

MEMORANDUM

TO: Michael Keneker, Associate Vice President & Controller
Andrew Dennis, Managing Director

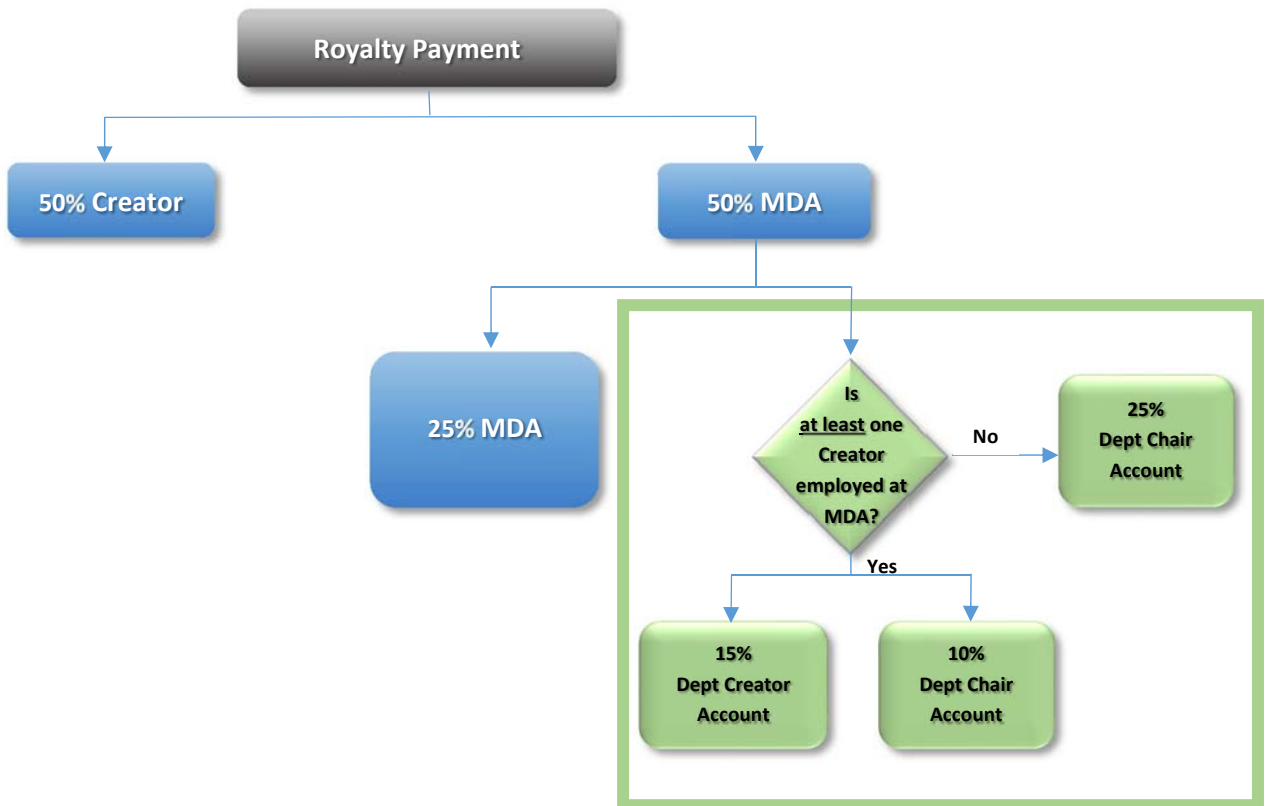
FROM: Sherri Magnus, Vice President & Chief Audit Officer *Sherri Magnus*

DATE: March 9, 2018

RE: 18-111 /18-119 Royalty Distributions - Phase II / III

BACKGROUND

Effective May 2006, the Institution's Intellectual Property Policy (ADM0345) required the distribution of royalty payments, as follows, after patent expenses have been recovered:



Scope of Internal Audit Review

Please note that this document contains information that may be confidential and/or exempt from public disclosure under the Texas Public Information Act. Before responding to requests for information or providing copies of these documents to external requestors pursuant to a Public Information Act or similar request, please contact the University of Texas MD Anderson Cancer Center Internal Audit Department.



Institutional Compliance requested that Internal Audit perform a full review of two royalty accounts for a particular Creator. We determined that this Creator’s royalty payments were not distributed according to Institutional policy. Specifically, after May 2006, the entire 25% distributed to departmental accounts was allocated to the Creator’s research account. According to Institutional policy and absent an exception in appropriate circumstances, only 15% should have been allocated to the Creator’s research account, with an additional 10% allocated to the department Chair. A memo detailing such an exception was not located during the review. This resulted in the underpayment of \$402,425 to the department Chair account for royalties related to this Creator.

The results of this initial review gave rise to questions about the distribution of all other royalty payments received after May 2006. Internal Audit began a review to ensure all royalty distributions were allocated according to policy. General Accounting currently distributes all royalty payments.

