KPMG

Contract Compliance Services

Deriving greater value from your third-party relationships

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Contents

Managing the risk and enhancing the value of commercial relationships

While organizations scramble to enhance their bottom lines, many of them are losing countless dollars. What's worse, they may not even realize it. The reason? In many cases, revenue can disappear because vendors, distributors, and licensees fail to meet their full contract obligations.

This doesn't mean your business partners do this deliberately. Much is due to the complexity of the environment. Third parties often work under highly complex contracts, where the requirements are not clearly identified or key responsibilities may be overlooked. In addition, contracts may not reflect changed circumstances. No matter what the reasons, the need to manage risks related to third-party relationships is critical if you want to regain full control over your costs—and revenues.

Regaining control and deriving full value from your products, licenses, and intellectual property begins by asking tough questions:

- How can you help your company manage its third-party relationships more effectively?
- How do you know if you're being overcharged by vendors?
- How can you be sure of third-party compliance when relying on self-reporting?
- How do you accomplish all this without jeopardizing your relationships with these companies?

The answer to all these questions is the same:

KPMG Contract Compliance Services (Contract Advisory).

Taking a closer look helps identify areas of risk

The process begins with a close examination of your third-party relationships. One area of concern can be self-reporting, since relying on third parties to report on the revenues they owe you can create significant risk of underreporting. Sometimes underreporting is deliberate, but more often it results from miscommunication, misunderstanding, or even a lack of incentive to report accurately. Regardless, inaccurate business partner or customer reporting can have a powerful impact on your bottom line. In fact, based on more than a thousand contract reviews conducted by KPMG compliance professionals, we estimate that as much as 70 percent of self-reporting by business partners or customers is inaccurate.

But underreporting isn't the only thing that can affect the value of your relationships. Another factor that comes into play can occur when third-party revenues, costs, and practices are passed along to your company. This can affect your ability to comply with such regulatory requirements as the USA PATRIOT Act, the Foreign Corrupt Practices Act (FCPA), the Office of Foreign Assets Control (OFAC), as well as section 404 of the Sarbanes-Oxley Act (S-O 404). If not monitored carefully, these pass-alongs can cause you to underreport revenue or overstate costs, which can be interpreted as a failure of your company's financial reporting controls. Or worse, that you're ignoring regulations to know your trading partners.

Gaining the most value from your third-party relationships

KPMG's Contract Advisory practice has a world of experience providing contract compliance services to a variety of clients in a wide range of industries around the globe. As a result, we know how to help you identify key risk areas, as well as monitor and manage them.

Our program includes on-site testing at third-party and business partner locations to help monitor compliance, identify errors, and, ultimately, help recover lost revenue or overcharges. We also can help with access to information that may be unavailable to you. For example, is the "best price" offered by a supplier really that? In many cases, we're able to review agreements between the supplier and other companies so we can help you determine whether the deal you were promised is the one you're getting.

A range of contract compliance services

KPMG's Contract Advisory practice can help with software licensing, royalties, licensing, resellers and distributors, advertising agencies, and more. As a result, we understand the complexities and nuances of a wide range of business contracts, processes, and procedures.

Among the specific contract services we offer are:

Royalty Reviews

We assist clients in the recovery of royalty revenues lost due to inaccurate and incomplete self-reporting by licensees. We also seek out the root causes of licensee underpayments and offer recommendations to help prevent future losses, while strengthening the underlying licensing relationships.

Distribution Reviews

We assist clients in enforcing their contracts with channel partners to recover payments that may have been overlooked or misreported, and incentives that could have been inappropriately claimed. We also help clients develop compliance processes and systems to better address contractual obligations and prevent future revenue leakage, such as in the gray market.

Vendor Reviews

We assist clients in the management of their vendor relationships by assessing compliance with various provisions of purchase agreements across the supply chain such as Most-Favored Customer clauses; cost-plus or time-and-materials arrangements; outsourcing arrangements with manufacturing or ad agencies; conditional pricing arrangements; and rebates, discounts, and other conditional incentives.

Ad Agency Contract Compliance

We perform various agency engagements to help identify significant cost recoveries or other improvement opportunities, while helping to maintain vital business relationships.

Intellectual Property Advisory

We advise our clients on Intellectual Property (IP) management strategies that range from external protection and public profile considerations to reviewing the organization's own internal use and holdings of IP; as well as internal programs, policies, and procedures aimed at governing IP.

Digital Content Reviews

We assist digital content owners in identifying and recovering uncaptured revenues. Our approach includes assessing the completeness and accuracy of self-reported data concerning the distribution of the client's digital content from third parties such as online Web sites, mobile carriers and their respective service providers, and peer-to-peer networks. We focus on understanding and testing the end-to-end systems and processes, including those involved in data capture, sales reporting, and royalty and revenue share calculations.

Working through differences in contract interpretation

If the licensee and licensor have divergent understandings of key contractual terms, they commonly disagree on the amounts owed. Because our nonadversarial approach focuses on the collection and analysis of facts, we often can help the licensee and licensor identify the source of disagreement, such as a previously unknown agreement, communication, or practice. This also enables the parties to more clearly understand the nature of their disagreement and focus their negotiation on the elements of greatest significance. Toward this end, clients sometimes request that we report our findings based on alternative contract interpretations provided by the licensor and licensee.
In short, our nonadversarial approach can help business partners resolve different interpretations without conflict.

Bringing insight to a complex environment

Gaining the full value due from contracts is clearly a chief concern for today's companies—in terms of enhancing income, reducing costs, and meeting regulatory compliance issues. Fortunately, KPMG's Contract Advisory practice is well positioned to help. In fact, we've been able to help our clients identify and recover billions of dollars.

