



AUDIT
OFFICE



REPUBLIC
OF CYPRUS

SCHEME TO PROMOTE THE AUDIOVISUAL INDUSTRY IN CYPRUS



**AUDIT OFFICE OF THE REPUBLIC
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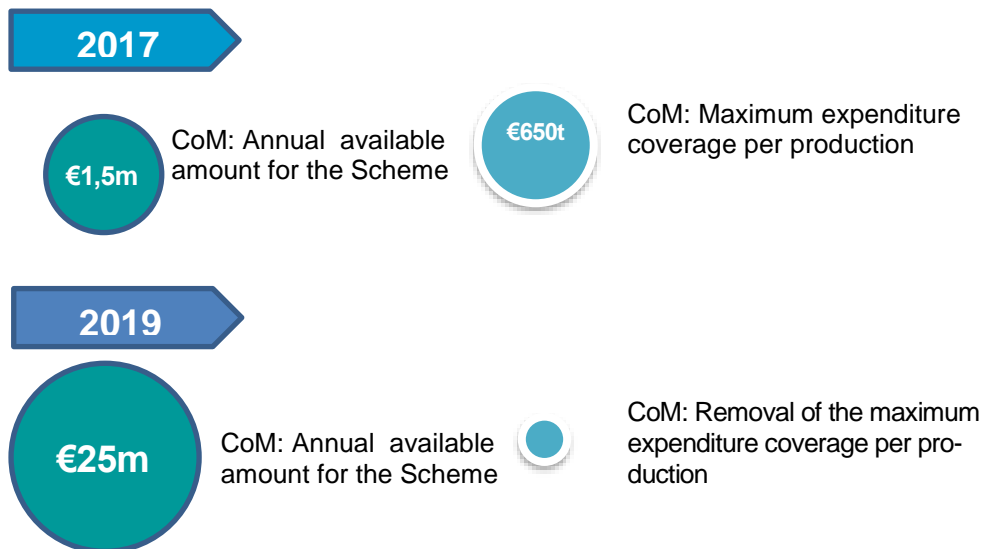
AUDITED ENTITY

Ministry of Finance

Executive Summary

On the 27.9.2017, the Council of Ministers (“CoM”) approved the Scheme to Promote the Audiovisual Industry in Cyprus (“the Scheme”), aiming for the promotion of the audiovisual industry and the promotion of the Republic of Cyprus (“RoC”), as a country for filming, with an annual available amount not exceeding €1.5 million per year and a maximum limit per production €650.000. The Scheme was later amended with two Decisions of the CoM, dated 2.1.2019 and 31.1.2019, by which, amongst others, the available amount and Budget for the incentive was increased to €25 million per year and the maximum limit of €650.000 for covering expenses per production was repealed. Due to the significant amendment to the Scheme, the Commissioner for State Aid Control (“Commissioner”) decided that a new measure was introduced, on the 26.2.2019, date of its publication in the Government Gazette of the Republic of Cyprus, without retrospective effect. The Scheme was amended by Decisions of the CoM, dated 5.2.2020, 3.6.2020 and 27.8.2020, by which the gradual payment of the subsidy was made possible, according to the progress of the production, as well as granting Certificate of Temporary Approval of Expenses Coverage, as guarantee for securing financing by the Cypriot banks.

The Competent Authority of the Scheme is the Ministry of Finance, implementation body is the Evaluation Committee of the Scheme of Audiovisual Industry (“the Evaluation Committee”) and managing body is the Cyprus Investment Promotion Agency (“CIPA”).



Within the framework of investigating a complaint, which was received by our Office on 14.6.2019, regarding the Scheme, we investigated its provisions for cash rebate for film production. We also examined the implementation of the provisions of the Scheme, in relation to the production of the audiovisual film JIU JITSU, which on the audit date was the most important production approved for entering the Scheme, with a Budget of €25.6 million, for which expenses for coverage had been submitted. Then, taking into account the seriousness of the findings that arose, our Office decided to extend its audit on the other two productions that had been approved in 2019, with a Budget of €0.9 million and €37.2 million, respectively. Additionally, we audited the De Minimis Scheme for the Audiovisual Industry in Cyprus, which was simultaneously implemented with the Scheme. The audit

revealed significant weaknesses and omissions, both regarding the provisions of the Scheme and the implementation of its provisions by the competent bodies.

The current compliance audit was carried out within the framework of the constitutional powers of the Auditor General for audit of the public expenditure.

