

“Worried that your licence agreements are not performing as they should?”

Intellectual Property – Asking the right questions

RSM! Bentley Jennison

With ten years experience in performing royalty audits of licence agreements we have recognised that licence holders could benefit from a diagnostic tool to help them evaluate the risk factors they face. It would give licence holders a significant advantage, if they could more easily assess whether or not a licence agreement merits closer monitoring, a self audit or a royalty audit performed by outside auditors.

Most of the licence audits we are retained to perform occur because the licensor is reacting to a variety of circumstances caused by the licensees – for example, late payments, no payments or incomplete reporting. Our objective was to provide licensors with a solution which would enable them to be proactive in identifying agreement issues rather than reacting to warning signs. The result is a ‘checklist’ which can easily be applied. The checklist is a series of questions relating to the licensee, the responses to the questions generate a numerical value and cumulative score. The risk factor is then graded according to the score total.

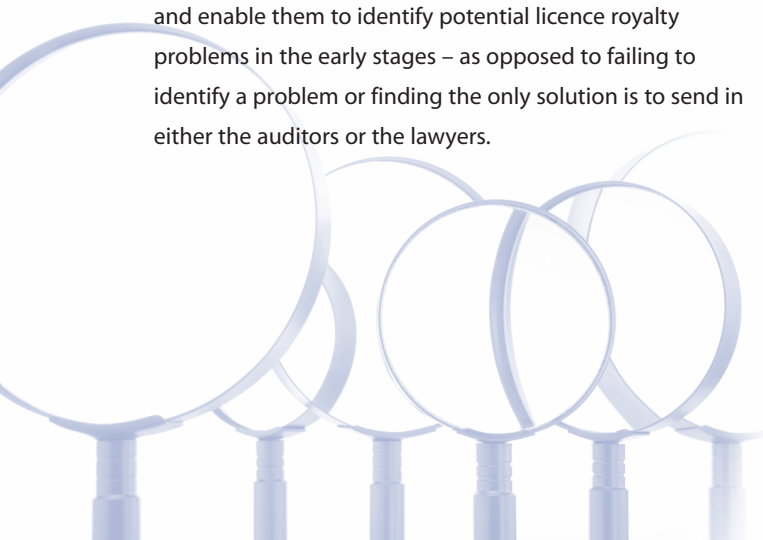
The checklist is a powerful tool to help licensors perform their fiduciary responsibility to their university or company and enable them to identify potential licence royalty problems in the early stages – as opposed to failing to identify a problem or finding the only solution is to send in either the auditors or the lawyers.

A tested solution

During development of the checklist we asked clients to test its validity against several of the licence agreements we had previously audited on their behalf. They found that, after applying the questions to the specific agreements, the numerical values of the answers indicated that the risk factor of the particular agreement justified the audit.

The checklist questions that most often generate the highest numerical values are:

- *Does your licensee remit its royalty payments on time?*
- *Does your licensee include a detailed supporting schedule with its payment?*
- *Is the royalty this period within plus or minus 5% of the last reporting period or the same period a year ago?*
- *Does the royalty calculation include a complex formula?* ►



Positive Results

In an audit, where the checklist had indicated a high risk factor, the licensee's sales subject to royalty were always being reduced by the maximum allowable percentage for the issue of sample products. On investigation, we found that samples were not included in the reported gross units sold and that the subtraction for issue of samples incorrectly reduced actual sales of licensed products.

The understatement of royalties was in excess of £0.75 million.

There was also a royalty audit where the reported sales by the various licensees did not ring true in terms of the licensor's understanding of the market for the licensed technology. In performing audits of the seven most significant licensees we recovered in excess of £2.5 million in additional royalties. In one case, the licensee reduced its actual sales to end-users as if the sale had been made at distributor prices. In yet other case, sales of licensed products in the licensed territory were erroneously omitted.

A proactive approach

When used as part of a semi-annual or annual review of a licence agreement the checklist can highlight the risk factors which have the potential to negatively impact royalty revenue.

Our specialist team can help licensors to be pro-active in reviewing their licensees, achieve effective results and uncover the risk inherent within any given licensee. In addition the vast majority of our royalty audits produce recoveries far in excess of the cost of performing for the services.

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