One reason why is the unique combination of advantages we're able to offer, including:

— *Significant experience.* Our dedicated partners and professionals have deep industry experience. This includes more than 450 dedicated professionals who have conducted more than 5,000 third-party reviews. As a result, we've been able to help companies around the world increase revenue or reduce costs as well as resolve complex relationship and contracting issues.

— *Integrated international teams.* KPMG's integrated international Contract Advisory teams comprise diversely skilled U.S. and global professionals with deep experience and specific industry knowledge of intellectual property and contract compliance issues.

— *Understanding of partner relationships.* We recognize the dynamics in business relationships and work in a nonadversarial way to help business partners understand the terms of their agreements. We also help establish compliance reviews as routine control measures.

— *A nonadversarial approach.* KPMG structures Contract Advisory reports to present facts and critical details in a manner that facilitates resolution with your partners. Our nonadversarial approach helps avoid confrontation and mistrust, leads to quicker and more successful resolutions, and protects vital business relationships.

— *Proven methodologies and approach.* Our approach reflects our leading practices and enables us to adopt detailed work plans that focus on the specific environment and underreporting or overclaiming evaluation.

— *Help where you need us.* Our Contract Advisory teams are able to tap into KPMG International's network of member firms to provide contract compliance professionals wherever—and whenever—you need them.

— *Enhanced ROI*. Better protection for intellectual property. More effective financial reporting controls. Improved relationships with key business partners. In-depth industry experience and a dedicated practice. These are just some of the reasons why companies around the world turn to KPMG's Contract Advisory professionals. Every day.

“KPMG has identified financial findings in 70% of the 1000+ contract compliance reviews completed in the last five years.”

Keeping royalty contracts on track

Every day, businesses lose countless dollars without even realizing it. The reason? In many cases, revenue can vanish because vendors, distributors, and licensees unintentionally fail to meet contractual obligations. Inaccurate third-party reporting can stem from highly complex contracts that do not clearly identify key requirements or responsibilities, or from changed circumstances, mistakes, or deliberate misstatements. Whatever the cause, the need to manage risks related to your third-party relationships is critical to achieving full control over your costs—and revenue.

If your organization licenses its intellectual property, royalty revenue likely is a key contributor to your bottom line. It's important to consider how well you are monitoring compliance of your third-party contractual relationships, identifying errors, and ultimately helping to recover lost revenue or overcharges. KPMG Contract Compliance Services (Contract Advisory) professionals help determine compliance of your third-party contractual relationships to help protect your bottom line.

Royalty compliance engagements

While most licensees do not purposely underreport the amount of money they owe, KPMG estimates that as much as 70 percent of self-reporting by business partners or customers is inaccurate, based on more than a thousand contract reviews previously conducted by our Contract Advisory professionals. Our royalty compliance reviews help clients recover lost royalty revenue resulting from inaccurate and incomplete self-reporting by licensees.

Common errors

KPMG's Contract Advisory professionals have identified issues of contractual noncompliance or misreporting more than 90 percent of the time while conducting contract compliance reviews. Several factors contribute to this prevalence, including:

— Deductions from gross revenue that are not allowable per the agreement

— Royalty calculations for bundled products that are not clearly defined in the agreement

— Missed products due to the introduction of additional products and/or manufacturing facilities

— Intercompany sales not being captured in the data gathering process for royalty calculations

— Licensee applying incorrect royalty rates per the contract due to tiered or changing rates

— Rate changes not being captured when pegged to indices such as the Consumer Price Index

— Differences in contract interpretation.

How KPMG Can Help

KPMG's Contract Advisory professionals seek out the root causes of underpayments and offer recommendations to help prevent potential future losses and strengthen the underlying licensing relationships. We specialize in a nonadversarial facts-based approach that helps clients identify significant cost recoveries and other improvement opportunities, while respecting business relationships. Key potential benefits of a royalty compliance review program include:

— **Improved** monitoring of business relationships

— **Enhanced** controls and internal process consistency

— **Measurable** return on investment (ROI)

— **Better** protection of intellectual property.

KPMG's royalty engagement approach

We develop an understanding of our client's licensing activities by obtaining answers to questions such as:

— How much royalty revenue do you generate per year? How many licensees do you have?

— How do you license your intellectual property? On a percentage of (net) sales basis? Per units sold?

— May licensees bundle licensed and unlicensed product for sale? Does the agreement address bundling?

— Does your royalty revenue come directly from licensees, or are there sublicensing arrangements?

— Do your license agreements contain potentially ambiguous contract terms that could be misinterpreted by a licensee?

— Do the terms of the audit clause enable an appropriate audit scope? Is there an audit fee pass-through provision?

— Do you have suspicions with respect to a licensee or the accuracy of its royalty payments?

— Do you have a royalty compliance program in place? Are you using external audit firms?

We emphasize strong communication

KPMG structures Contract Advisory engagements to provide informed communication at all levels:

— **Planning and coordination:** We establish open communication and understand client expectations.

— **Scope of work:** We work with our client to identify key risks and agree on the engagement scope.

— **Pre-fieldwork data collection and analysis:** We gain an understanding of the agreement, obtain client and third-party data and documentation, conduct planning meetings, perform preliminary analysis, and develop a detailed work plan.

— **On-site fieldwork:** We conduct an opening meeting to discuss fieldwork objectives and provide process transparency. Fieldwork is customized to address specific objectives and may include interviews, completeness testing, system testing, documentation of royalty reporting processes, and determination of preliminary findings. We commonly conclude fieldwork with an exit meeting to summarize open data requests, establish next steps, and agree on the timing of open items.

— **Post-fieldwork and reporting:** After fieldwork, licensees generally provide additional information to address preliminary findings. Upon completion of our post-fieldwork efforts, we report to our client.