The most important findings, from the audit, are set out in summarized form below. The importance of the reference is graduated by the colour intensity, in increasing order from the lightest to the most intense colour:

S/N	FINDINGS	RISKS	RECOMMENDATIONS /COMMENTS
1	The Scheme that was implemented since its start date up until 4.2.2020, included differentiated provisions in relation to the approved one by the Council of Ministers.	Elimination/differentiation of the provisions of the Scheme that are not covered by the required approval of the Council of Ministers	After oral indication of the issue to the Evaluation Committee in December 2019, by our Office, the Council of Ministers approved, ex post, on 5.2.2020, after a relevant Proposal of the Ministry of Finance, the Scheme that was being implemented.
2	The Evaluation Committee informed the Ministry of Finance about various weaknesses found by our Office, in relation to the Scheme that was being implemented until 4.2.2020, which, however, the Ministry did not take into account in its Proposal to the CoM, ignoring the risks that arose.	Continuation of the implementation of the Scheme, without dealing with the weaknesses found and the relevant risks, in relation to the state subsidization of expenses, within the framework of its implementation.	Adequate study of the weaknesses and risks found and evaluation of our relevant recommendations, by promoting relevant changes on the Scheme where it is deemed necessary by the Ministry of Finance.
3	On 3.6.2020, the CoM made an amendment on the Scheme, in order to allow the payment of the cash return at regular intervals, before the completion of the film without the granting of any collateral by the production company.	In case of interruption of the film production and non-completion of the film, the state will lose the amount paid without the expected benefit	This provision must be reexamined, taking into account the risks arising for public finances.
4	New amendement of the Scheme, by the CoM, on	Technocrats of the Ministry of Finance pointed out that this	This provision must be reexamined, taking into

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	27.8.2020, provides the right to the applicants to assign the Certificate of Temporary Approval for Expenses Coverage provided by the state, to a Cyprus bank, as a financing collateral for the specific production.	means serious risks for the state.	account the reservations of the technocrats of the Ministry of Finance.
5	It seems that the Commissioner did not examine all the amendments made to the Scheme.	The Scheme, as amended might not be compatible with the Union law.	The Ministry of Finance must ask, without delay from the Commissioner, to evaluate the scheme, as it is formed today.
6	There was direct communication between a specific producer and the Minister of Finance, in respect of the provisions of the Scheme and the changes on it.	Changes serving the interest of specific persons may be promoted	Direct contact with specific beneficiaries must be avoided and if this is deemed necessary, it must be done with transparency, within the framework of public consultation.
7	The Scheme does not set limitation to the participation percentage of foreign ownership in the production companies.	There is no limitation to the benefits of the Scheme ending up outside the RoC and the European Union.	Methods for the maximization of the benefit for the Republic must be studied, compared to the cost it will bear as is, for example, the strengthening of the provisions for employment of people or services purchase from the local market.
8	The Scheme does not have definition of the term, nor is there a maximum limit of “above the line expenses”, regarding mainly people leading and affecting the creative direction of the production, the narrative style and the expenses.	The term is interpreted at the producers’ discretion. The absence of maximum limit might be exploited by the producers, who can unlimitedly increase their remuneration amounts.	Inclusion, in the Scheme, of the definition of the term “above the line”, for securing a uniform handling of the applications and specifying a maximum limit.
9	The approved eligible expenditures of the productions	Subsidizing of non-eligible expenditures.	

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	include significant expenditures, pre- and post-production, which are almost impossible to verify if they were incurred in Cyprus.		Establish a control mechanism to ensure that such expenditures are subsidized only if incurred in Cyprus.
10	The cultural criteria do not ensure the contribution of the productions approved in the culture, nor the quality of the result. It is indicative of the fact that the two productions that were completed and released in 2020 secured very low evaluation scores from websites that deal with the subject.	Granting low-quality production and/or productions with limited contribution to the culture.	Setting qualitative criteria and re-examined of cultural criteria.
11	The Chairman of the Evaluation Committee also exercises all the executive powers for the implementation of the Scheme.	Self - review threat	Taking measures for adequate segregation of of duties
12	The Chairman of CIPA and the accountant/auditor of all the productions that have been approved until today are partners at the same audit firm.	Possible conflict of interests of CIPA, as management body, during the examination of clients' applications of the partner of the Chairman of CIPA.	Such conflicts of interests must be declared and their influence on the way applications are examined assessed.
13	The most significant part of the expenditures of the two completed productions was paid outside Cyprus and the EU.	The benefit arising for the RoC from the Scheme is disproportional of the funding paid by the state.	Before the continuation of the Scheme, the Ministry of Finance assign the preparation of the study to experts, in order to valuate any benefits arisen, for the RoC, by the implementation of the Scheme up until today, based on the completed productions.

