dictate the **procedure** by which the CPA must examine the data underlying each annual statement.

As noted above, the AICPA cautions against confusing auditing standards and auditing procedures. Music Reports has not had adequate time to explore all of the myriad possibilities with its auditors, and we welcome the Copyright Office’s input as to this point. But in our understanding there may be any number of procedures that are appropriate to examine the small number of data points that are common to the calculation of the royalty pool in every annual statement for a given offering under Subchapters B and C of Section 385. These data points are highly scrutinized as it is: by the CFO of the licensee, by the sound recording owners and performance rights organizations who license their copyrights subject to voluntary agreements containing strict audit provisions, by the licensee’s potential investors, etc. And where the existing regulations have never dictated any particular auditing procedure, it is overreaching to require a process audit of processes used to collect the data in every high-volume context.⁴ Such a requirement will come as a expensive surprise to all statutory licensees currently engaged in Subchapter B and Subchapter C licensed activities, since it is a dramatic departure from the simple existing requirement of ‘generally accepted auditing standards.’”

(iii) The Requirement of Nested Opinions

The NMPA/HFA proposal provides that in high-volume contexts, only the CPA for the statutory licensee can certify annual statements of account. Under this proposal, where a service provider is used by the statutory licensee to generate the annual statement, the CPA for the licensee must nevertheless certify the statement. In doing so, it must rely on the ‘review of a

⁴ Taken to its extreme, the NMPA/HFA proposal would require a process audit of the data appearing on a statement of account for a service that offers: one work; played once; to one subscriber, in a month.

report and opinion' rendered in accordance with the AICPA's Statement on Standards for Attestation Engagements No. 16 (SOC 1) Type II, or a similar attestation standard. Music Reports does not disagree with this particular standard, which we believe is the best existing standard for the examination of service providers. However, this approach 'nests' the opinion of the service provider's CPA within a separate certification by the CPA for the statutory licensee. Music Reports' proposal, on the other hand, would require the CPA for the service provider to sign the annual statement directly, rather than provide its opinion to the statutory licensee for reliance in its own certification of the annual statement. Music Reports believes, based on its experience, that the nested approach will increase the expense and difficulty of obtaining certification of annual statements without improving the reliability of the certification.

III. The Music Reports Proposal

Two and a half years ago, when the Joint Commenters first began to discuss this topic in depth, Music Reports suggested a simple, two-pronged framework for addressing high-volume statement situations. Because most licensees rely on a third-party service provider to manage their royalty accountings under the Statutory License, the company proposed that not one, but two CPAs should certify any statement where a service provider generates that statement. The CPA for the statutory licensee would certify that the data provided to the service provider for calculation of the royalties payable to all publishers is correct, and the CPA for the service provider would certify that the controls relevant to the processing of the statements were suitably designed and operated effectively. Music Reports' proposed regulations, attached hereto as Exhibit A, embody this simple proposal.

CONCLUSION

In view of the foregoing, Music Reports respectfully requests that the Office adopt the Proposed Regulations with the further modifications set forth in Exhibit A.

Dated: December 10, 2012

Respectfully submitted,



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Exhibit A

Music Reports' Proposed Regulations
on
Certification of Statements of Account

December 10, 2012

Monthly Statements of Account

(f) (1)

(iv) One of the following statements:

...

or

I certify that (1) I am duly authorized to sign this Monthly Statement of Account on behalf of the compulsory licensee, (2) I have prepared or supervised the preparation of the data used by the compulsory licensee and/or its agent to generate this Monthly Statement of Account, (3) such data is true, complete, and correct to the best of my knowledge, information, and belief, and was prepared in good faith, and (4) this Monthly Statement of Account was prepared by the compulsory licensee or its agent using a process that was subject to an examination, within the twelve month period preceding this certification, by a licensed Certified Public Accountant in accordance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements No. 16 (SOC1), Type II, as amended or superseded from time to time, or a similar attestation standard established by the American Institute of Certified Public Accountants, the opinion of whom was that the internal controls relevant to such process were suitably designed and operated effectively during the period of the examination.