Global joint venture case study – Brand royalty compliance

A large American retailer had a joint venture deal with a Japanese retailer that self-reported sales and royalties to the American company and remitted quarterly payments. The American company was interested in how business was being conducted by the joint venture with respect to its products and engaged KPMG to do a royalty compliance review.

Our approach

KPMG obtained sales data at the transaction level for the test period 2005 through 2010. KPMG ran queries at the transaction level and recalculated royalties due to the American retailer, resulting in $7.8 million in potential under-reported royalties from the Japanese retailer to the American retailer.

Results

KPMG learned that when its retail clients engage in joint ventures with international companies, the international companies sometimes tend to misinterpret the agreements between the parties and report royalties based on their own accounting practices that are often different from the terms of the joint venture agreement.

Wireless technologies case study – Intellectual property rights

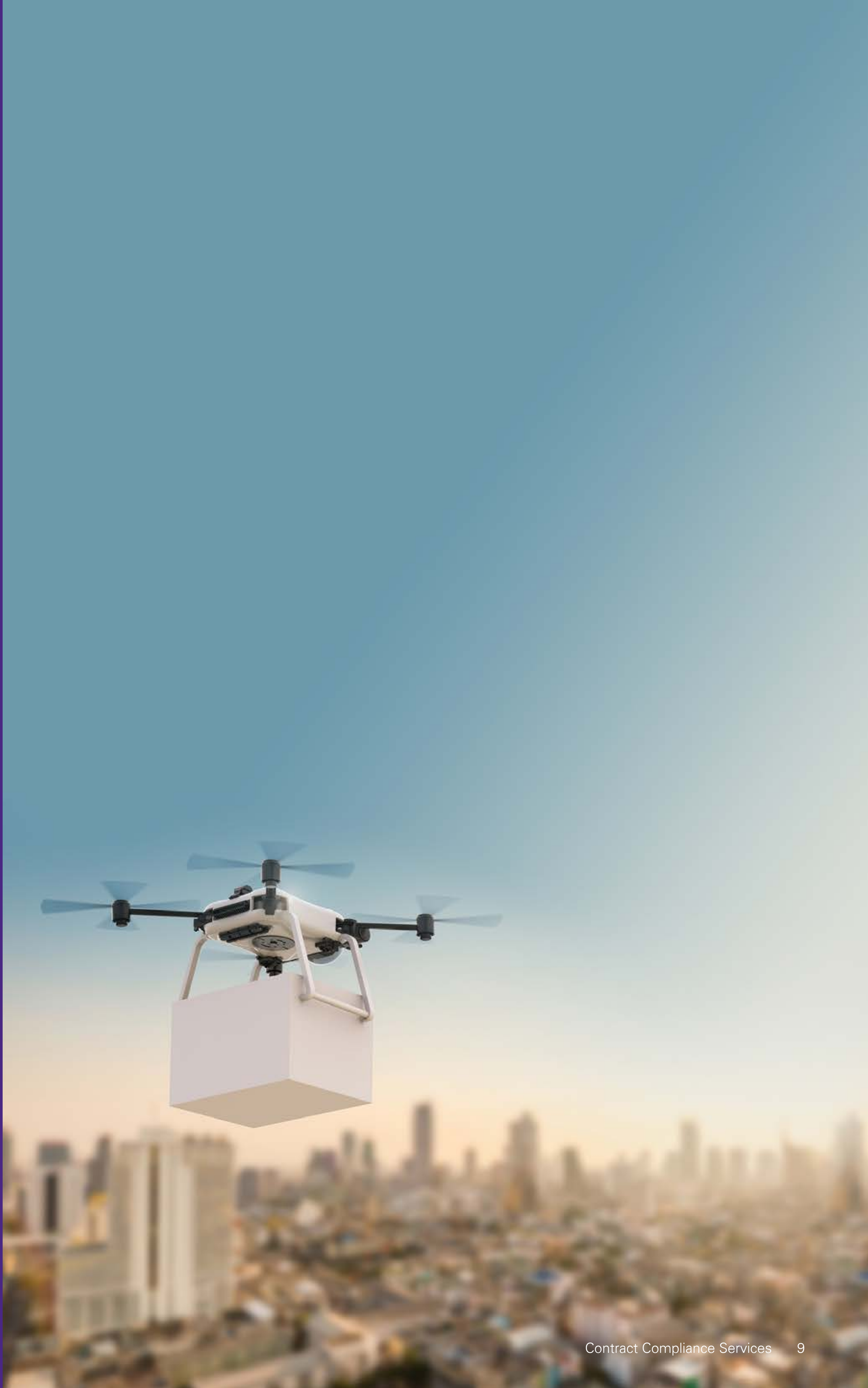
Our client developed wireless technologies used in mobile devices and wireless networks. It partnered with many of the world's leading wireless companies, and utilized its license compliance program to gain insight into the royalty reporting of its licensees.

Our approach

KPMG first developed an understanding of how the technology could be identified in various products. With royalties based upon a flat fee per unit depending upon region sold into, quantity sold, and device type, we conducted interviews and collected accounting data to identify sales that met these criteria. We also explored potential risks associated with sublicenses and affiliates.

Results

KPMG identified noncompliance with the license agreement resulting in underreported royalties exceeding $20 million for the review period. Examples of misreporting included instances of the licensee taking unallowable deductions against royalties, nonreporting on certain brands, incorrect reporting of royalty rates relating to dual-mode devices, and nonreporting of sales by the licensee's affiliates.



