The Intellectual Property Audit

Shanel Punnoose†
Karnataka State Law University’s Law School, Navanagar, Hubli, Karnataka 580 025, India
and
Valli Shobhana
#207, Gandhi Estate, Kalyan Nagar, Phase 3, Motinagar, Hyderabad, Andhra Pradesh 500 018, India

Received 29 June 2012

This article endeavours to elucidate on the intellectual property (IP) audit and focuses on comprehensive procedure of the same, not only from an organization’s perspective but from an auditor’s perspective as well. The article also dwells on India specific IP audits, which are tad different from the audits in developed economies, although incorporating a few steps from the standard audits would yield enhanced outcome. The second part of the article endows with the factual scenario of IP audits in India. While generation of IP has become a routine affair, the technique of its management and protection continues to remain unidentified by most businesses. Thus IP audit plays a significant role in serving the purpose of reaping benefits from the IP generated. Additionally, it plays a key role in a circumstance which involves private/public funded research. In such a research deriving profits, protecting IP generated and commercialization of the same cannot be disregarded given the magnitude of the investments involved.

Although ensuring a return on investment from IP has become a norm in today’s economy, there still are entities whose primary focus is not generation and commercialization of their IP, but mitigating plausible risks that may arise due to negligence. IP audits have a pertinent role to play in such entities, as mitigating IP related risk is as important as its protection and management.

One should also note that an IP audit is an optimum level exercise and seeks a high level focus for a profitable result. An uninformed mind coupled with non-co-operation from the entity in whole or part could not only cripple the effect of a sound/upright audit but also make it an expensive affair. Generally, an institution or the entertainment industry, like in the case studies illustrated in the article, may usually perform an audit every six months where generation of IP is frequent, while a technology based company can go for an audit once in two to three years based on their need/objective.

**Keyword:** IP audit, intellectual property, IP policy, IP audit process, intangible assets

In a robust economy that the Indian nation has developed into, over the years, as the most favoured destination in the landscape of commercial bigwigs, from multi-nationals to home grown corporations have been filled with a cascade of events.

‘My sugar cubes are now sugar-free. Movies have Dolby Surround, while music has SRS WOW effects; TV is lit by light emitting diodes (LEDs), what’s to wonder is about the diminishing popularity of cathode ray tube (CRT) today! Tungsten got replaced by the mixture of argon & mercury in compact fluorescent lamp (CFL) and the hair shampoos nourish our hair without burning the eyes with its pH7 mixture. Even the water we drink has been ozonised, treated with UV for consumption.’ All of this transformation is a result of focused research and subsequent innovation that has followed.

The previous decades have witnessed a comprehensive shift in business gears all over. The erstwhile approach of overlooking intellectual property (IP) has had its reconciliation and the paradigm shift and focus in the present day is on a more sustainable economy, eloquently knowledge based. Though most world leaders of business pasture have realized their revenue to be in direct proportionality to their intangible form of assets than the tangible form they already hold: the tact to excavate, acquire, secure and effective utilization for a commercial line of attack has been sheepishly overlooked as a matter of legal outlook.

Intellectual property rights (IPR), its protection and management has achieved perceptible momentum with un-paralleled and limitless emphasis on R&D and activities on thought processes that has resulted in novel and innovative ideas. These ideas form the backbone of a possible venture of trend-setting

†Corresponding author: Email: shanelpunnoose@gmail.com
Investment to build a sturdy IP asset bank has been the prime chapter in the books of business leaders in their purpose to optimize their value by way of IP commercialization. However, the successful realization of such an IP wealth has been an unturned page by the very same business leaders, which has been much more alien in the case of SME’s (Small & Medium Enterprises).

In the incidents akin to this, IP audit plays a momentous role in reflecting the organization’s current position with regard to its IP asset bank. An audit of prescribed nature optimizes strategic utilization of IP and comprehensive security in the company’s free operation facilitating the attainment of the set objectives.

What is an IP Audit?

"Measurement is the first step that leads to control and eventually to improvement. If you can’t measure something, you can’t understand it. If you can’t understand it, you can’t control it. If you can’t control it, you can’t improve it."

