

AUDIT SURVEY - ASSOCIATED FILM PROMOTIONS

This report summarizes the results of our review of the Company's movie placement relationship with Associated Film Promotions (AFP). This audit was requested by Mr. N. V. Domantay, Vice President Brand Management and Mr. J. M. Coleman, Manager Media Services. Principle audit objectives included: (1) review of current and past contractual agreements, (2) review of Company internal control systems, and (3) review of performance of AFP.

Background

B&W entered into an agreement in July, 1979, whereby AFP agreed to attempt to place B&W advertising and products in selected new movie productions. Under the current agreement (1/1/83), B&W pays a retainer fee of \$30,000 quarterly for this service (quarterly fees were \$12,500 in 1979 and 1980, \$13,125 in 1981 and \$15,125 in 1982). According to this agreement, B&W is not guaranteed a specific minimum number of placements for this fee although AFP is to use its best efforts to present to B&W as many appropriate placement opportunities as possible. B&W has also made payments to AFP over the last several years for special movie placements. The difference between a regular placement and a special placement is that a special placement involves payments by AFP to various personnel involved in the movie production and implicitly B&W's exposure in the motion picture should be more prevalent and/or more prominent. B&W payments to AFP since the inception of the contract have totaled \$687,500 for special placements and \$278,000 in retainers.

AFP also provides services for B&W with regard to our Plitt Theaters, Inc. (Plitt) contract (Plitt runs B&W commercial messages in theaters they operate). AFP is responsible for delivering copies of B&W's commercials to Plitt's theaters and for monitoring the Plitt agreement. B&W payments to AFP for their Plitt work have totaled \$300,000. In addition, B&W paid AFP \$204,000 in August, 1983, in order to cancel the future commission payments AFP would have been entitled to based on an oral commitment associated with the B&W-Screenvision agreement. (Screenvision runs B&W commercial messages in theaters they have under contract.) B&W had an agreement with AFP to pay a 3% media fee to AFP for their services in monitoring Screenvision's performance under that agreement (this would amount to about \$250,000/year as long as we used Screenvision). However, according to Mr. Domantay, it was later determined by B&W that this function could be performed by C&W and that the use of AFP was superfluous; thus, a one-time buy out was negotiated with AFP.

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Special Motion Picture Placements

B&W has made payments to AFP for the following special placements:

<u>Date</u>	<u>Movie</u>	<u>Amount</u>
8/81 & 3/82	Tempest	\$ 70,000 (1)
4/82	Shaker Run	5,000
4/82	Blue Skies Again	7,500
7/82	Smokey & Bandit III	10,000
8/82	Never Say Never Again	20,000
1/83	Harry & Son	100,000 (2)
3/83	Tank	25,000 (2)
3/83	Where the Boys Are	100,000 (2)
4/83	Killing Ground	50,000 (2)
6/83 & 8/83	Sylvester Stallone (5 movies)	<u>300,000</u> (2), (3), & (4)
	Total	<u>\$687,500</u>

- (1) B&W was to receive a bonus placement in Traces for this payment.
- (2) Not yet released.
- (3) B&W owes AFP an additional \$200,000 for the Sylvester Stallone movies.
- (4) It is our understanding that the Marketing Department is pursuing the possibility of having AFP obtain life and disability insurance on Mr. Stallone in order to protect B&W's position in the matter. We support this as an additional control measure.

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During a field visit we were informed by AFP personnel that AFP keeps two sets of books for its movie placement activities. One set of books is for their daily operations (commissions earned and ordinary business expenses) and the "second set of books" is for all their special movie placements (e.g., the Sylvester Stallone movies).

Mr. Robert Kovoloff, President of AFP, and Mr. James Ripslinger, Senior Vice-President, are primarily in charge of operations. They told us the following concerning the monies involved with the special placements:

- (1) They are the only two individuals at AFP who know that a "second set of books" exists.
- (2) AFP does not profit from the special placements. They act only as "middlemen" between B&W and the movie studios.
- (3) AFP distributes payments based upon the instructions of the movie producer.
- (4) The producers normally do not want payments in the form of checks to individuals. They prefer cash, jewelry, cars, etc.

It should be noted that this "second set of books" appeared to have been prepared solely for the auditor's visit.