SUMMARY RESULTS

Based on our review of 80 license agreements, royalty payments have not been consistently distributed to MD Anderson departmental accounts according to policy. We identified \$7.6 million that was inappropriately allocated to creator research accounts instead of department chair accounts. Furthermore, based on the December 31, 2017 Free Balance Reports, a total of only \$5.1 million is available for reallocation to the chair accounts for the misallocations noted above.

On January 16, 2018, the President concluded that the Institution should accept responsibility for the mistake and agreed to compensate the Chair accounts for the unfunded royalty revenue during the FY 2019 budget process.

OBSERVATIONS / RECOMMENDATIONS

The recommendations below are provided to enhance internal controls surrounding the administration of royalty payments to ensure the accuracy of distributions and compliance with Institutional policy.

<p><u>Observation 1:</u> Royalty Payments Incorrectly Distributed</p>	RANKING: Medium
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Our review of royalty payments revealed that \$7.6 million was inappropriately allocated to creator research accounts by General Accounting (GA). This is comprised of the following:

- \$5.3 million was inappropriately allocated to creator research accounts based upon prior guidance from the Office of Technology Commercialization (OTC), a misinterpretation of the revised policy, and accounting error as noted below:
 - \$4.9 million was inappropriately distributed based upon prior guidance from OTC. While no exception to the policy could be located during this review, General Accounting was instructed to distribute the entire 25% to the creator’s research account, indicating that the Chair should not share in the proceeds for agreements executed prior to May 2006.

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- \$155,387 was inappropriately distributed to the creator's research account for one creator who also serves as a Department Chair. According to General Accounting, they were instructed by OTC to distribute all royalties for this Department Chair to the creator's research account, even though the agreements were effective after May 2006.
- \$265,059 was distributed by General Accounting to the creator's research account in error. We tested license agreements effective after the policy change in May 2006. Royalty payments for 22% of the agreements tested were inappropriately distributed 25% to the creator's research account versus being allocated according to policy.

On January 16, 2018, the President concluded that the Institution should accept responsibility for the mistake and agreed to compensate the Chair accounts for the unfunded royalty revenue during the FY 2019 budget process.

- \$2.3 million was inappropriately allocated to creator research accounts following the termination of all creators associated with the license agreement. It appears that all remaining funds spent in the research account following the termination of the last creator was done so under the stewardship of the Chair. Therefore, while the funds were not distributed according to policy, the Chair ultimately had the access afforded by the policy, and no additional action is necessary.

Recommendation

We recommend that processes be developed going forward to ensure royalty payments are distributed according to Institutional policy.

Management's Action Plan:

Responsible Executives: Christy Harrison and Andrew Dennis

Owner: Mike Keneker and Ferran Prat

Due Date: 03/01/2018

General Accounting and Office of Technology Commercialization have received clarification regarding the interpretation of institutional policy for royalty distributions for agreements effective prior to May 2006. Going forward, all distributions will be made according to the policy as shown in the graph in the Background section of this document unless an exception in an appropriate circumstance exists per the IP Policy.

Additionally, departments will no longer be permitted to request funds be distributed to a single chartfield string. In order to ensure departmental distributions are properly recorded, individual chartfield strings will be established for each Creator receiving funds.

Observation 2:**Portfolio Management of License Agreements****RANKING: Medium**

While OTC utilizes a technology management system to maintain license agreements, there was not sufficient coordination and oversight between OTC and General Accounting to ensure the following:

- Timely and accurate distribution of royalty payments
- Timely collection of documentation from creators necessary to initiate royalty distributions
- Modifications to royalty distributions upon termination of all creators for each agreement, as applicable

As a result, royalties have not been distributed according to policy, which potentially increases our reputational risk among the Institution's research community.

Recommendation

We recommend that oversight processes be implemented to ensure timely and accurate distribution of royalty payments in accordance with Institutional policy. In addition, we encourage management to explore additional functionalities in the current technology management system to enhance license agreement portfolio management.

Management's Action Plan:

Responsible Executives: Christy Harrison and Andrew Dennis

Owner: Mike Keneker and Ferran Prat

Due Date: 01/31/2019

General Accounting and the Office of Technology Commercialization will collaborate on the options to optimize the current OTC technology management system (Inteuml). Options to be explored currently include interfacing Inteum with PeopleSoft HCM personnel records to identify Creators who have left the institution or have been promoted, refining royalty payment calculations through the use of Inteum to ensure accuracy of distribution payments, auto-creation of journal entries associated with the accounting for royalty payments, and streamlining the interaction with Creators and M. D. Anderson's Tax Compliance and Treasury groups to ensure accurate and timely personal royalty payments.

Additionally, the general ledger transactions will be monitored on a quarterly basis to ensure that they reflect the calculations derived through Inteum.

We appreciate the courtesy and cooperation extended to us during this review.

cc: Ben Melson, Senior Vice President & Chief Financial Officer
 Ferran Prat, Senior Vice President
 Christy Harrison, Executive Director & Assistant Controller