Untangling the audit: How devs can find out if are owed royalties

Loxley Royalties Management's Dave Noble talks game-makers through the process of finding out whether they are owed money from their game sales

The deal is in the bag – congratulations!

After months of pitching and having signed an enormous contract with an equally enormous section dedicated to the calculation of royalties and profit share and audit rights, you are finally in the 'royalties' club and also an entrant to the complex world of royalty accounting – possibly the driest but most critically important financial topic to feature on a computer game development website like this.

We will make this as bearable as we can.

In a perfect world, you will have certainly contracted a great lawyer and negotiated a fantastic deal which earns you a royalty from first dollar out on gross game sale receipts (no deductions) and with no refund of royalties when price protection gets going. It also states your preferred audit company, frequency of audit and contains a few extra words that allow you to recharge the full cost of the audit (including travel to the publisher) in the event that a unreasonable audit error rate be found – say 0%. Oh, and a lifetime audit clause NOT restricted to 18 months.

So, how’s your contract looking? We hope it ticks some of these boxes, but no worries if it doesn’t quite hit the jackpot. We have to admit to seeing only a few coming close – and those featured a combination of experienced CEOs and ‘super media’ lawyers. Successful developers choose to audit an agreement at least once in a contract lifetime; not something every developer could afford or necessarily set out to do but it is best practise.

Would it help to have the inside track?

Simply speaking, the more complex the contract, the greater the opportunities for error.

Complexity can take many forms but the most usual crime is a very long-winded Net Receipts Clause that allows every deduction under the sun and may also use the ‘estimated’ or ‘average’ swear words and blanket percentage deductions for no apparent reason.

Listing the types of errors publishers make when compiling royalty statements is probably best explained in bullet points. Here are some examples of what we have experienced:

- Non-existent or late statements
- Entire sales territories excluded from Net Receipts
- Entire distribution channel (for example: digital) excluded from Net Receipts
- Incorrectly calculated Withholding Tax applied as a deduction
- Entire SKUs (Stock Keeping Units) missing from sales reports and therefore Net Receipts
- Bundle deals incorrectly apportioned resulting in lower Net Receipts
- Merchandising income missing or under reported
- Licensing deals revenue for spindle-related sales omitted from Net Receipts
- Cost of Goods deducted in error for digital download
- Retentions not released or under released
- Mobile statements missing distribution partners
- Advances not correctly reported on statements leading to miscalculations of breakeven

- Face of the statement errors: transposition errors and simple addition/subtraction
- Over-inflated average costs applied to profit share
- Inappropriate estimates applied to profit share agreements
- Royalty breaks incorrectly applied

Really hope you're still feeling confident….

Accident or deliberate?

Very few companies deliberately mislead their trusted partners and it does seem incredible this can happen. We are often asked: "Are Publishers dishonest?"

Really???!

Most are honest. Occasionally, some are opportunists!

Many have disjointed systems which are unable to reflect the contract agreements well. Too many to mention employ overworked accounting/royalty staff who then struggle with accuracy work.

Small to medium publishers rarely have sophisticated royalty software and organic processes – you know what I mean.

Cash Receipt-based contracts add another level of complexity. Actual costs can't always be captured – no matter what the promise and will need to be audited.

Digital distribution models don't always fit well with existing royalty processes. And co-publishing deals should ALWAYS be audited – there is just so much going on there.

Getting yourself 'on the audit page'

So, you've received your first statement. Things don't look too bad out there, the sellthrough is better than you expected but you haven't seen a penny – super disappointing but hey, there's always Q2 after release, right?

Sorry, not in our experience. Price protection kicks in so quickly after release that unless you are shipping FIFA you might not see anything gold or glittering past Q1 of the release.

This is the time to consider what information is still available to you:

- What's happening commercially?
- Is this an accurate position?
- Will anything improve next quarter?
- What would I do differently next time?

You can do this through a number of means, including requesting supporting data from your publishers and conducting your own checks, asking a specialist auditing company to conduct an online audit focusing on key areas (the eco/often affordable model), or commissioning a physical audit at the publisher premises.

Either way, its Truth or Dare out there.

Happy Days

If you decide to audit, this is what you can expect to happen at the publisher's:

- A welcoming email setting out possible dates for the audit (usually we have to wait one or two months, especially at the large publishers)
- A pleasant email introduction to the publisher's nominated royalty manager
- Suggestions for where to stay and travel tips
- A dialogue prior to audit agreeing the audit process and documents to be reviewed
- Copies of the contract and statements (if needed)
- A professional and courteous welcome on arrival – yes, really!
- Timely production of the audit documents and assistance with questions throughout
- An open dialogue concerning the product in question
- Additional documents and assistance from sales, marketing and/or operations staff as required
- Probably a joyful wave on leaving
- Follow-up questions answered in a timely manner

- A swift negotiation between all parties concerned – everyone has stuff they need to do next

In summary, publishers expect to be audited!

Myths and legends addressed

Publishers don't like being audited

The truth is that this is happening all the time more and more as IP is licensed and joint ventures embarked upon.

Publishers hold back information at audits

Most are very helpful and pleased to help.

Relationships break down when developers audit publishers

Relationships break down when developers lose trust with publishers. Audits repair this trust, or at least provide the truth that can then help repair the relationship and get it back on an even keel.

Audits cost loads of money and don't find anything

An auditor is probably going to be paid a little more per hour than say your average man in the street BUT you can expect information which will ensure your future contracts are more water tight and commercial than ever before.

Dave Noble is senior auditor and head of business development at Loxley Royalties Management, an auditor that has uncovered more than $16m in unreported royalties for computer games firms.*

*You can find out more by heading to **www.loxleyroyalties.com**, or calling Noble on +44 (0) 7792 127911. Alternatively, call Faye Sieracki on +44 (0) 7971 966119.*

** Source Media Forensics and Loxley Royalties Management data combined*