CASE STUDY: LARGE UNIVERSITY

Royalty review reveals more than $1 million in lost revenue for university

Overview

Our client is a large university that developed and licensed patents for vaccine technology for animal diseases.

Background

The university patented certain vaccine technologies, and entered a license agreement with a large multibillion dollar pharmaceutical company to commercialize the product. In exchange for licensing the technology, the university receives royalties on commercial products sold that incorporate the patent technology. The university previously engaged RSM to audit the licensee on two prior occasions, with RSM successfully identifying that the licensee had underpaid royalties.

Project

Based on the amount of royalties received and the success of past royalty audits with the licensee, the university chose RSM to perform another royalty investigation. The licensee had not been reviewed in several years, and the university, based on the previous audits, felt it was appropriate to audit it again for compliance with the license agreement, as it related to sales in the United States.

The license agreement stated that royalties were to be paid on net sales of licensed products (i.e., gross sales less certain allowable deductions). The contract dictated that deductions must be made based on actual amounts. During the inspection, the RSM team found that for certain costs, the licensee used estimated costs instead of actual amounts incurred. The licensee never reconciled, and adjusted the estimated costs to the actual costs. RSM quantified the actual costs, which were less than the deduction the licensee had been taking, resulting in an underpayment of royalties.
RSM also discovered significant sales of two products that utilized the licensed technology, which were not included in the royalty reports. Additionally, RSM determined the licensee was not including licensed product sales of their sublicensees in the sales amounts presented to the university.

RSM’s cumulative findings of underreported royalties from U.S. sales over a five-year period exceeded $1 million. A provision in the agreement allows for the cost of the audit to be transferred to the licensee if the audit identifies underreporting of royalties that exceed a certain percentage threshold. As the cumulative findings exceeded the threshold, the university was able to pass the cost of the audit to the licensee.

Outcomes

RSM identified underpayment of royalties totaling more than $1 million. The team’s findings included shipping calculation errors, omitted products and flawed sublicensing processes. In addition to the underpaid royalties, the client discussed findings with the licensee, in an effort to implement new practices for future compliance.

The benefits to our client included:

- Discovery of significant underpayment of royalties over a five-year period, with a recovery in excess of more than $1 million, in addition to late payment penalties and interest
- Transfer of the cost of RSM’s work from our client to the licensee, after reaching a royalty underreporting threshold in the contract
- Identification of future revenue streams from additional royalty-bearing products