



Example Audit Work Program For Magazine Shrink Analysis

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EXAMPLE AUDIT WORK PROGRAM FOR MAGAZINE SHRINK ANALYSIS

The following audit program was developed by CMG with the sole purpose of communicating suggested protocols for on-going shrink analysis (audits). At the date of its release, it serves as a draft overview to begin discussions on designing and implementing on-going audit procedures. We anticipate that the audit program would be enhanced as more knowledge is gained through parallel test efforts. Please refer to CMG's Scan Based Trading Position Statement for our risk assessment, and other requirements, that must be in place prior to entering into an SBT relationship for magazines.

This audit program is only a guide, and is not intended to replace judgment of management or an auditor. In addition, the audit program should be expanded with detailed audit procedures, as necessary, to fit the requirements of each SBT relationship, based on business partner information, product flow and an internal control structure.

For purposes of this document, following are definitions of SBT, Pay From Scan ("PFS") and Shrink respectively, for your reference.

Scan Based Trading ("SBT") – A change in both financial and operational policies and procedures in the exchange of magazine product for newsstand distribution. SBT in this definition includes a shift in inventory to the manufacturer (i.e., publisher), direct payment terms between the manufacturer and retailer ("Retailer"), service fee / commission payment for the wholesale distributor ("Distributor"), and operational changes in handling the product between supply chain partners.

Pay From Scan ("PFS") or Pay On Scan ("POS")– A trading relationship where the financial arrangement is changed to pay from point of sale. PFS focuses on the changes in financial terms only and, in many cases, is a stepping stone to move to full SBT. For magazine distribution, this name has also been coined with payment changes whereby Retailers are requesting direct payment to wholesaler distributor from point of sale data.

Shrink ("Shrink") - The difference between the point of sale and order regulation sales data (difference between point of sale data and implied sale according to wholesaler's copy returns counts). Shrink can be caused by many factors including but not limited to; incorrect invoicing, reorders, understated/overstated returns by the Distributor or understated retail sales attributed to theft, unscannable magazine codes, scanner system problems, or in-store execution problems.

As noted in CMG's SBT Position Paper, CMG believes that SBT will change the supply chain dynamics significantly, including roles and responsibilities, as the relationship between the manufacturer (the publisher or its sales & marketing representative) becomes increasingly important. The emphasis on flexibility and adaptability are key to customizing these new trading relationships between parties.

The CMG Scan Based Trading Position Statement and soft copy of this document (and other attachments) are available on CMG's website at www.i-cmg.com.

Auditing and On-going Monitoring

Auditing will be a critical function not only in the set-up and testing of an SBT Program ... it will also be a cornerstone for the on-going monitoring of the program to ensure that the appropriate internal controls are in place and operating effectively. There are several stages (and recommended audits) that CMG recommends:

- CMG Audits during Set-up and Parallel Testing (Phase I)

As noted in our SBT position paper, CMG recommends that a period of time be dedicated to the set-up and testing of the new processes and systems under a SBT arrangement. This is imperative to ensure that the appropriate roles and responsibilities are defined, that data synchronization and quality of data are addressed and, most importantly, that all supply chain partners are part of designing and implementing a new program that ensures all transactions are processed completely and accurately. During this phase, CMG specifically:

- ✍ Audits twelve months of prior historical scan sales to wholesaler order regulation data. Audit period will begin 120 days prior to actual date of audit. This will ensure all physical returns have been processed and credited.
- ✍ Performs on-site reviews / audits, as appropriate by our Field Audit Team.
- ✍ Requests that the wholesaler engage a 3rd party to review its internal controls.

- On-going External 3rd Party Audits

Once the new systems and processes have been cutover to production, CMG and its representative publishers request that the wholesalers engage a 3rd party auditor to perform an annual update and review of its internal controls environment.

- On-going Monitoring and CMG Audits

In addition to the annual 3rd party review of the wholesalers internal controls environment, CMG also envisions that they would perform on-going / monitoring (as noted in the work plan below) and on-going on-site reviews / audits by our field Audit team.

ON-GOING MONITORING RECOMMENDED AUDIT WORKPROGRAM

Audit Objective:

This audit program is intended to:

- Compare retailer invoiced product (order regulation data) including appropriate adjustments (i.e., returns, reorders, shortages, overages, damaged product) to point of sale data on a sample basis as determined by the sample selection below.
- Establish other "audit / monitoring" reports to monitor sales from scan data, such as recap reports per chain / store for specified period.
- Discuss / review and test operational and system procedures for SBT relationships.