-H James Harrington

The above excerpt strikes a chord appropriately indicating the significance of an IP audit within an entity of any size, scale or magnitude. In its generic sense an audit is the process of making an official investigation and examination. Thus, through logical deduction, an IP audit is a comprehensive tool officially undertaken by a company, enterprise or an organization to ensure appropriate management and protection of IP and derive optimum business value and steer clear of any possible litigation that is likely to arise in the future.

Purpose of an IP Audit

Although the objectives of IP audits are dependent on the context, the paradigm objective of conducting an audit is fourfold:

1. Excavate IP generated within the company resulting in creation of an inventory of protectable IP.
2. Conclusive evaluation concerning maintenance of IP filed or protected by the company.
3. Ascertain that there is a process inclusive of generation, excavation, protection and management in place and such processes of IP are flawless.
4. IP risk mitigation

IP audits can play a crucial role in taking an IP savvy company to the next level and must form the core of every company’s IP strategy. Following best practices in IP enables a company to identify, protect and manage IP efficiently. For example in September 2008, Google introduced to the world its open source operating system ‘android’, which is now the single largest competitor to Apple’s Operating System the ‘iOS’;

Both the giants are at loggerheads over each other’s line of products, the disputes ranging from designs to patents.

While Apple along with its partners outbid Google to acquire Nortel’s patent portfolio for a whopping $4.5 billion,3 Google made an official announcement to acquire Motorola Mobility Inc 4 for a whopping $ 12.5 billion at an increased rate of 63%.

Apple’s move was aimed at enhancing the acquisition of available patent portfolio in the open market. Likewise Google’s strategic move paved way for the following advantages: a level-playing field amongst competitors, and a portfolio of 24,500 patents and patent applications filed by Motorola Mobility Inc.

The deal clearly depicts that the estimated rise of 63% than its original closing price was the worth of Motorola’s intangible assets integrated into its IP portfolio; 5 so was the case with the Apple-Nortel deal.

The acquisition of portfolios by Apple and Google indicated their aggressive strategy of deriving business mileage from the rich patent reserves of Nortel & Motorola Mobility Inc respectively.

Now, consider the example illustrating that a sound IP portfolio contributes in safeguarding ones IP and mitigating any related risks.

In 1948 Polaroid invented the instant camera and shared the technology with Kodak. A few years later Kodak developed its own instant camera. Polaroid sued Kodak and got paid a whopping $873,000,000. Kodak went wrong the moment it failed to take necessary steps to avoid infringing upon Polaroid’s patents. The adoption of Polaroid’s camera technology without permission amounted to infringement of Polaroid’s IP. Since Polaroid had registered its IP, it was able to protect its invention.6

The aforementioned illustrations are answers in themselves to highlight the significance of undertaking an IP audit.

Apart from having an IP portfolio, keeping it alive is as important as protecting it. Many a time, IP can be lost due to non-payment of renewal fee, inadvertent publication, delay in filing statements.
with patent office, inappropriate marking, non-disclosure of necessary information and so on. In the process of keeping up with day-to-day activities, IP departments might inadvertently miss out on one or more of the simple but time consuming steps to keep their IP portfolio in good shape. Such errors can also be minimized by performing regular IP audits and establishing best practices.

Performing an audit at regular intervals will ensure that the IP of the company is not lost and utilized effectively. While an initial audit to set up the best practices may be performed by an external expert, these audits may be effectively performed by the IP department of a company. To summarize, it can be stated that IP audit; because it is essential to strategize the inventions; it is vital to increase the IP number and create IP asset inventory; it is necessary to assess the worth of IP and review the process; it is important to ensure optimal utilization; it is essential to enforce and defend the IP rights and have a risk mitigation system. In the nutshell, IP audit facilitates and ensures maximum and appropriate utilization of IP rights.

**IP Audit Process**

IP audit is an indispensable road map to stay ahead in the race to the destination with reference to the four fold objectives acknowledged earlier, or any other objective as the company may identify. Every company differs from the other in objectives, transaction and also the path that leads to the objective. While businesses in the developed economies have employed emblematic audit pattern, diverse audit pattern apposite to realization of objective is the way to go among the Indian commerce. However, several in-depth conversations with experts in the IP field implied that the following are the customary steps implicated in every audit process in its sequential order:

1. Formation of an IP audit team, subsequently an audit plan;
2. Assessment of company’s profile and organizational structure;
3. Analysis of the data accumulated; and
4. An audit report.

