

# Intellectual Property Licence Auditing

Raja Sengupta

## Standard Operations – Protecting the licence values through Audit

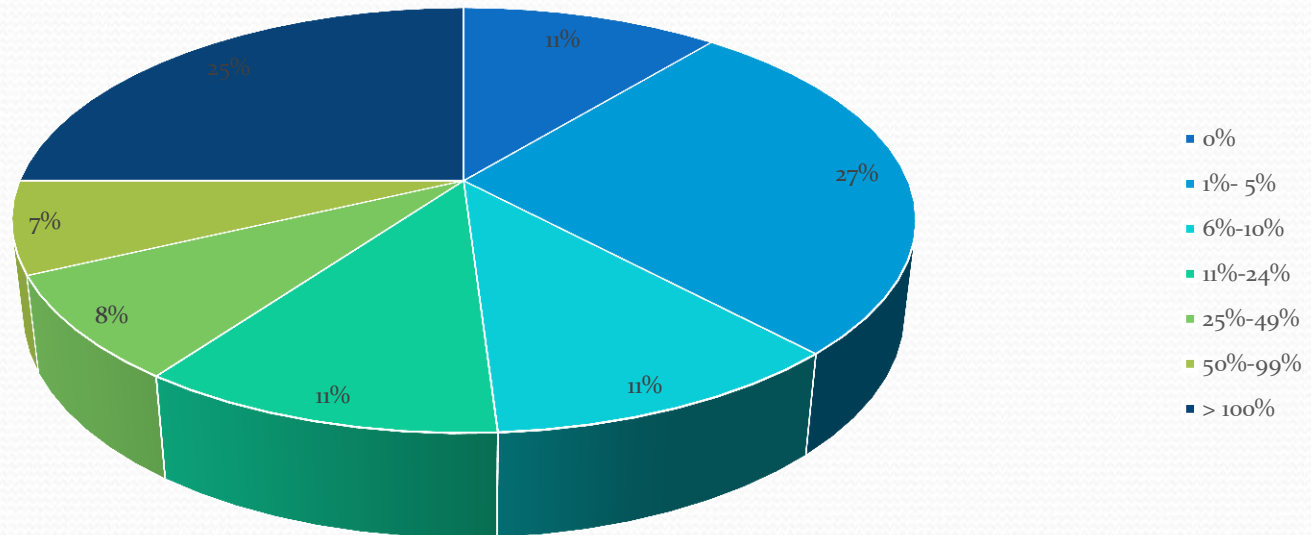
- The audit deterrent – Needed?
- Disrupting the status quo
- Consequences of not undertaking audits?
- What is a standard operational audit

## Audit findings – proportion of Licensees who have underpaid

- Audited Licensees underpaying and in what proportion?

© Invotex IP, USA

Under reporting Levels



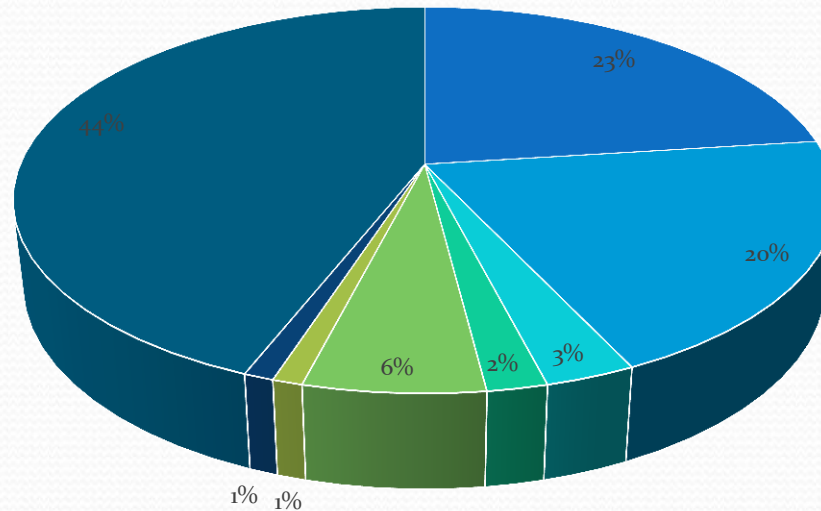


## Issues that are the causes of the shortfall

- Audit discovery – causes of royalty shortfall

© Invotex IP, USA

Nature and associated proportions creating under reporting



- Under reported Sales
- Disallowable deductions
- Royalty rate errors
- Mathematical errors
- Sub licensee matters
- Milestone payment
- Transfer pricing
- Licence interpretation