Annual Statements of Account

210.17(f)(2)

(2) Each Annual Statement of Account shall also be accompanied by the certification of one or more licensed Certified Public Accountants (“CPA”), as applicable. Each such CPA shall certify that they have conducted an examination in accordance with the professional standards of the American Institute of Certified Public Accountants (“AICPA”) and rendered an opinion in accordance with the requirements of section (i), (ii), or (iii) below, as applicable. The report of each such examination shall state in substance either:

(i)(A) that the CPA has conducted an examination of the accompanying Annual Statement prepared by the compulsory licensee, and

(B) an opinion based on such examination that the accompanying Annual Statement presents fairly, in all material respects, the compulsory licensee’s usage of musical works identified in the Annual Statement and the statutory royalties applicable thereto in accordance with 17 USC 115 and 37 CFR parts 210 and 385, as amended or superseded from time to time;

or

(ii)(A) that the CPA has conducted an examination:

(I) of the data regarding the compulsory licensee’s usage of musical works identified in the Annual Statement, and such other data as are relevant to the calculation of the statutory royalties applicable thereto in accordance with 17 USC 115 and 37 CFR parts 210 and 385, as amended or superseded from time to time (collectively, the “Usage and Royalty Data”); and

(II) in accordance with the attestation standards established by the AICPA, as amended or superseded from time to time (the “Attestation Standard(s)”) of an assertion by management of the compulsory licensee that the internal controls relevant to the processes used to generate the Annual Statement were suitably designed and operated effectively during the period covered by the Annual Statement,

(B) that such examination included examining:

(I) either on a test basis or otherwise as the CPA considered necessary under the circumstances and in its professional judgment, the Usage and Royalty Data, and

(II) within the twelve month period preceding the certification in accordance with the Attestation Standards, the processes used to generate the Annual Statement, and

(C) an opinion based on such examination that:

(I) the Annual Statement presents fairly, in all material respects, the Usage and Royalty Data, and

(II) the internal controls of the compulsory licensee relevant to the process used to generate the Annual Statement were suitably designed and operated effectively during the period of the examination;

or

(iii) if a third party or third parties, acting on behalf of the compulsory licensee (“Service Provider(s)”), provided services with respect to the relevant Annual Statement:

(A) the report of the CPA responsible for auditing the Usage and Royalty Data shall state in substance:

(I) that such CPA has conducted an examination of the Usage and Royalty Data;

(II) that such examination included examining, either on a test basis or otherwise as the CPA considered necessary under the circumstances and in its professional judgment, the Usage and Royalty Data; and

(III) an opinion based on such examination that the Annual Statement presents fairly, in all material respects, the Usage and Royalty Data; and

(B) the report of the CPA responsible for auditing the processes used by a Service Provider to generate the Annual Statement shall state in substance:

(I) that such CPA has conducted an examination of an assertion by management of such Service Provider that the internal controls relevant to the processes used to generate the Annual Statement were suitably designed and operated effectively during the period covered by the Annual Statement;

(II) that the examination included examining, within the twelve month period preceding the certification, in accordance with the American Institute of Certified Public Accountants’ Statement on Standards for Attestation Engagements No. 16 (SOC 1), Type II, as amended or superseded from time to time, or a similar Attestation Standard, the processes used to generate the Annual Statement; and

(III) that the internal controls of the Service Provider relevant to the process used to generate the Annual Statement were suitably designed and operated effectively during the period of the examination.

(iv) Each certificate shall be signed by an individual (in which case the references therein to “we” may be replaced by “I”), or in the name of a partnership or a professional corporation with two or more shareholders.

Exhibit B

Music Reports' Marked Proposed Regulations
on
Certification of Statements of Account

December 10, 2012

Monthly Statements of Account

(f) (1)

(iv) One of the following statements:

...

or

I certify that (1) I am duly authorized to sign this Monthly Statement of Account on behalf of the compulsory licensee, (2) I have prepared or supervised the preparation of the data used by the compulsory licensee and/or its agent to generate this Monthly Statement of Account, (3) such data is true, complete, and correct to the best of my knowledge, information, and belief, and was prepared in good faith, and (4) this Monthly Statement of Account was prepared by the compulsory licensee or its agent using a process that was subject to an examination, within the twelve month period preceding this certification, by a licensed Certified Public Accountant in accordance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements No. 16 (SOC1), Type II, as amended or superseded from time to time, or a similar attestation standard established by the American Institute of Certified Public Accountants, the opinion of whom was that the internal controls relevant to such process were suitably designed and operated effectively during the period of the examination.

