



Royalty Accounting and Contract Compliance Issues to Consider in a Merchandise Licensing Program

By Lewis Stark, EisnerAmper LLP

Licensors should “protect the professional skepticism of your personnel. Separate your royalty audit/settlement function from business relations and sales.”

The concepts behind a proper royalty accounting and contract compliance program might seem to be complex and arcane. However, no matter how technical royalty and contractual obligations may be, there are a number of straightforward actions that both licensors and licensees should consider and take to better understand their contractual obligations. Doing so will place them in a better position to properly adhere to the agreements and protect their rights and properties.

For licensors: Know as much as you can about your licensees. It is important to ensure that any potential licensee’s business processes (their sales/discounting and allowance model and accounting and royalty systems) are structured in a way that enables them to adhere to the financial provisions of your license.

Obtain this information and write a license with well-defined and clearly stated financial provisions that are tailored to your licensee’s business environment. This will enhance your licensee’s ability to comply with such provisions resulting in more accurate royalty accountings. Countless times I have heard licensees comment that their sales, discounting and allowance requirements are not in sync with their reporting obligations. This results in royalty disputes that can become costly.

Stand up for your rights! Be proactive in protecting your properties. The key is: “Trust but Verify.” Monitor your licensee’s products in the marketplace; compare your licensee’s royalty accountings to product approval files to identify both unreported products and sales of unapproved products and maintain a royalty compliance program. If you remain silent, the marketplace may take advantage. We have seen 10 to 25 percent royalty increases for established

licensors after starting a licensing compliance program.

Protect the professional skepticism of your personnel. Separate your royalty audit/audit settlement function from business relations and sales personnel. We have been in settlement negotiations where close relationships have actually hindered the resolution process.

For licensors and licensees: Put it in writing. License agreements are often amended verbally but all amendments need to be documented in writing. It is commonplace to find that small requests are not documented when the use of a simple confirming email could suffice. Verbal agreements will not be enforceable if there ever is a dispute. Personnel change; your “verbal understanding” with someone who has since left the company may be of no value and could become costly. Document all changes to your license agreements.

We had a situation where a licensee purportedly received a verbal waiver to discount a product beyond contractual limitations and to sell the product outside of the licensed channels. Because the licensee could not document the waiver and the license had subsequently been acquired by another entity, the licensee ended up having to make good on the contractual deficiency.

For licensees: Enter into agreements that make sense financially. There’s real risk in assuming you can change or circumvent the rules after the game has started. Similarly, have a thorough understanding of the financial provisions and be sure your understanding matches that of the licensor. Being on the same page helps avoid incurring unexpected royalty costs.

We have been involved in situations where the licensee reported royalties

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based on his business model and not the agreement, resulting in large royalty underpayments. Their argument that the agreement did not consider the characteristics of their business did not resolve the dispute and proved costly.

Build a reputation for rendering accurate and transparent royalty statements. You'll be surprised at how this can build your standing and become, in the long run, a competitive advantage.

Take advantage of the tools at your disposal. Explore the functionality of various brand licensing software packages. Implement a package that fits your model and/or the reporting requirements of your largest licensors. This will enhance your ability to monitor minimum guarantees, deadlines and milestones and to report accurately. Another benefit is to create an archive of accounting records to support your royalty accountings for royalty periods, subject to audit, that can extend over many years.

The Bottom Line for both licensors and licensees: Create systems, processes and procedures to enable you to understand, adhere to and monitor your license obligations. Clear and unambiguous licenses, coupled with honest, straightforward dealing, go a long way toward mitigating costly problems and ruined relationships down the road.

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High Point Furniture Market (U.S.)

4/2/11 to 4/7/11

International Home Furnishings Center - High Point, NC
www.highpointmarket.org

Playcon

5/4/11 to 5/6/11

Hyatt Regency Scottsdale at Gainey Ranch - Scottsdale, AZ US
www.toyassociation.org

LIMA San Francisco Spring Networking

4/5/11

ROE Restaurant - San Francisco, CA (U.S.)
www.licensing.org/events/view/599/

License India Marketing Conclave

5/6/11

Tivoli - New Delhi, India
www.licenseindia.com

LIMA Chicago Spring Networking Reception

4/5/11

Mike Ditka's Chicago - Boardroom - Chicago, IL (U.S.)
www.licensing.org/events/view/605/

LIMA Licensing Essentials/Spring Fling

5/12/11

Hotel Verta, Battersea, London (UK)
www.licensing.org/uk/springfling/

flip Speed Networking

4/6/11

AVVenue - New York, NY (U.S.)
www.licensing.org/events/view/596/

National Stationery Show/Surtex

05/15/11 to 5/18/11

Jacob Javits Center - New York, NY (U.S.)
www.nationalstationeryshow.com/ www.surtex.com

London Book Fair

4/11/11 to 4/13/11

Earls Court Exhibition Center - London (UK)
www.londonbookfair.co.uk

BookExpo America

5/23/11 to 5/26/11

Jacob Javits Center - New York, NY (U.S.)
www.bookexpoamerica.com

LIMA East Coast Spring Networking Reception

4/26/11

Charlie Palmer's Metrazur - New York, NY (U.S.)
www.licensing.org/events/view/606/

Licensing International Expo

6/14/11 to 6/16/11

Mandalay Bay Convention Center - Las Vegas, NV US
www.licensingexpo.com