## Standard operational Audits

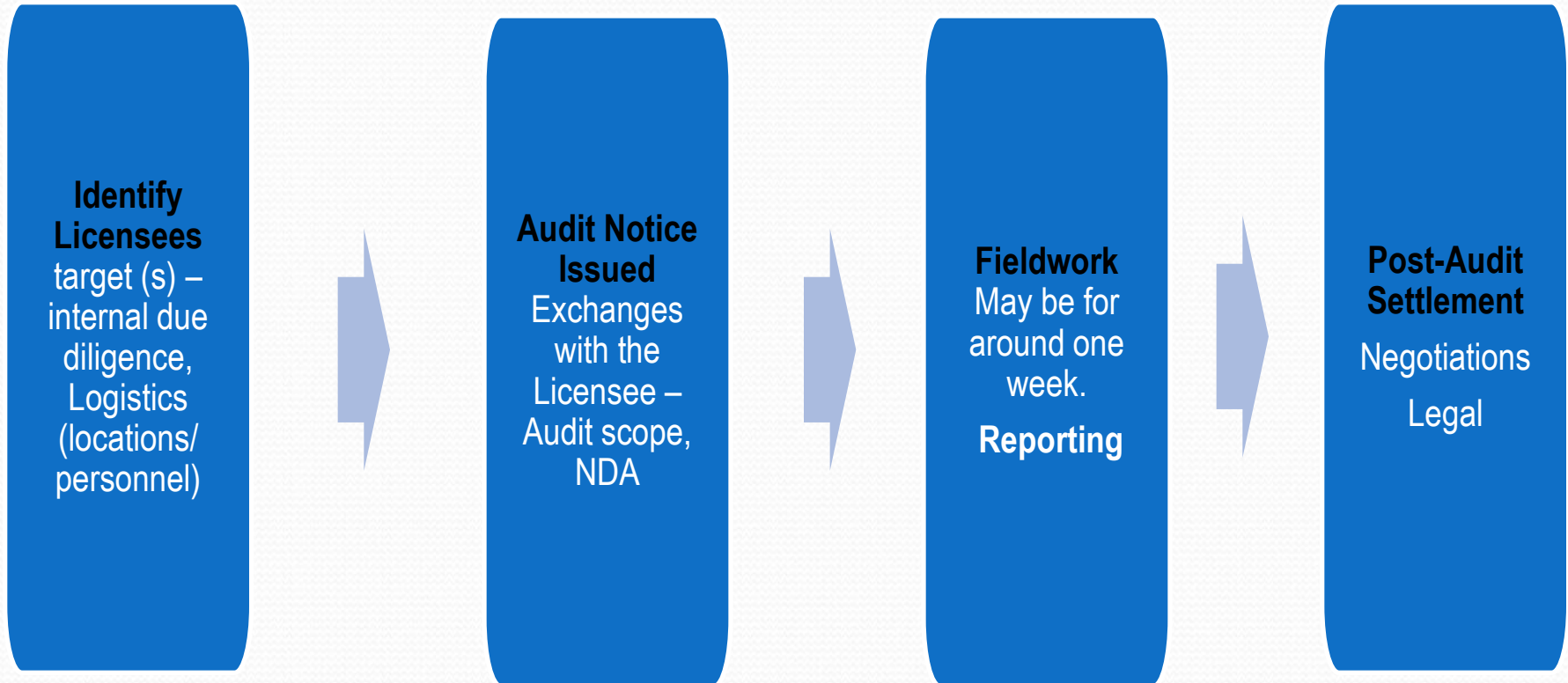
- Getting assurance on a consistent basis – Royalty income accuracy
- Understanding your portfolio – risk assessments – Audit targets
- Targeting licensees:
  - Value of running royalties and potential loss – early audits?
  - Exceptional audits – specific risks and red flags
  - Audit time limits
  - Complex group structures – intergroup transactions
  - Complex licences
  - Licensee risk – a number of facets
  - Product risks – High tech or other short life span products
  - Strategy for random selection



## Planning for the audit

- Background:
  - Importance of continued communications with The Licensee
  - Understanding Licensee operations – manufacture and sale of licensed products
- Audit targets
  - Communications – Audits are part of the standard business practices;
  - If appropriate audit programs of > 1 licensee – “not singled out”
  - Not a question of trust – Commercial entities are regularly audited
- Audit preparations
  - Licence Agreements and amendments
  - Royalty returns, calculations
  - Relevant correspondence – any aspect on Royalty calculations, definitions
  - Sub licences and rights to review their reports and returns
  - IP covered by the agreement – can be simple or complex
  - Contentious legal aspects – definitions
  - Internal and External information – Due diligence, SEC reports
- Licensor discussions – Timing, resources and costs

## The Audit process



Varying time lines from start to end – may range from Three – Six Months and in some instances over one/ two years.



## The audit process – risks and benefits

- Financial
  - Returns over four years - \$200K, \$1.8M, \$3M, \$13M.
  - Does not quantify effect on future revenues
- Commercial
  - Relationship issues – positive and negative
  - Legal aspects – Courts attitude to passive managers
- Time and resource
  - An effective audit will need dedicated internal time
- External and other costs
  - External auditors costs, legal or technology opinions
  - Travel costs to negotiate settlements



## What are the Licensor options

### 1. Do Nothing

- My boss will never notice - No time & resource;
- This is not a high profile activity;
- We don't know if anything is really being lost;
- Our information is very confidential - cannot discuss.
- Our relationship is more important.

### 2. Follow a reactive policy

- If something comes to my attention I'll deal with it.

### 3. Follow action plan

- Effective Licensee management
- Systematically seek assurance that obligations are reported and paid

## Conclusions

- All assets require maintenance
- Licensees will underpay
- Post-licence management is a low effort high added value function
- A strategy for licence management
  - Protects the licensed portfolio
  - Providing assurance and transparency
- If you sit on your rights you will lose them

# Intellectual Property Licence Auditing