Keeping distribution contracts on track

Every day, businesses lose countless dollars without even realizing it. The reason? In many cases, revenue can vanish because vendors, distributors, and licensees unintentionally fail to meet all their contractual obligations. Inaccurate third-party reporting can stem from highly complex contracts that do not clearly identify key requirements or responsibilities, or from changed circumstances, mistakes, or deliberate misstatements. Whatever the cause, the need to manage risks related to your third-party relationships is critical to achieving full control over your costs—and revenue.

If your organization moves its product through distributors, retail channels, or resellers, it's important to consider how you are monitoring compliance of third-party contractual relationships with your distribution partners. KPMG Contract Compliance Services (Contract Advisory) professionals can help determine the compliance of your third-party distribution partners to help you identify errors, improve self-reporting systems, and, ultimately, help you protect your bottom line

Distribution channel compliance engagements

While most distributors do not purposely report information inaccurately, KPMG estimates that as much as 70 percent of self-reporting by business partners or customers is inaccurate based on more than a thousand previous contract compliance engagements conducted by our Contract Advisory professionals. Inaccurate reporting can result in the manufacturer overpaying the distributor in program incentives, the introduction of counterfeit products, and possible damage to a company's brand and reputation.

Common errors

KPMG's Distribution Channel professionals have seen a pattern of client oversights that have a potential to deprive them of the revenue they may be due, including:

- Recovery of incentives paid to distributors where they have not complied with the associated terms and conditions
- Identification of gray market activity and recovery of incentives paid on gray market activity
- Introduction of counterfeit products in authorized channels along with gray market products
- Limited visibility and enforcement of the channel by the client
- Business partner participation in the buying and selling of client products on the open/parallel market
- Potential sales of product into embargoed countries and Foreign Corrupt Practices Act violations
- Errors in or manipulated reporting of sales/inventory that limits monitoring and exploitation of the data by stakeholders
- Issues with importation to BRICME (Brazil, Russia, India, China, and the Middle East) countries, causing customs and product delays
- Lack of required integration of product resulting in bare component sales that increase the speed of pricing erosion.

How KPMG can help

KPMG's Contract Advisory Distribution and Channel Management professionals help ensure that third-party distributors and resellers adhere to their contractual obligations. We understand that factors such as complex/ambiguous contracts, lack of experienced resources, and hesitancy to disclose confidential information can lead to inaccurate reporting. We specialize in a nonadversarial, facts-based approach to help identify significant cost recoveries or other improvement opportunities while respecting your vital business relationships.

If inaccurate reporting and loss of revenue or overpayment of rebates are identified, our professionals seek out the root causes and offer recommendations to recover lost revenue or overcharges and help prevent future losses.

KPMG's distribution channel compliance approach

To get results, KPMG's Contract Advisory professionals focus on the specifics of your business. To learn more about how your partners self-report on product distribution, we obtain answers to questions such as:

- From which types of channel partners do you receive reports of point-of-sale or inventory data? From distributors? Resellers? Retailers?
- Do you offer incentives (i.e., special pricing, promotions, price protection, marketing funds, etc.) to channel partners based on the point-of-sale or inventory data they report?
- Do you have any known or perceived gray market issues (i.e., genuine product sold through unauthorized channels) or counterfeit product issues?
- Do you have mature processes and functioning controls in place to monitor and administer channel reporting or incentive program accounting, claims, and payments?
- Do you currently have a functioning channel partner compliance/market integrity program in place? Which external compliance partners do you use, and are you completely satisfied with their performance?

Do you have authorized partners complaining of losing deals to non-authorized partners or at prices that do not make sense?

U.S. pharmaceuticals case study—Sales, rebates, and distributions

A major U.S. pharmaceutical company engaged KPMG to provide assistance in determining whether rebate programs that pay in excess of $4 billion per year to self-reporting U.S. wholesalers and healthcare providers were resulting in accurate claims.

The KPMG engagement team looked at internal processes/controls for sales reporting for returns, discounts, and rebates to identify potential weaknesses. Our professionals worked with the company to develop a compliance program for each of its major wholesalers. We audited a transaction-level audit trail of product procured, shipped to the wholesaler, booked into inventory transferred between distribution centers, sold to the end customer, and then claimed on a rebate submission back to the wholesaler.

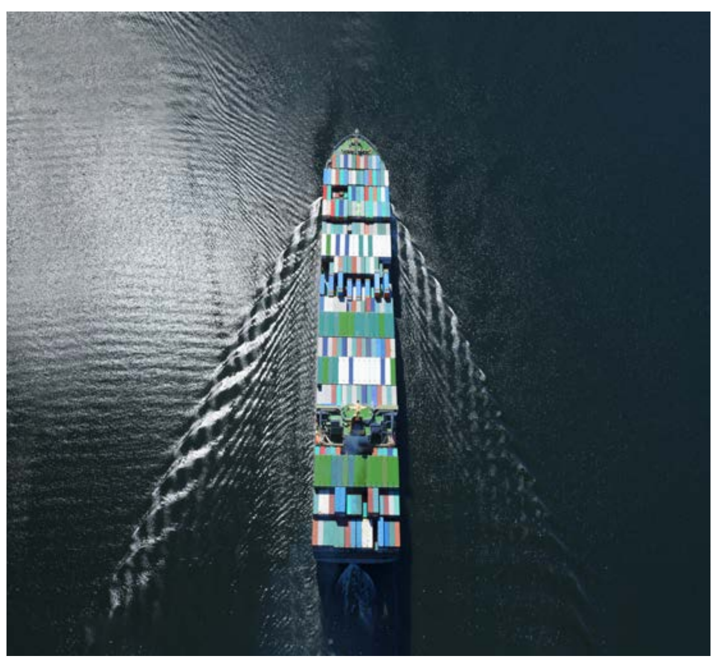
KPMG identified potential recoverable multimillion-dollar amounts due to incorrect claims, and we helped the client implement robust process improvements to help ensure future claims would be submitted more effectively.