The current contract states that "AFP shall perform for B&W...such services as B&W may from time to time authorize with respect to...(2) the placement of specified B&W products and/or related items and materials in feature motion picture films." B&W pays AFP \$30,000 quarterly for this service. According to AFP personnel, AFP does not make any commission on the special placements; therefore, we consider the special placements (as well as the regular placements) to be covered by this agreement in the absence of an agreement specifically relating to the special movie placement payments.

The contract between B&W and AFP also states that "AFP shall keep and maintain books and records relating to this Agreement in accordance with generally accepted accounting principles consistently applied." In our opinion, AFP violates this contract provision by keeping two sets of books although the "second set of books" is

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purportedly only for special placements. The contract also stated that "AFP shall use its best efforts to reduce its agreements with third parties to writing...." We found no evidence that AFP is following this provision of the contract (e.g., we were informed that there is nothing in writing between AFP and the movie producers describing how and for what duration B&W products and advertising will be used in the special movie placements contracted, and there is generally nothing in writing concerning the payments AFP makes to third parties). This is a control weakness.

In order to strengthen controls we recommend that AFP be required to conform to the contracted terms dealing with (1) maintaining their records according to generally accepted accounting principles, and (2) putting their agreements with third parties into writing. We further recommend that AFP be required to make all payments (for money B&W pays AFP for special placements) by check to the movie's producer. (The check AFP writes to the movie producer should be for the same amount that AFP receives from B&W).

Mr. Domantay stated that implementing these controls would not be possible if we plan to utilize this form of media. He stated that he believed that the additional controls he agreed to implement in the section of this report titled "Internal Controls at B&W" would be sufficient to control special placements.

Regular Motion Picture Placements

Addendum No. 1 - Section 1.2 of the contract between AFP and B&W specifies procedures to be followed by B&W and AFP for the placement of B&W products and advertising in movies (see Exhibit I, attached). These procedures were not being followed by either AFP or B&W. B&W had virtually no records on file that indicated (1) which movies were made available by AFP for B&W placement; (2) which movies AFP had attempted B&W placements; and (3) which movies AFP actually had made advertising or product placements. AFP records indicate that they have attempted to make placements for B&W in over 150 movies or television shows and have succeeded in making placements in 22 movies and one television show (See Exhibit II).

We recommended that Section 1.2 - Addendum No. 1 of the contract between AFP and B&W be followed completely by both parties. Mr. Domantay agreed to implement this recommendation.

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Internal Controls at B&W

No procedures have been in place at B&W to ensure that AFP actually has been placing our products in movies. Because of this, we viewed seven movies in which AFP has indicated that they have made placements for B&W (two of which involved special payments). Our observations are as follows:

Body Heat - We observed a Kool poster on a wall in a restaurant. It appeared three times in the movie. The first time it was on screen for approximately a minute, but was blurred except for a couple of seconds. The other two times the sign was blurred. We also observed the two lead characters in the movie smoking Marlboro throughout the movie.

First Blood - We observed a Kool Lights billboard on screen for a couple of seconds. We saw a glimpse of a Raleigh billboard and a Barclay poster.

Jinxed - The top half of a Barclay pack appeared on screen momentarily.

Only When I Laugh - We observed a blurred pack of Kool on the front of a vending machine. The lead character of the show bought a pack of Marlboro from the machine. She smoked Marlboro throughout the movie.

Nine to Five - We observed no B&W products or advertising in this movie. We did see a cigarette vending machine in the movie.

Never Say Never Again (\$20,000 special payment) - We observed what appeared to be a pack of Kool Super Lights on screen for one or two seconds. The word Kool could not be seen. A pack of Winston appeared briefly in this film.

Tempest (\$70,000 special payment. The Company also was to receive a bonus placement in Traces. We were unable to obtain a copy of Traces.) - We observed what appeared to be a pack of Barclay on screen for a second. The word Barclay could not be seen. Mr. E. T. Parrack (Vice President of Brand Management when the Tempest was released) stated that Mr. Kovoloff called

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shortly after Tempest was released and told us that B&W did not receive much exposure and he promised to provide placement in two or three other movies as a "make good". Records currently available at B&W do not indicate which movies were to be utilized.

With the exception of the Sylvester Stallone movies, there is virtually nothing in writing at B&W which indicates what specifically B&W is to receive. The agreement involving the Sylvester Stallone movies only specifies that he will be smoking our products in four of the five movies and that B&W signage will be included. The agreement does not specify the length of time or frequency of which our products will appear nor does it assure that the visual clarity of the product logo will be acceptable to B&W.

