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Transforming Ideas into Opportunities


Risky Business:
Why a Royalty Risk Assessment and Compliance Program Makes Cents

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With you today




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Learning Objectives

- Discuss strategies to ensure the accuracy of current and future royalty payments from licensees.
- Identify current and future financial risks to universities and research institutions within its expanding portfolio of royalty entitlements.
- Develop a plan for an ongoing royalty compliance monitoring process.



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What is a risk assessment and why is it important?



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Third-Party Licensee Relationship Management (TPRM) Lifecycle

Most organizations are **REACTIVE** to problems instead of **PROACTIVE** to risks.

- Many organizations believe that the due diligence prior to contracts being signed is sufficient to mitigate risk. Often times, no further assessments are done until problems appear with the third parties.
- Your licensees provide specialization and expertise that is invaluable to commercializing your intellectual property. Their success is your success.
- Effective relationships begin long before negotiation discussions and contracts are signed, and continue for long after contract execution.

Post-contract compliance monitoring is an **vital part** of third-party licensee relationship management as a whole.



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Why is royalty risk a key consideration?

- Royalty agreements **trust your licensee to self-report** in accordance with the terms of the agreement(s).
- It's your **fiduciary responsibility** to ensure stakeholders are receiving complete and accurate royalties and to protect your intellectual property.
- Not identifying and mitigating risks can lead to **revenue loss and/or patent infringement**.
- Chances are, your license agreement **portfolio is diverse** and includes license agreements in different stages of commercialization across various industries.
 - How do you determine where and how to spend your limited resources (people, time, money)?
 - Which licensees or agreements need more of your time? What are the right areas of focus for optimal time-value return on your investment?

A royalty risk assessment provides a structure and framework to evaluate your portfolio and develop a unique plan to monitor your university's royalty risk.



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Value and benefits of a royalty risk assessment

A risk assessment will help your technology transfer office identify, measure and monitor key risk areas in your license portfolio through **a process of discovery and assessment**. The results of the risk assessment helps your office to focus in on present-day compliance, but will also help you anticipate potential issues in the future.



Enable Strategies to Support your Mission—Develop a contract compliance strategy that aligns first, second and third lines of defense to understand potential risks and create solutions that support your mission, vision and values.



Educate Key Stakeholders—Educate your stakeholders on risk trends that affect your TTO to improve decision making and increase the effectiveness of your resource allocations.



Gain 360° View of Your Portfolio—Develop an understanding of your licensee, including start-up companies, established commercialized licenses, and agreements nearing termination/patent expiration across all industries, enabling your office to have constructive conversations with, and reporting to, key stakeholders.



Risk Transformation—Develop a risk-based compliance monitoring plan that helps you better anticipate and identify potential issues, prioritize certain third parties, and ultimately reduce the burden of compliance activities, while increasing revenue streams.



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Royalty risk assessment objectives



- ✓ Develop a greater understanding of risk and its importance to the university's strategic objectives.
- ✓ Enhance accountability and responsibility by embedding risk management in the technology transfer office's culture.
- ✓ Obtain better control over unanticipated issues and potential revenue leakage by implementing internal compliance monitoring techniques to mitigate risk.



How do you conduct a risk assessment?



Royalty risk assessment process



- ✓ Risk assessments are **SCALABLE** and **FLEXIBLE**—there is no “one size fits all” approach.
- ✓ It can be as formal—or informal—as your university needs, depending on your portfolio and objectives.



Royalty risk assessment process

Develop an approach that makes sense for your university

- Identify project sponsors, team, and other stakeholders to be involved in the process
- Define your strategic objectives for the risk assessment
- Establish and define risk factors, risk appetite, measures/scales
- Determine approach to collecting data (e.g., questionnaires, facilitated sessions, one-on-one interviews, etc.)
- Identify the population of royalty agreements and which agreements in your portfolio will be part of the risk assessment process.

Which agreements to include in your risk assessment is unique to your university and agreement portfolio. Potential decision-making criteria may include:

- quantitative-based: significance of annual revenue received (i.e. select all agreements with royalties that exceed certain dollar annually)
- qualitative-based: determination based on history, relationship or other known issues/factors



Royalty risk assessment process

Identify and measure risk

- Develop impact and likelihood criteria
- Collect and catalogue risk data for each agreement using predetermined techniques and factors
 - Conduct surveys/questionnaires, targeted interviews, workshops or voting sessions
 - Utilize internal and external data available to discuss and assign risk to each agreement
 - Depending on data collected, determine if other techniques should be deployed



Example risk assessment scorecard

Each agreement is structured differently and, based on the type of agreement and the licensee, various potential red flags (i.e., risk factors) exist. The example scorecard shows example risk factors for a royalty license agreement.

- A risk-based scorecard can be customized for types of licensees.
 - Your risk factors for pre-revenue start-ups may be different than risk factors for established, multinational organizations.
 - Risk factors can also be customized based on industry-specific agreement risks (i.e., pharma considerations for chargebacks, software considerations for licensed users, etc.).
- Use various sources and approaches to measure risk:
 - Internal/objective data - utilize internal data available from your systems and/or historic royalty reports (changes in sales volumes reported and associated royalties, payment frequency and dates, etc.), length of the relationship/license agreement, patent expiration timeline, etc.
 - Observational/subjective data - length of the relationship, quality of the relationship with the licensee (i.e., is the licensee responsive to questions), is there high-turnover in the licensee's staff, etc.
 - External data – industry/product trends, negative news analysis, better business bureau data, matches to government watch lists, etc.