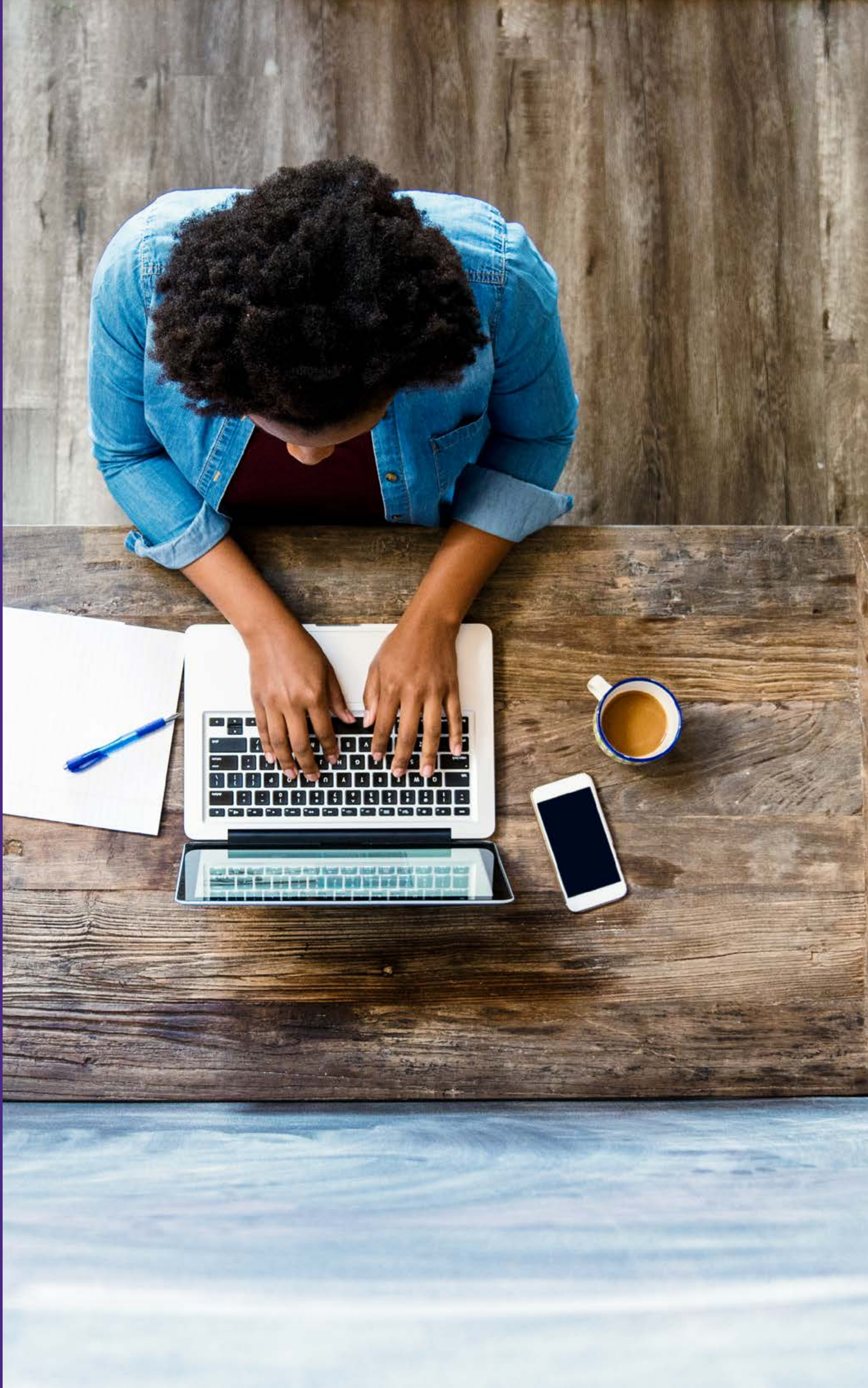
Fortune 500 manufacturer case study – Channel project management office

KPMG collaborated with our client's newly appointed channel management director to set up a compliance project management office (PMO) and develop a worldwide compliance program. This program included understanding the client's internal processes and controls, agreeing on the program objectives with senior management, and communicating objectives to our client's partners. KPMG also worked with our client on a risk ranking process to allow our client to identify which partners to review and what process to employ from inventory counts with limited point-of-sale testing, through to full channel compliance projects. This international work was coordinated globally from the US, with teams from Asia, Europe, and the Middle East teams providing support.

On average, KPMG has completed 20 – 30 reviews per year, identifying hundreds of millions of dollars of incorrectly claimed incentives as well as significant gray market activity and other noncompliance activities, such as sales to embargoed countries and FCPA violations. These reviews also resulted in reclaiming incentive payments as well as penalties for involvement in gray market activity.

KPMG provided support and input to allow the efficient and global rollout of the program. We identified recommendations for the strengthening contractual terms and conditions and process improvements for both our client and its partners. In addition, KPMG developed an efficiently repeatable process with the client, which resulted in expansion of the program to its OEM and system integrator channels.





Keeping your vendor contracts on track

Every day, businesses lose countless dollars without even realizing it. The reason? In many cases, revenue can vanish because vendors, distributors, and licensees unintentionally fail to meet all their contractual obligations. Inaccurate third-party reporting can stem from highly complex contracts that do not clearly identify key requirements or responsibilities, or from changed circumstances, mistakes, or deliberate misstatements. Whatever the cause, the need to manage risks related to your third-party relationships is critical to achieving full control over your costs—and revenue.