**Audit Team and Audit Plan**

The circumstances that possibly arise while setting up an IP audit team are twofold. The first is a situation which includes a start-up or an entity that does not have an established IP system in place. In such a case services of an external expert to induct the best system shall be sorted. However, while making this choice the trust factor should be given due consideration as an audit is an exhaustive inclusion of the evaluation of company profile and relevant sensitive documents. Thus an expert or a team of experts of high repute shall be brought in for the task. The second situation is wherein an entity already has an established IP system in place and the audit is a routine to assess, evaluate and update the current process and practice with a purpose of raising the bar to the next level and sealing of any lacunae that may have gone unnoticed earlier.

Although choosing the right team holds the key in any exercise, in this case where the task mandates diverse expertise and skill, being succinct with the evaluation and precise with the results becomes pertinent. Composed approach, unbiased mindset, ability to present uninfluenced opinions and intellect which is the blend of law, technology and management are the prerequisites to form a team that will deliver the optimum.

Accumulation of relevant background data is the step precedent to drafting an audit plan. The focus of the plans are object, reviewing the documents and interviews with key personnel, scope, time schedule, important risks and opportunities and an outline for the final report of the audit. The importance that the key personnel within the company hold, in making the IP audit process implementable and acceptable is manifold. Taking them into confidence and bringing a sense of realization among stakeholders the value of such an exercise are amongst the steps which contribute to a successful audit. In Dr Kalyan’s words ‘An IP system must integrate every individual into the process, which cannot function successfully independently’. Further, laying out an audit plan essentially facilitates ascertainment of facts pertaining to the details and formalities of audit. The approval of plan is followed by commencement of audit.

**Assessment of Company Profile and Organizational Structure**

Review of company’s profile and organizational structure is significant in order to define the areas of inquiry. This involves amassing of information which can be classified into primary information and secondary information. While internal and external interactions of the company and effect of these interactions on the IP owned form the primary information, IP assets that are owned by the company including the area, and the form of
expected report, business documents, marketing documents, policy documents, process documents, etc., are secondary information.

The process of accumulation of primary and secondary information initiates from a scratch. The audit team during this process, in necessary situations, is duty-bound also to educate about IP and its facets to the personnel rendering information. Accrual of primary and secondary information is followed by discerning the status quo of IP owned by the company and relevant disputes if any.

Analysis of the Data Accumulated

Systematic, calculative and logical research which is in concomitance with the data derived is the essence of this step. Based on the information, the mitigation and prospects are explored; a contrast between the company’s functioning and the best functioning existing is laid down. Additionally, all the agreements of the company may be examined to ensure maximum benefit in coordination with the various other reliable databases available.

The Audit Report

Rendering an audit report marks the conclusion of audit process. The report includes the objective of the audit, the audit plan and how it was executed along with the result of the analysis. It should describe and evaluate intellectual property defects that have been identified in the audit. Based on the defects, remedial actions that need to be taken or that has been taken should be mentioned. Furthermore, response to any such specific information that the party seeks must be dealt with, in the report. The audit report should be confidential and its distribution should be limited. After the audit report has been prepared and the recommendations have been given the, IP audit team can come up with a re-orientation training program for the employees and the senior managers.9

Recapitulating, in the Indian context there is no standard procedure laid down for IP audit since the process of IP auditing is dependent on the purpose of IP audit and various other factors.

The Outcome of an IP Audit

"However beautiful the strategy, you should occasionally look at the results".10

-Sir Winston Churchill

Likewise, however ideal the audit plan and process, it is the result that it yields is the matter of focus. The outcome of IP audit determines the starting point for the company to initiate its expedition towards the objective of maximization of business benefits through IP assets. It renders the company with outlines to reach new heights.

