

ARIZONA STATE UNIVERSITY
Report on Audit of Schedule of Intellectual
Property Royalties
Year Ended June 30, 2001

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Year Ended June 30, 2001

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Arizona Board of Regents

Dr. Lattie F. Coor, President
Arizona State University

We have audited the accompanying Schedule of Intellectual Property Royalties for the year ended June 30, 2001. This schedule is the responsibility of Arizona State University's management. Our responsibility is to express an opinion on this schedule based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 5, the University's Office of Technology Collaborations and Licensing did not recover \$53,071 in legal fees that it was entitled to. If these legal fees had been recovered, distributions to principal inventors and principal inventors' laboratories would have been decreased by \$17,866 and \$17,690, respectively, and the net royalties available to the Office of Technology Collaborations and Licensing and the competitive grant program would have been decreased by \$3,651 and \$13,864, respectively, for the year ended June 30, 2001.

In our opinion, except for the effects of not recovering the legal fees discussed in the preceding paragraph, the Schedule of Intellectual Property Royalties referred to in the first paragraph presents fairly, in all material respects, the gross intellectual property royalties received by Arizona State University, the distribution of the net intellectual property royalties to the principal inventors and principal inventors' laboratories, the net royalties available to the University's Technology Office and competitive grant program and the fees recovered, allocation to the competitive grant program, and operating expenses of the University's Technology Office for the year ended June 30, 2001, in conformity with U.S. generally accepted accounting principles.

This report is intended solely for the information and use of the Arizona State Legislature, the Arizona Board of Regents, and Arizona State University and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Debbie Davenport
Auditor General

November 28, 2001

ARIZONA STATE UNIVERSITY
Schedule of Intellectual Property Royalties
Year Ended June 30, 2001

	<u>Gross Royalties Received</u>	<u>15% Administrative Fees Recovered</u>	<u>Legal Fees Recovered</u>	<u>Net Royalties Available For Distribution</u>	<u>Distributions to</u>		<u>Net Royalties Available To</u>	
					<u>Principal Inventors</u>	<u>Principal Inventors' Laboratory</u>	<u>Office of Technology Collaborations and Licensing</u>	<u>Competitive Grant Program (Note 6)</u>
Patents								
<u>Cancer Research Institute (CRI)</u>								
BASF	\$ 250,000	\$ 22,500	\$ 4,866	\$ 222,634	\$ 74,213	\$ 74,211		\$ 74,210
Oxigene	320,000	24,000		296,000	98,672	98,664		98,664
Seattle Genetics	30,000		21,073	8,927	3,151	2,975		2,801
Teikoku	452,860	30,000	15,339	407,521	147,499	144,166		115,856
Total Cancer Research Institute	<u>1,052,860</u>	<u>76,500</u>	<u>41,278</u>	<u>935,082</u>	<u>323,535</u>	<u>320,016</u>		<u>291,531</u>
Physics								
Molecular Imaging	<u>55,917</u>	<u>4,351</u>		<u>51,566</u>	<u>17,189</u>	<u>17,189</u>		<u>\$ 17,188</u>
Chemistry & Biology								
Advanced Concrete	10,241	879		9,362	3,121	3,121		3,120
Goodyear	15,000	1,500		13,500	4,500	4,500		4,500
Intrinsic Bioprobes	2,000		2,000					
Moletech	35,000	5,250	8,098	21,652	7,217	7,217		7,218
RCT	115		115					
Total Chemistry & Biology	<u>62,356</u>	<u>7,629</u>	<u>10,213</u>	<u>44,514</u>	<u>14,838</u>	<u>14,838</u>		<u>14,838</u>
Civil Engineering								
Intel	<u>65,000</u>		<u>64,481</u>	<u>519</u>	<u>173</u>	<u>173</u>		<u>173</u>
Electrical Engineering								
Microlab	<u>100,000</u>			<u>100,000</u>	<u>35,000</u>	<u>33,334</u>		<u>31,666</u>
Copyrights								
<u>Technology Based Learning</u>								
ASCD	10,313	559		9,754	3,251	3,251		3,252
Cisco System	125,000			125,000	43,334	41,667		39,999
State of Hawaii	25,000			25,000	20,000	3,333		1,667
University of Hawaii	25,000			25,000	20,000	3,333		1,667
State of Washington	200,000			200,000	33,333	133,333		33,334
T.H.E. Journal	7,329	525		6,804	2,268	2,268		2,268
Total Technology Based Learning	<u>392,642</u>	<u>1,084</u>		<u>391,558</u>	<u>122,186</u>	<u>187,185</u>		<u>82,187</u>
Physics								
Custom Vacuum	<u>1,250</u>			<u>1,250</u>	<u>417</u>	<u>417</u>		<u>416</u>
Psychology								
Dream Street Films	<u>778</u>			<u>778</u>	<u>259</u>	<u>259</u>		<u>260</u>
Know How								
<u>Information Technology</u>								
Egan Visual	<u>15,728</u>			<u>15,728</u>		<u>15,728</u>		
Total	\$ 1,746,531	\$ 89,564	\$ 115,972	\$ 1,540,995	\$ 513,597	\$ 589,139	\$ 146,728	\$ 291,531

Total administrative fees and legal fees recovered, and distributions to OTCL and the Competitive Grant Program

\$ 643,795

Less:

Allocation to the Competitive Grant Program (Note 6)

- 0 -

Operating expenses:

Personal services \$ 248,269
Employee-related expenses 51,285
Outside legal expenses 597,318
Office operating expenses 141,827
Travel 6,232

Total operating expenses 1,044,931

Net operating loss \$ (401,136)

See accompanying notes to schedule.