Contractual relationships with vendors provide advantages such as reduced costs and increased competitiveness to both customers and vendors. But few customers have the time or resources to determine whether their vendors are in full compliance with complicated agreements that may include most-favored-customer provisions, pass-through and conditional pricing models, and time-and-cost allocations plus overhead, among other terms. KPMG Contract Compliance Services (Contract Advisory) professionals can help you determine your vendors' compliance across a wide range of industries to help protect your bottom line.

Common errors

KPMG's Vendor Services professionals have seen a pattern of client oversights that may have resulted in significant overpayments to their partners, including:

- Incorrect assessment of "most-favored pricing" arrangements, excluding relevant pricing mechanisms for comparative products
- Duplicate and overpayments of invoices
- Missed opportunities to leverage identified compliance issues during negotiations of new contracts
- Overcharging of products and services due to errors and/or manipulation of billing information
- Lack of consolidation of vendors to maximize volume discounts.

How KPMG can help

While most vendors do not purposely overcharge or incorrectly bill the agreed charges, KPMG estimates that as much as 70 percent of business partner/vendor self-reporting is inaccurate based on more than a thousand previous engagements our Contract Advisory professionals have performed.

To assist clients in managing vendor relationships, our Contract Advisory professionals help determine purchase-agreement compliance across the whole supply chain and other indirect vendor relationships. We examine most-favored-customer clauses, cost-plus or time-and-materials arrangements, outsourcing arrangements, conditional pricing arrangements, and rebates, discounts, and other conditional incentives.

We understand the complexities of vendor relationships that include, among others:

- Material and equipment vendors
- Contract manufacturers
- Third-party logistics providers
- Business process outsource providers
- Application service providers
- Leasehold management.

How KPMG can help

By seeking out potential causes of inaccuracies and consulting with the client on potential control improvements to help prevent future errors and strengthen the underlying vendor relationships, we help encourage adherence to contractual pricing and other arrangements, a major issue for all companies.

KPMG's vendor compliance engagement approach

To get results, we arrive at an understanding of your organization's contracts with third-party vendors and suppliers of goods or services by obtaining answers to questions such as:

— Do you have significant vendor/supplier agreements that include cost-plus or time-based pricing, process improvement guarantees, or IP protection?

— Do you have any most-favored-customer, best-in-class, or other derivative/complex pricing arrangements in place with any of your vendors?

— Do you have any pass-through pricing, authorized sales channels, on-time delivery, quality guarantees, or other complex terms and conditions with any of your vendors?

— Do your longer-term facilities lease contracts contain price escalation clauses, common-area maintenance allocations, or expense pass-through provisions?

— What mechanism do you have for reviewing your vendor spend, and for conducting a risk assessment of your vendor population and appropriately reacting to those risks?

— Do you have a functioning compliance program to monitor suppliers for adherence to the terms and conditions of their agreements? Which external compliance partners do you use, and are you completely satisfied with their performance?

— Do you have significant joint venture or co-marketing arrangements? Do you have sufficient and accurate information from these activities to adequately monitor results and identify trends?

Global manufacturer case study – Most favored pricing

A global technology client facing budgetary overruns asked KPMG for help determining whether its outsource manufacturer was meeting certain most-favored-customer pricing arrangements in the contract. Using a consistent global methodology, KPMG's Contract Advisory engagement team ultimately was able to help the client achieve verifiable findings, control budgets, and preserve strategic relationships.

KPMG's program focuses on identifying key attributes affecting price and comparability, including documenting the supplier's compliance process; identifying comparable sales to its competitors; calculating appropriate price adjustments; identifying and qualifying possible violations; and confirming the numbers with the supplier.

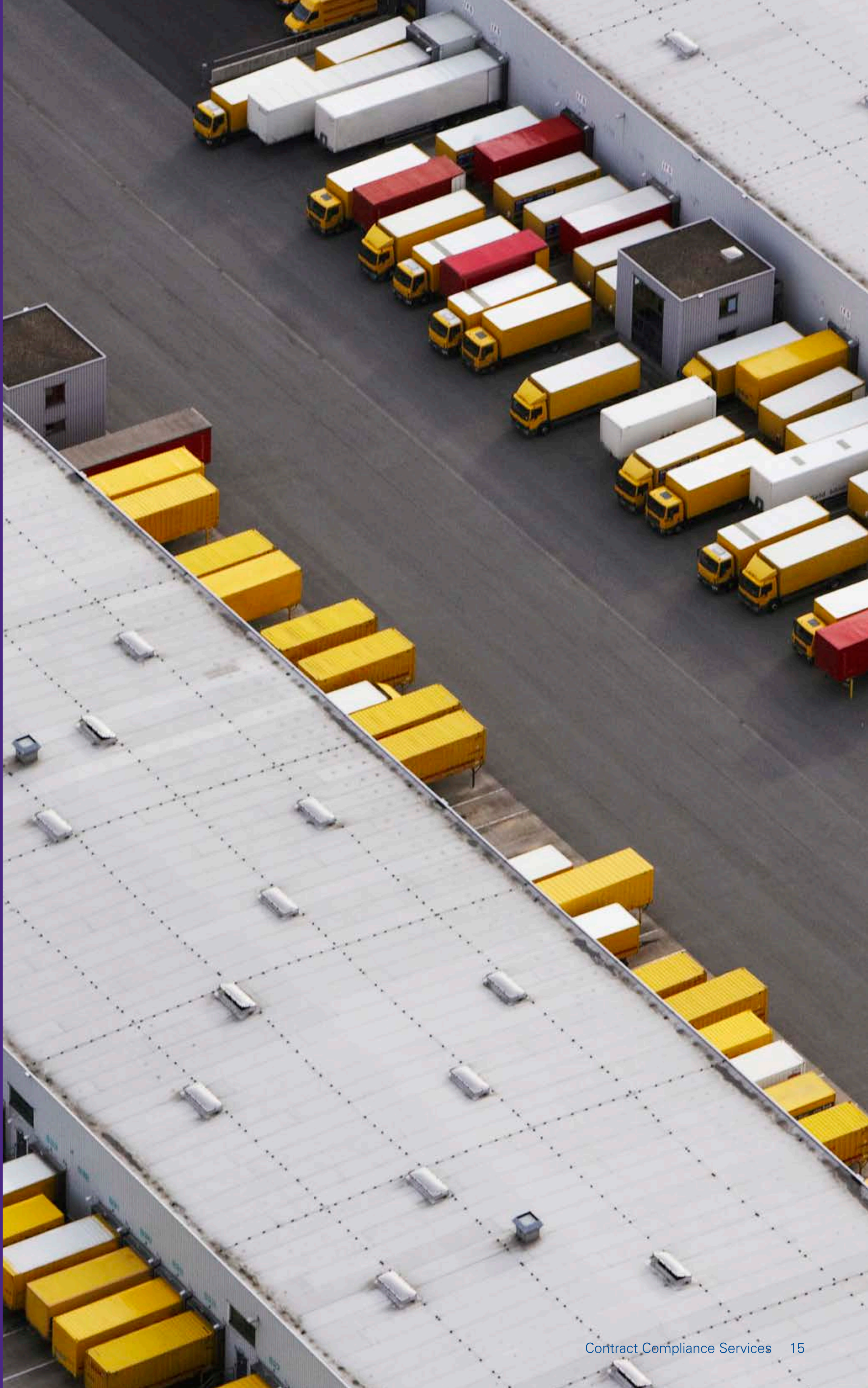
The program has served to provide a clearer understanding of contractual obligations and requirements by the supplier base, helped clarify the concept of comparability and appropriate price adjustments, enhanced the renegotiating of pricing agreements, and improved the client's business relationships. The client's enhanced contract management program has identified approximately $33 million in potential cash savings to date and the client has expanded the engagement's scope from contract manufacturer materials suppliers to include other equipment and services suppliers.