The results of an IP audit are squarely reliant on its objective. For instance, if the status quo demands drafting of report, the result of an IP audit is derived in the form of a report. Such a report essentially includes, but is not restricted to, developmental history of the impugned technology, description and evaluation of IP defects uncovered in the audit, proposal of specific remedial action that needs to be taken or that has been taken, and response to any other specific need for information the parties commissioning the audit may have.11

To quote a different situation, if the audit concerns an acquisition transaction, the report should provide essential data pertaining to rights available and the rights required by the acquiring party, and endow the basis for valuing the rights that are to be acquired.11

The deliverable of an IP audit is by and large a report or catalogue from an audit team to the management of a company. The report is essentially an instrument employed in the management of company’s IP assets. In other words, it lays down ‘further steps’ for reaping the benefits and answering the issues concerning the uncovered IP during the audit. Those ‘further steps’ may include revised policies, procedures, cost-cutting by elimination of maintenance of unessential registrations or patents, protection of important (but currently unprotected) IP assets, enforcement of IPR where infringement has been identified, and remedial steps to fill any gaps in the company’s existing IP rights.12 In short, the product of an IP audit will be a report, which includes the following elements:

1 Inventory of IP held by the company and uncovered during the audit, which needs to be protected;
2 Review of IP policy and processes of the company in the light of its business goals; and
3 Recommended IP action points with appropriate prioritization.13

Significance of IP Audit

The following case studies enumerate the significance of IP audit with enhanced precision. The case studies zero-in on the existing state of affairs in an IP audit, its necessity, the challenges faced by the IP audit team and the results of an IP audit sufficing
the benefit of an entity. Any pessimistic element in the same is with the objective of endowing the reader with enhanced perceptive of the concept of an intellectual property audit and shall not be perplexed with inattention of the authors.

Case Study of a University

Stature/Background
The focus of the current case study is a premier academic institution for technical education in India. The institution is one among the frontrunners with the elite of meritorious students opting to study in higher technological education, basic and applied research and industrial consultancy. It has established itself as a leading technological institute with equal attention towards teaching, research and industrial consultancy. With more than thirty diverse, aptly-equipped departments with research amenities, excavation of IP is a routine affair in the institution.

Objective of IP Audit
As against the conventional objective of carrying out an IP audit, the objective here was to mend and rectify the current IP practices and bring in place an adept IP policy and establish a process, without compromising on the university culture in order to facilitate further research from the scholars and ensure protection and commercialization of IPs created.

Although the institution endeavoured to ensure optimum protection and commercialization of the IPs produced, the endeavour failed to meet the ideal requirement pertaining to IP management in addition to ambiguities in parts. One of the prominent observations was the institution professing confidentiality over interactions, which was in contrast with the academic objective. The prime objective of IP audit was to mend policies akin to these and lay down policy and procedure aiding future research.

Challenges
The institution composed of diversified plenitude of departments, more than thirty in number. The verity to be noted is that each department functions independently and is accustomed to a work fashion of its own. Since the audit process included extracting information through personal interviews, devising an interview to bring together personnel of different mindsets to the same table was one of the most challenging tasks.

Assigning the process without apprising the stake holders can be analogous to leaving a boat in the whirlpool without the oar. Assigning the stake holder itself was yet another formidable task on the agenda.

In addition, outlining a composite strategy for thirty odd departments varying in their work culture seemed equally insurmountable.

However these challenges were met with apt groundwork. Studying, the ways institutions are set up in India was essential, prior to the commencement of the audit process. Keeping in view that the questions framed for auditing and the mindset required is that for an institution and varied from those for any other audits, an apt team was formed. In an audit like this, studying the fashion in which each department functions was very essential. This requirement was also met by the auditors. Given the initial polite demeanour of the auditors, the attempt to establish faith in the auditors was not as difficult as it seemed.

Results
An audit does not yield a tangible result unless the process is coupled with commitment of the auditors. The IP audit process was indeed brainstorming considering the number of departments and difference in their work culture. However, the outcome of the process, post keen assessment of every minute detail pertaining to the IP was a report consisting of various recommendations and modifications.

From the case study it is implicit that a comprehensive IP Process Model would enhance the growth of institution with an IP perspective. Also establishing a unit which would look after the routine affairs concerning IP would aid the institution to great extent in making it IP friendly.