Annual Statements of Account

210.17(f)(2)

(2) Each Annual Statement of Account shall also be accompanied by the certification of one or more licensed Certified Public Accountants (“CPA”), as applicable. Each such CPA shall certify that they have conducted an examination in accordance with the professional standards of the American Institute of Certified Public Accountants (“AICPA”) and rendered an opinion in accordance with the requirements of section (i), (ii), or (iii) below, as applicable. The report of each such examination shall state in substance either:

(i)(A) that the CPA has conducted an examination of the accompanying Annual Statement prepared by the compulsory licensee, and

_____ (B) an opinion based on such examination that the accompanying Annual Statement presents fairly, in all material respects, the compulsory licensee’s usage of musical works identified in the Annual Statement and the statutory royalties applicable thereto in accordance with 17 USC 115 and 37 CFR parts 210 and 385, as amended or superseded from time to time;

or

(ii)(A) that the CPA has conducted an examination:

_____ (I) of the data regarding the compulsory licensee’s usage of musical works identified in the Annual Statement, and such other data as are relevant to the calculation of the statutory royalties applicable thereto in accordance with 17 USC 115 and 37 CFR parts 210 and 385, as amended or superseded from time to time (collectively, the “Usage and Royalty Data”); and

_____ (II) in accordance with the attestation standards established by the AICPA, as amended or superseded from time to time (the “Attestation Standard(s)”) of an assertion by management of the compulsory licensee that the internal controls relevant to the processes used to generate the Annual Statement were suitably designed and operated effectively during the period covered by the Annual Statement,

_____ (B) that such examination included examining:

_____ (I) either on a test basis or otherwise as the CPA considered necessary under the circumstances and in its professional judgment, the Usage and Royalty Data, and

_____ (II) within the twelve month period preceding the certification in accordance with the Attestation Standards, the processes used to generate the Annual Statement, and

_____ (C) an opinion based on such examination that:

(I) the Annual Statement presents fairly, in all material respects, the Usage and Royalty Data, and

(II) the internal controls of the compulsory licensee relevant to the process used to generate the Annual Statement were suitably designed and operated effectively during the period of the examination;

or

(iii) if a third party or third parties, acting on behalf of the compulsory licensee (“Service Provider(s)”), provided services with respect to the relevant Annual Statement:

(A) the report of the CPA responsible for auditing the Usage and Royalty Data shall state in substance:

(I) that such CPA has conducted an examination of the Usage and Royalty Data;

(II) that such examination included examining, either on a test basis or otherwise as the CPA considered necessary under the circumstances and in its professional judgment, the Usage and Royalty Data; and

(III) an opinion based on such examination that the Annual Statement presents fairly, in all material respects, the Usage and Royalty Data; and

(B) the report of the CPA responsible for auditing the processes used by a Service Provider to generate the Annual Statement shall state in substance:

(I) that such CPA has conducted an examination of an assertion by management of such Service Provider that the internal controls relevant to the processes used to generate the Annual Statement were suitably designed and operated effectively during the period covered by the Annual Statement;

(II) that the examination included examining, within the twelve month period preceding the certification, in accordance with the American Institute of Certified Public Accountants’ Statement on Standards for Attestation Engagements No. 16 (SOC 1), Type II, as amended or superseded from time to time, or a similar Attestation Standard, the processes used to generate the Annual Statement; and

(III) that the internal controls of the Service Provider relevant to the process used to generate the Annual Statement were suitably designed and operated effectively during the period of the examination.

(iv) Each certificate shall be signed by an individual (in which case the references therein to “we” may be replaced by “I”), or in the name of a partnership or a professional corporation with two or more shareholders. ~~The certificate number and jurisdiction are not required if the~~

certificate is signed in the name of a partnership or a professional corporation with two or more shareholders.

...