Supplier compliance case study – Cost savings

A global FORTUNE 50 client had carried out "supplier reviews" with an internal team but found it was unable to access supplier information necessary for validating compliance with complex and confidential contract terms. The company wished to increase its capacity to achieve consistency between different locations.

The client engaged KPMG to help develop a program to help achieve this. The engagement team demonstrated KPMG's capacity to scale up this program. Because our global network of dedicated Contract Advisory professionals has practical experience in dealing with the relevant issues and follows the same methodology, we are able to deliver consistent service in a particular marketplace or across geographies.

In the first 18 months of the engagement, the KPMG program identified more than $30 million in potential cost savings and cash recoveries for our client.
In addition, we provided analysis that enhanced the client's ability to improve its systems and processes, addressing persistent contractual issues, weaknesses in audit clauses, and quality of supplier reporting to help reduce the client's overall cost of compliance and develop more robust supplier agreements.



Keeping ad agency contracts on track

Every day, businesses fail to realize the anticipated returns on their marketing, advertising, and promotional spend. The reason? In many cases, the agency unintentionally fails to meet all their contractual agreements because of highly complex agency agreements that reflect the evolving nature of agency compensation models and changes in the approaches to digital advertising and social media. Whatever the case, the need to manage risks related to your advertising agency relationships is critical to achieving the full potential of your marketing, advertising, and promotional investments.

Marketing, advertising, and promotional expenditures represent a significant cost of doing business in today's competitive marketplace. The behind-the-scenes processes related to advertising agency performance are often an unknown for many businesses. With the growing importance of online advertising, measurement of agency and placement performance has become even more difficult. If you rely on your agency to self-report on contract compliance and proactively monitor media placements, it's important to consider how well it is doing the job. While most agency personnel are beyond reproach, executing and interpreting today's complex contracts can easily lead to mistakes—and overcharges. KPMG Contract Compliance Services (Contract Advisory) professionals can help determine compliance of third-party contractual relationships to help protect your bottom line.

Ad agency compliance engagements

Accurate and reliable reporting from your marketing, advertising, and promotional agencies is critical to understanding how your marketing budget is being spent and the impact it is having. While most advertising agencies do not purposely fail to deliver under the terms of their agreements, KPMG estimates that as much as 70 percent of self-reporting by business partners is inaccurate based on more than a thousand previous KPMG Contract Advisory reviews. Our professionals have the industry knowledge to perform ad agency compliance engagements that may help you recover lost value from inaccurate and incomplete self-reporting.

Common errors

KPMG's professionals have seen a pattern of agency and client oversights that have diminished the value of the advertising dollars being spent, including:

— A lack of coordination between creative, promotional, and media agencies responsible for elements of a given project resulting in duplicate billings to the advertiser

— Standard industry media commissions being erroneously charged to the advertiser in addition to an agreed-upon agency compensation methodology

— Missed ROI on media spend due to the agency not performing and reviewing a post-buy analysis to evaluate performance of the media versus audience targets and requesting make-goods where needed

— Failure to globally coordinate local Agency performance in accordance with global agreements in place between the agency and the advertiser.

How KPMG can help

KPMG Contract Advisory engagements seek out root causes of overcharges by evaluating:

General billing

— Fees and commissions

— Adherence to contract billing terms

— Discounts and rebates owed to clients

— Review of direct client expenses

Creative services

- Legal clearance procedures for creative work
- Licenses for intellectual property
- Advertising production charges
- Use of independent contractors

Media services

- Execution of approved media plans
- Placement confirmation
- Vendor credit procedures
- Post-buy analysis procedures

General operations

- Segregation of agency duties
- Internal controls
- Conflict of interest compliance
- Tracking of budgets versus actual charges.