Benefits
According to the auditors the report was certainly a satisfactory outcome meeting the objectives and aiding growth of the institution. But the challenges that came the institution’s way detracted it from adopting the recommendations and modifications in the report. At length, the recommendations were non agreeable by different factions of decision- makers in the institution. The tale thereafter remains a mystery.

Case Study of a Production House

Stature/Background
Focus of the current case study is a South Indian Movie Production House established by a renowned producer-director. The entity has various other subsidiaries and mainly focuses on production of Indian movies, consequently excavating intellectual
properties mainly—copyrights, trademarks, designs and in a few cases, patents. Since it is an entertainment company, it consists of various departments including production, marketing, licensing, distribution, physical sales and so on.

Objective of the IP Audit

Procedure and policies to protect and ensure non infringement of IP was already in existence in the company. With the aid of that existing policy, the company had appropriately secured a few categories of its IP. The objective to approach the firm of expertise for an IP audit was to restructure the current IP policy to a new-fangled fool proof procedure and ensure comprehensive protection as the company assumed that the procedure followed by it was not in consonance with the needs of the company. However, this assumption proved to be right after the audit. In addition, the company also set an objective of extracting suggestions for IP protection, necessary modifications, improvements and the manner in which deals, agreements, licenses etc are to be fashioned.

Unlike the institution referred to in the preceding case study, the sole objective here in was to strengthen and improvise on the existing IP policy for optimum revenue generation.

Challenges Faced During the Audit

The company consisted of various departments ranging from production to sales. These departments functioned through the aid of their personnel distributed in various levels within the departments. Additionally excavating, protection, non-infringement and management of IP are the responsibility of every personnel at each level. Hence, each department showcased reasonably good knowledge concerning IP. The challenge of the auditors was to devise interviews specifically matching the convenience of each level and to lay down the policy that is implementable and comprehensible at all levels of functioning. Also, reviewing of agreements entered into by numerous departments was easier said than done.

Results

A dynamically magnificent IP policy, drafted, was the outcome of an intense IP audit process. Post the IP audit which included interviews with various key personnel, reviewing of numerous agreements and so on, and the auditors drafted an IP Draft policy that would suit the requirements of all IP related concerns that may arise in the foreseeable future. Additionally, the auditors also submitted a report recommending protection of IPs under unprotected category for instance patents and designs, strengthening of third party agreements, specific process for each department, etc.

During the audit process it has been observed that the company possessed unorganized and ad-hoc strategies, policies and procedures. It has also been noticed that there was no benchmark set in the company which placed the possibility of accepting apparently profitable, but actually burdensome terms. Although there were stakeholders in the company, no ownership was conferred on them.

Giving due consideration to all the above mentioned instances, the audit report made recommendations. Post application of the recommendation, the company now possesses an organized policy, benchmarks and stakeholders with ownership.

It may, therefore, be affirmed that fine tuning the IP system, laying down strategies to protect IP and owning a deal that ensured facilitation of enhanced commercialization are the factors leading to an IP friendly institution.

Benefits

The company implemented the recommendations to the last word. Hitherto, they are reaping the fruits of a hygienic and efficient IP inventory for the last few years. A sturdy growth in the revenue due to IP has also been observed and tracked.

Case Study of a PSU (Public Sector Undertaking)

Stature/Background

The subject of the audit herein was a state owned giant—widely acclaimed, large scale innovative, engineering and manufacturing enterprise. The company has been engaged in the design, engineering, manufacture, construction, testing, commissioning and servicing of a wide range of products and services for the core sectors of the economy, viz. power, transmission, industry, transportation, renewable energy, oil & gas and defence. Considering the nature of company, the excavation of the IP in the same is a moot point.

Objective of IP Audit

Due to lack of knowledge about IP, its protection and management, the audit process had to be initiated from the scratch. Thus alike most of the conventional
audits, the purpose herein were to aid excavation, generation, utilization and protection of IP that the company has the potential to generate. Ignorance about IP also resulted in fragile policy or procedure pertaining to IP. Hence strengthening and revamping of the IP policy in consonance with status quo of the company and establishing IP portfolio were among the prime objectives.