ARIZONA STATE UNIVERSITY
Notes to Schedule of Intellectual Property Royalties
Year Ended June 30, 2001

Note 1 – Gross Royalties Received

Arizona Revised Statute §15-1647 requires the University to distribute income derived from its intellectual properties. It also requires the University to issue an audited report annually detailing its intellectual property royalties, related expenses, and distributions.

Note 2 – Administrative Fees Recovered

Through December 31, 2000, the University collected a 15 percent administrative fee to help recover the cost of operating its Office of Technology Collaboration and Licensing (Office). Effective January 1, 2001, the Office no longer collected this fee.

Note 3 – Legal Fees Recovered

The Office typically incurs legal/patent fees associated with both (1) licensed patents currently generating royalties and (2) unlicensed patents and pending patents that are not generating any royalties. Legal fees are typically incurred on potentially patentable discoveries many years before a patent is actually licensed and royalties are received. Further, not all legal fees are recoverable (i.e., some patent cases generate insufficient or no royalty revenue to cover all the legal costs associated with the case).

Any legal fees incurred by the University for subsequently licensed patents are recovered (i.e., deducted) from the gross royalties received for those patents, leaving a net royalty amount available for distribution. During the year ended June 30, 2001, the University received 41 royalty payments involving 21 licenses. For the same period, the University also incurred legal/patent fees for approximately 132 of its unlicensed cases.

Note 4 – Net Royalty Distributions

For the year ended June 30, 2001, each of the eligible recipients (principal inventors, principal inventors' laboratories, and either the Office or the bio-medical/bio-technical competitive grant program) received a share of the net royalties available for distribution. In most cases, the distribution was an equal share (i.e., one-third), except for:

ARIZONA STATE UNIVERSITY
Notes to Schedule of Intellectual Property Royalties
Year Ended June 30, 2001

- Cases involving the first \$10,000 of royalty revenue where 50 percent of the first \$10,000 of royalty revenues, after recovery of administrative and legal fees, is distributed to the inventor, one-third of the net royalty revenue is distributed to the inventor's laboratory, and the remainder is distributed to the Office or the Competitive Grant Program, or
- Cases where a separate agreement has been entered into between the University and the inventor.

Note 5 – Pre-1996 Legal Fees

In 1996, the Office converted to a new computer system that is a comprehensive database application designed to track activities associated with intellectual property cases, including legal expenses. At the time of conversion to the new system, only some summary legal fee information was carried forward. For fiscal year 2001, the Office undertook the time and labor intensive task of tabulating, by case number, legal costs incurred prior to 1996 and updating the database to reflect these prior period costs. However, the Office did not delay the distributions of patent royalties until such time that all legal fees had been captured and an appropriate analysis was performed to determine that the correct amounts were distributed to inventors, laboratories, the technology office, and the competitive grant program. This resulted in the failure to recover \$53,071 of legal fees for the year ended June 30, 2001.

Note 6 – Bio-Medical/Bio-Technical Competitive Grant Program

Effective for the year ending June 30, 2001, the University decided that the Office's net share of licensing revenue associated with Cancer Research Institute (CRI) inventions would be set aside to support a competitive grant program to further research in the bio-medical/bio-technical field. For the year ended June 30, 2001, distributions and deductions associated with CRI royalties exceeded royalty revenue; therefore, no funds were available for the grant program. Calculation of the funds available for the grant program follows:

ARIZONA STATE UNIVERSITY
Notes to Schedule of Intellectual Property Royalties
Year Ended June 30, 2001

Bio-Medical/Bio-Technical Competitive Grant Program
Statement of Funds Availability
Fiscal Year 2001

Cancer Research Institute (CRI) gross royalty revenue		\$1,052,860
Less:		
15% Administrative fee recovered (prior to January 1, 2001)	\$ (76,500)	
CRI Legal fees recovered during fiscal year 2001	<u>(41,278)</u>	
Total fees recovered		<u>(117,778)</u>
Net CRI royalties available for distribution		935,082
Distributions:		
CRI principal inventors' share (royalty payments)	(323,535)	
CRI laboratory share	<u>(320,016)</u>	
Total distributions		<u>(643,551)</u>
Net undistributed CRI royalty revenue		291,531
Deductions:		
Unrecovered fiscal year 2001 CRI legal fees (1)	(182,441)	
Office operating expenses allocable to CRI (2)	<u>(140,639)</u>	
Total deductions		<u>(323,080)</u>
Competitive Grant Program funding deficit (3)		<u><u>\$ (31,549)</u></u>

- 1 Actual fiscal year 2001 CRI legal fees incurred were \$208,647, of which \$26,206 were recovered in fiscal year 2001

- 2 Consists of:
 - (a) CRI share of the Office operating expenses totaling of \$107,290, calculated by multiplying the Office Fiscal Year 2001 net operating expenses of \$427,451 (total Office expenses of \$1,044,931 less (i) outside legal fees of \$597,318 and (ii) Office operating expenses of \$20,162 which are administrative service charges directly related to CRI paid royalties) by CRI's percentage share of the expenses. For fiscal year 2001, CRI had 65 active cases of the 259 cases managed by the Office, or 25.1%; and

 - (b) Administrative service charges of \$33,349 directly related to CRI legal fees (\$13,187) and inventor royalty payments (\$20,162)

- (3) Since deductions exceed undistributed royalty revenue, no fiscal year 2001 monies are available for the Bio-Medical/Bio-Technical Competitive Grant Program. The fiscal year 2001 funding deficit will be carried forward to the fiscal year 2002 Competitive Grant Program calculation.