Our professionals focus on industry risks such as undisclosed use of related-party advertisers that charge excessively high fees; unauthorized expenditures such as personal benefits to agency employees; nonplacement of ads; inappropriate calculations of total service costs; and expenditures through unauthorized media or locations, among others.

Focus on performance

KPMG's Contract Advisory professionals focus on the specifics of your business. To learn more about how your partners self-report on advertising production and placement, we obtain answers to questions such as:

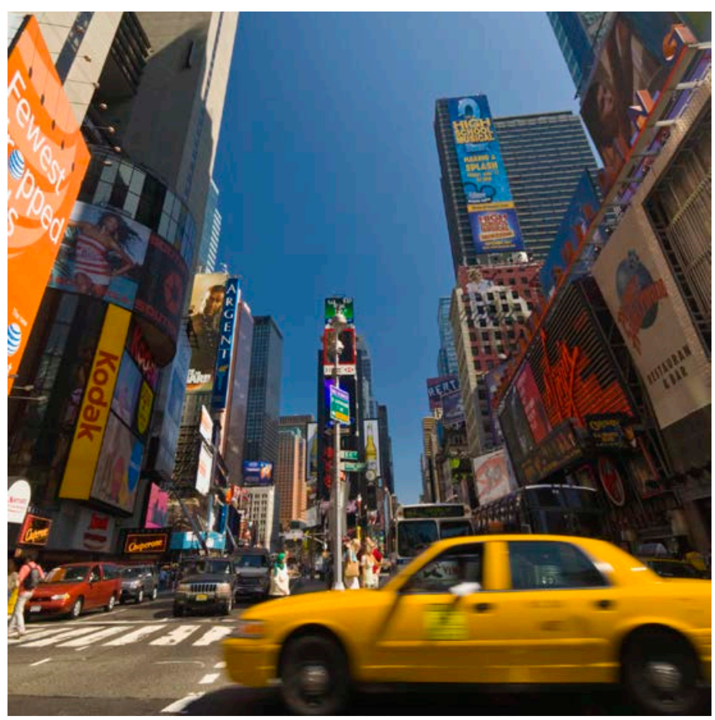
- Have you evaluated the ROI of your advertising spend?
- Has your advertising become increasingly fragmented between alternative channels of advertising such as TV, Internet, print, etc.?
- How much do you spend with creative, marketing strategy, promotional and media agencies every year? Is your spend coordinated across these various types of agencies? Are agency invoices reviewed on an individual agency basis or an aggregate project basis across agencies?
- How has your mix of agency fees and commissions versus media spend changed over time? Is your advertising budget increasing? Are there significant variances in advertising budgets compared to actual expenditures?
- Do your agreements with creative, marketing strategy, promotional, and media agencies require them to submit periodic reports on the media billings, production expenses, and time reported to support the total service costs?
- Has the advertising agency honored and made adjustments for any "true up" clause in the contract by reconciling hours estimated with actual hours worked?
- Has the advertising agency provided you with any documentation of media reconciliation (from the agency itself or from a third party) validating that advertisements are being placed?
- Are your agreements with advertising agencies centrally managed? Do they contain a right to audit?

A word about media and production transparency

In June 2016 the Association of National Advertisers (ANA) released the results of a study performed by K2 Intelligence into media transparency in the U.S. The study focused on business practices related to all types of media (digital, television, print, etc.) Certain nontransparent business practices were identified:

- Agencies acting as a principal, rather than as an agent for clients. Agencies resold free or discounted media at a profit to clients, adding in fees and commissions, without disclosing that this media was actually owned by the agency.
- Agency failure to disclose and refund rebates paid to it by media owners for client purchases. Rebates were paid as cash, free media, or fees for phantom "services" to the agency or holding company.

In our experience, and as the report cited, these activities were enabled by weak agreements between the agency and advertiser, failing to explicitly require transparency or disclosure of transactions or the use of agency-affiliated entities. Accordingly, transactions with related parties within the agency holding company structure often go undisclosed.



Ad agency case study – Media compliance

A large consumer products brand engaged KPMG to perform a global review of its advertising agency to determine whether the agency was in compliance with the terms and conditions of its media buying agreement. The engagement involved a substantive review of billings to the client, testing of fees charged in respect of FTEs, and testing to determine whether all rebates and discounts received were being passed back appropriately.

Results

KPMG's Contract Advisory professionals identified some discrepancies in billing, staffing, and rebates. Disallowable costs and commissions had been passed back to our client, while certain credits had not. Because the agency did not monitor FTE levels in each country, it was not delivering the correct number of FTEs. The fact that not all countries were required to fill out timesheets posed a control issue. In addition, we identified a significant level of cash rebates and free space that could be passed back to our client. The findings represented a 60 to 1 return on investment (recovery/KPMG fees). In addition, KPMG was able to suggest some areas where the client could consider modifying the language of the agreement to facilitate future evaluations of agency accuracy.

Major advertising case study – Subcontrator costs

A large telecommunications company engaged KPMG to review the books and records of an advertising agency to determine whether the agency's billings complied with contractual requirements.

Results

KPMG's Contract Advisory professionals found some discrepancies. The agency lacked documentation to confirm that it had provided the contractually required number of advertising hours and services for which it was paid an annual service fee. The review also determined the agency had billed for services that, contractually, should have been covered by the annual fee, and there had been violations of a provision of the agreement that required subcontractor costs to be passed through with no mark-up. Both parties desired to continue the business relationship. Based on KPMG's findings, the agency worked with the client, agreeing to pay an appropriate financial settlement that was satisfied through reductions of future invoices. The resolution represented an 8 to 1 return on investment (recovery/KPMG fees). In addition, the agency agreed to pay KPMG's fees for the engagement.

Contact

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