**Challenges**

The generation of IP is a part of everyday regime of the company. Efficient protection could be ensured solely when the generation is coupled with knowledge. As the company’s knowledge about IP was still in its nascent stage, most of the IP has been left unprotected. Convincingly educating each personnel about the IP and extracting relevant information from such personnel was a challenge. Also laying down a road map was an uphill task.

**Result**

The upshot of this exhaustive IP audit was a report which laid down a comprehensible roadmap on the lines of the recommendations given. The report included recommendations, few of the prime recommendations were to encourage maximum filings for protection in order to familiarize its personnel with the concept of IP; to take adequate steps to avoid IP infringement, to build an IP culture and have IP training sessions and also to formulate IP policy and procedure. The report also suggested incorporation of the ownership of IP clauses, to define the interaction with third parties and incorporate the same IP clauses in agreements, incorporate notices, perform a consistent IP watch and enforce IP violations. All these would result in contributing to the growth of IP database in the company and managed accordingly.

**Benefits**

The benefit from the entire IP audit in a PSU is that, once the entire IP of the company is categorized, protected-policy wise, all the changes could be tracked. Additionally, a repository of the IP database which is safe and secure is available for reference. An efficiently managed IP in a company as large as this can only benefit the employer and its employees. Moreover a large company with diversified employee culture that is well aware of its IP protection, infringement, policy, measures will be a tremendous strength and value addition by itself.

**Case Study of a SME (Small & Medium Enterprise)**

**Stature/Background**

The focus of this IP audit is a SME that has a size of 100-400 employees and generates revenue of 80 percent with 30 percent profit. The enterprise is a highly diversified business conglomerate, operating in the areas of manufacturing services, products, technology, engineering, software and systems integration and has innovative products, services and solutions to markets like healthcare, communication, industrial and transportation resulting in the generation of IP.

**Objective of IP Audit**

The existing fashion of functioning in the organization has not succeeded to seal all the loopholes and ensure maximum protection and utilization as the enterprise ignored the use of IP for business development and advantages. Thus the prime objective in carrying out this audit was to identify and strategize unprotected IP of the enterprise and suggest improvements in existing IP processes and agreements.

**Challenges**

Prior to the IP audit, there was no IP policy and procedure in existence and enforcement in the enterprise. Although most of the employees were aware of the benefits and value of their IP creation, steps and measures taken for its protection and preventing the loss was an unknown territory. Enlightening the employees about protection and utilization of IP and extracting information relevant to auditors was a difficult task when compared to the experience of the auditors in prior audits.

**Results**

The report of this audit process contained various recommendations in view of protecting the IP generated and utilizing them to the peak. It began with listing various forms of IP in the company from trademarks, domain names, patents and copyrights. The prominent recommendations were to protect the protectable yet unprotected IP, establishment of an IP portfolio, devising a well structured and organized approach towards accruing business and advantages through IP etc.

**Benefits**

The incorporations and enforcements ensured a steady generation of IP in the company that would be
protected by the company policy itself, thereby steadily contributing to the business generation processes. A strong information and physical security IP policy that has been framed also helps the information remain confidential. In addition to all of these, modified employment agreements in sync with IP clauses help the company deal with attrition rates and tackle such setbacks effectively.

Conclusion

With the support from the Indian-Centric IP audits, it is learnt that whichever be the industry, whether an academic research institution, entertainment industry based production house, government backed PSU or any other industry, generation of IP is a routine affair. In a fairly progressive knowledge based economy like ours, intangible assets like IP, goodwill etc., have been gathering and gaining unprecedented prominence, focus and investments. Thus excavation and utilization of IP should come to be the primary focus of every business to cope up with this current trend; and IP audit is the path that would lead to efficient and effective utilization of IP generated that would, in turn be the cornerstone for a sound IP culture in any entity.

It is an indisputable fact that the industry has gained enormously with the aid of a standard IP audit process practised world-over, however the adaptations at various stages to cater to the culture of Indian business would yield better results thereby facilitating entities to stay in sync with their vision for their company.

References