Currently, AFP can call any one of at least four individuals at B&W (Senior VP Corporate Marketing, Senior VP Domestic Marketing, Vice President Brand Management, and Manager Media Services) for approval of a special movie placement. In addition, B&W currently pays 100% of the agreed amount before the movie is released. In order to strengthen internal control we recommended that multiple approvals be required for each special payment. B&W Presidential approval should be obtained for payments exceeding \$75,000. We further recommended that some part of the payment (e.g., 80%) be withheld until the movie is released and viewed by appropriate B&W personnel.

We recommended that a formal inspection system be adopted to view each movie involving either the retainer or a special payment. We recommended that a specific performance agreement be obtained from AFP for each special placement. This agreement should specify which brands, and the frequency, duration and type of placement (product, billboard, etc.) and visual clarity required. We also recommended that B&W marketing management inquire into the special placements for Never Say Never Again and Tempest and recover the payments (a total of \$90,000) or obtain "make goods" if appropriate.

Mr. Domantay agreed with all the above recommendations. In addition he stated that as an additional control measure the Marketing Department would begin budgeting this form of advertising as a separate line item in the Advertising Media budget.

Exclusivity Clause in Contract

The contract between AFP and B&W states that "AFP shall not perform any service...in connection with any tobacco product not manufactured

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or distributed by B&W without first obtaining B&W's consent." We noted a magazine article quoting Mr. Kovoloff as stating that he represented five cigarette manufacturers.

We recommended that Marketing management verify with AFP that they are not representing any other tobacco companies besides B&W.

Mr. Domantay stated that he talked with Mr. Kovoloff concerning this matter and Mr. Kovoloff stated that B&W was his only client in the tobacco industry. Mr. Kovoloff said he was simply trying to confuse the magazine reporter so she could not find out who his client was in the tobacco industry.

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D. L. CHAVERS
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EXHIBIT I

1.2 Placement of Product, etc. in Motion Picture

A. Beginning January 1, 1983, AFP shall perform the following services for B&W:

1. AFP shall, from time to time, (1) inform B&W of the availability of upcoming feature motion pictures which present opportunities for B&W's cigarettes, other tobacco products and/or related items and materials to appear in the film thereof as part of the scripted action, and (2) furnish to B&W information, including, but not limited to, the following concerning each such feature motion picture:
 - (a) Title of motion picture
 - (b) Name of production company
 - (c) Names of Producer and Director
 - (d) Names of principal actors/actresses
 - (e) Outline of the subject of the motion picture
 - (f) Brief statement of how B&W's products and/or related items and materials may be used in the motion picture
 - (g) Anticipated rating of the motion picture, i.e., "G", "R", etc.
2. Once B&W, based on the information supplied by AFP pursuant to Paragraph 1.2(A)1, has authorized AFP to explore placement opportunities in a particular motion picture, AFP shall do so and, as soon as possible thereafter, furnish B&W a synopsis of the motion picture, a list of the cast, and a list of the placement opportunities available in the motion picture film.
3. Although AFP is not required to present a specific minimum number of placement opportunities to B&W, AFP shall use its best efforts to present to B&W as many appropriate motion picture film placement opportunities as possible during the term of the Agreement.
4. Once B&W has approved a placement opportunity, AFP shall arrange for the placement(s) authorized by B&W. Once the placement(s) appear in the released version of the motion picture film, AFP shall provide to B&W a statement confirming that fact.

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EXHIBIT I

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- B. B&W will review the information provided by AFP pursuant to Paragraph 1.2(A)1 and, if it is interested in having AFP explore placement opportunities in one or more of the motion pictures involved, will notify AFP of the motion pictures B&W is interested in and of the B&W brands which B&W would like to have placed in each motion picture. After reviewing the information provided by AFP pursuant to Paragraph 1.2(A)2, B&W shall promptly notify AFP of those placement opportunities that meet its approval and supply at no cost to AFP all necessary product and related items or materials.

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EXHIBIT II

Movies

1. Cheaper to Keep Her
2. Honky Tonk Freeway
3. Nine to Five
4. Wacko
5. Night People (All Night Long)
6. Body Heat
7. Body & Soul
8. All the Marbles
9. Kill & Kill Again
10. Two for the Price of One
11. Only When I Laugh
12. Making Love
13. Sharkey's Machine
14. The Entity
15. Jinxed
16. First Blood
17. Love Child
18. Blue Skies Again
19. Star Chamber
20. Private School
21. Summertime
22. Savannah Smiles

Television Show

The A Team

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