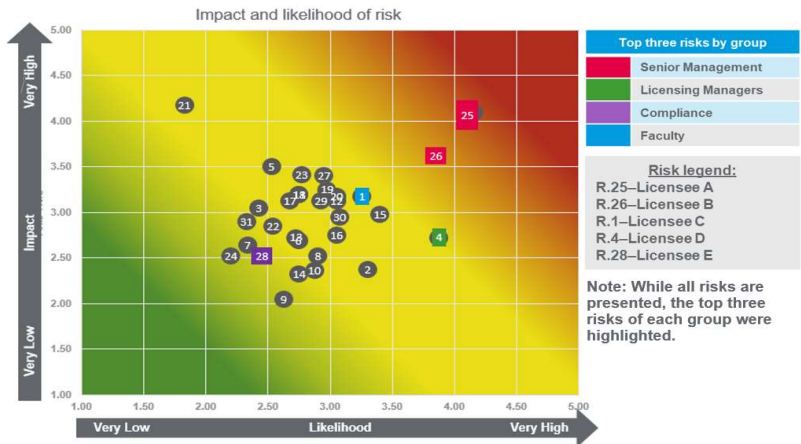


License Agreement Scores		
Risk Factors	0	Score 5
Agreement complexity	2.2	
Significance of agreement to the organization	4.0	
Number of third-parties involved	1.0	
Changes in key third-party personnel	1.5	
Changes in third-party accounting systems	3.2	
Performance compared to industry/market conditions	3.0	
Changes in agreement terms	4.7	
Timeliness of compliance by third-party	2.7	
Lack of compliance by third-party	2.0	
Mergers and acquisitions related to the third-party	1.0	
New products or activities related to the third-party agreement	4.0	

Royalty risk assessment process

Prioritize risks

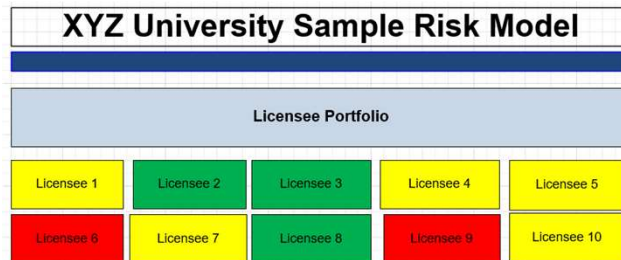
- Evaluate each risk using predetermined criteria.
- Develop a prioritized list of the top risks and riskiest agreements and/or licensees.
- Determine whether additional criteria will be utilized to prioritize risks.



Royalty risk assessment process

Ratify the risk assessment

- Summarize risk results by licensee/agreement
- Validate the risk assessment results with key stakeholders (i.e., licensing managers, legal department, inventors, etc.)
- Establish accountability for key risks/licensees by assigning license managers/owners and monitoring protocols depending on the risk level






Now what?
Internal monitoring
and external royalty audit
considerations



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Internal monitoring considerations

Depending on the risk ratings assigned to each licensee, there may be additional risk mitigation activities that you can perform internally to provide oversight and reduce risk, including:

- Periodic **internal touchpoints** to discuss status and changes with agreements/licensees
- **Agreement calendar** to track due dates and receipts (system opportunity)

For **riskier licensees**, oversight activities may include:

- An abstract of the **key terms and conditions** for each agreement (system opportunity) to use as a reference to review the payments/invoices as they are received
- **Trend analysis** for each agreement to identify significant increases/decreases in prices, sales, rebates, expenses, etc. over the course of the agreement (system opportunity)
- Processes/budget to **conduct internal or external audits**, as needed.
- Track **amendment considerations** for future use

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External royalty audits: process and approach



- Develop a project plan (scope, schedule, budget, etc.) to align expectations with all parties. As part of this, define the key audit procedures to perform and identify the critical areas
- Establish a communication plan to define the preferred method and frequency of communications throughout the audits
- Gain a thorough understanding of the processes and existing relationship of each of the third parties examined
- Issue document request to the third party and complete planning activities based on initial information received
- Test compliance with the underlying agreement through review of supporting source documents and completion of analytical procedures
- Monitor performance relative to the project plan; routinely communicate status
- Analyze potential monetary exceptions and quantify impact
- Discuss initial findings and potential recommendations with you and the third party
- Draft report and related findings and recommendations
- Deliver insights to management and collaborate on the development of practical corrective action plans, as appropriate

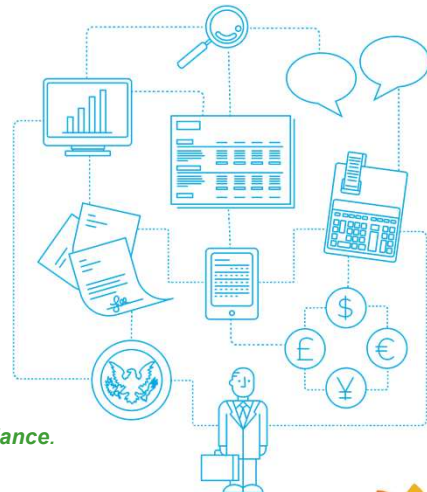
Audits should have a flexible and responsive approach to match your diverse third party reporting environments.



Common audit issues

- Clerical errors/cell formula errors
- Inconsistent/incorrect agreement interpretation
- Unreported sales or payments by foreign locations
- Over-reported deductions such as rebates, chargebacks and discounts
- Over-reported cost of goods sold
- Transfer pricing issues
- Unreconciled accounting accruals or adjustments
- Unallowable deductions/expenses passed through
- Products recorded in incorrect category
- New products/services not reported
- Noncompliance with termination clauses (sell-off periods, etc.)

Over 75 % of contract compliance audits uncover monetary non-compliance.



QUESTIONS?

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