Audit Scope:

All stores within a chain and its divisions therein which have met requirements to enter into an SBT relationship as outlined by CMG's SBT Position Statement.

Audit Sample Selection:

Audit sample should:

- Be determined quarterly at the beginning of the month preceding the next audit quarter.

- b. Provide appropriate audit coverage to manage the financial exposure based on materiality as agreed by the parties. For example, a proposed formula is:

$$25\% \times \text{total retail sales of CMG Titles} = \text{Audit Sample } \{1\}$$

$$\text{Total Retail Sales of CMG Titles} = \text{XXX}$$

- d. If, during the audited quarter, specific concerns are raised regarding stores not within the sample selection, these stores will be added immediately. The wholesaler should be able to track 100% of all stores and provide specific store data for specified recap reports as outlined by CMG.

The audit sampling process should be randomly generated through a computer algorithm that statistically covers sample rotation based on materiality parameters. CMG recommends that the generation of the sample selection be performed by the publisher / national distributor. At this point, the sample selection will be forwarded to the Wholesale Distributor who will perform the actual cover count related to this sample of stores. This ensures that the sample size and location remains independent.

Sampling will be based on store sales volume, demographics, and length of time a store has been operating under an SBT relationship. This information will be required from the wholesaler or retailer as we determine the stores to audit.

Audit Description / Procedures:

I. Monthly Shrink Audit / Analysis

CMG will be responsible for performing the audit reconciliation for the sample set of stores. Retailer and Wholesale Distributor agree to provide appropriate data feeds (daily / weekly or monthly) as requested by CMG. This will include, but is not limited to:

<i>Retailer</i>	<i>Distributor</i>
Store List /Authorized Titles	Store List / Account Mapping
POS Data (Daily)	POS Data (with identification of issue code / daily) Order Regulation Data

Files can be transmitted as a flat file, spreadsheet or ANSI standard documents; however, file format should be adhered too. Please contact CMG Helpdesk for these file formats (cmghelpdesk@i-cmg.com) or see Attachment III.

CMG will create and make available these audit reports (by title) through EDGE (CMG's web-based reporting system). The point of sale data will be compared to the net sale of the order regulation data to determine Shrink levels as a percentage of sales. A monthly report will be produced reconciling issues that were off-sale 90 - 120 days from prior. In other words, all returns for sample selection should be returned, processed and data transmitted within 90 - 120 days from off-sale. In reviewing this report monthly, auditor should investigate all material or unusual results considering:

- All issues with a Shrink % of draw exceeding or below (+ / -) agreed upon percentages.
- Completeness of title store list / title file.

In reviewing this data, Distributor and Retailer will provide immediate response to questions raised on audit findings.

II. Weekly Sales Trends

In addition to the above audit report, we will review and monitor weekly sales trends such as:

- Sale Trends at Store Level
- Sale Trends Summarized Across Chain by Issue

III. Quarterly or On Demand Field Audits

CMG's Wholesale Compliance Team (Field Auditors) will perform site audits of SBT accounts on a periodic basis. These visits will be determined based on:

- Materiality
- Significant Events at Retailer or Distributor (e.g., system conversion)
- Monthly Shrink Analysis / Audit Results
- Prior Site Audit Findings

Site Audits will include reviewing the 3rd party audit report, gaining an understanding of the internal control structure and performing detailed audit tests (including observation) of critical internal controls.

Protocol Agreement Regarding Shrink Charge-back

As inferred in CMG's SBT Position Statement, CMG could enter into a direct financial arrangement with some retailer(s) for SBT accounts. Under this plan, the wholesale distributor could potentially be paid under a service fee program. In regards to the protocol for handling the Shrink charge- back, CMG will discuss protocol details directly with each Retailer. However, in general, the following would be expected:

- a.) CMG, Retailer and Wholesale Distributor agree on protocol that includes an acceptable tolerance level and allocation for Shrink.
- b.) The estimated Shrink allowance will be re-evaluated quarterly, based on average Shrink analysis from the monthly audits and adjusted accordingly.
- c.) If, during a given month's audit, average Shrink levels go above the acceptable tolerance level, an emergency response team ("ERT") will be called to action to identify causes and implement fixes within a given month.
- d.) Where Shrink averages have been greater than acceptable tolerance levels for months following ERT call to action; CMG, Retailer and Distributor will settle charge back, as appropriate.