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14	Based on the evidence submitted during the evaluation stage of the applications, the compliance of all the provisions of the Scheme was not documented. However, the Evaluation Committee recommended to the Ministry of Finance the approval of cash return, to the maximum permitted rate.	Pre-approval of applications that might not have been eligible and they should have been rejected	In-depth examination and confirmation of compliance with the provisions of the Scheme, by the Evaluation Committee, before submitting the recommendation for approval of expenditures coverage.
15	In the case of the production S.O.S. Survive or Sacrifice, the people who, for evaluation purposes of the eligibility of the application, counted as Cypriot citizens, they had been naturalized, obviously, within the framework the Cyprus Investment Program, in September 2017.	If the naturalization had not been preceded, the application of the company would not have been eligible, and it would have been rejected.	
Regarding the procedures followed in the stage of examination and temporary approval of expenditures return of the production JIU JITSU, the following were found:			
16	An issue of possible conflict of interests arose for one of the film's producers, who acted as external consultant of CIPA for the preparation of the Scheme. CIPA approached a private legal advisor for advice, who expressed the opinion that there is not any conflict of interests.	Individuals acting as consultants of the State for drafting specific Schemes, within the framework of which they are then presented as applicants, might promote terms and conditions for serving their own interests.	Our Office requested a relevant opinion from the Law Office of the Republic, which states the reasons why it considers that there does not seem to be a conflict of interest, but is recommended as in the case of the participation of individuals in Schemes, for which they were involved during their preparation, is deemed undesirable by the competent authorities, this should be included in a relevant provision of the Schemes.

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17	<p>Out of the eligible expenditures of €21.854.950 that were submitted for examination, €17.914.428 is transactions between connected parties. In spite of the significance of these amounts, the provision for keeping the “Arm’s Length Principle”, based on which the amounts charged between the applicant and any connected with him/her companies, for the provision of goods or services, are commercially reasonable, has not been audited.</p>	<p>Expenditures that were considered as eligible for subsidize , to be inflated and not to represent the expected amount based on the usual commercial practices, aiming for securing the highest subsidize.</p>	<p>Before the payment of any subsidize, keeping the Arm’s Length Principle must be examined. Also, submitting a list of the connected parties of the applicant and a statement of the transactions with the connected parties to the Evaluation Committee must be required.</p>
18	<p>One of the producers of the film, stated in a television interview that he, together with the Minister of Finance and the General Director of the Ministry of Finance, made changes to the Scheme, in order to improve it and increase the principal photography in Cyprus, highlighting that in Cyprus invited by the Chairman of the Evaluation Committee.</p>	<p>Changes to be promoted, through non-transparent procedures and personal contacts, for the benefit of specific applicants.</p>	<p>Our Office requested for comments from Ministry of Finance regarding the statements of Producer B.</p>
<p>Regarding the procedures followed at the stage of examination and temporary approval of expenditures return of the production MAN OF WAR AVC Ltd the following were noted:</p>			
19	<p>The company repeatedly failed to meet the approved contractual milestones , in relation to the production of the film and requested for a series of extensions from the Evaluation Committee, which approved them, except from the last one.</p>	<p>Breach, by the production company, on essential terms and conditions set out for purposes of receiving funding by the State.</p>	<p>The Evaluation Committee, in all cases, should insist on complying with the terms that set on the production companies, as conditions for the payment of subsidize.</p>

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20	<p>Due to the favourable, for the company, changes that have been made on the Scheme within 2020, especially regarding the gradual payment of funding and the granting discretion of the Certificate of Temporary Approval of Expenditures Coverage, to a Cypriot bank, as funding collateral, the company, after approval of the Evaluation Committee and the Ministry of Finance, withdrew its application and submitted a new one, in order to exploit the amended provisions of the Scheme.</p>	<p>Withdrawal and resubmission of applications, which means increased administrative cost, aiming for benefit, from the applicants, of the differentiated provisions of the Scheme.</p>	<p>Our Office considers that the Evaluation Committee and the Ministry of Finance should not have accepted the request of the company, which omitted, as arises, due to its fault, in complying with the approval terms of its initial application.</p>

