

# **Intellectual Property Audits**

## **By William W. Cochran**

### **Introduction**

The purpose of this paper is to define and describe Intellectual Property Audits, and contrast the Intellectual Property Audit with similar concepts such as Intellectual Property Evaluations and Intellectual Property Due Diligence Processes. This paper also explains the purpose of an Intellectual Property Audit and discloses how an Intellectual Property Audit can be conducted, taking into consideration factors such as the scope of the audit and the procedures to be used. Lastly, this paper provides a sample memorandum and a checklist of processes that can be reviewed in a patent audit.

### **Definition of An Intellectual Property Audit**

An Intellectual Property Audit is a review of the intellectual property management policies and procedures used by an organization to identify, acquire, and protect its intellectual property, and to protect the organization from the intellectual property of others.

This differs from other closely related concepts. For example, an Intellectual Property Evaluation is a process used to place a value, usually a monetary value, on a particular piece of intellectual property, such as a patent, copyrighted software, or a trade secret. Intellectual Property Evaluations may be necessary if intellectual property assets are pledged to a financial institution, or any time the assets of an organization must be determined.

Another closely related concept is the Intellectual Property Due Diligence Procedure, which is an evaluation of an organization's intellectual property holdings, either in a particular area, or corporate-wide, which usually occurs in association with an acquisition or sale of a business, a stock or asset transaction, or other purchase or sale involving intellectual property rights.

Hence, the Intellectual Property Audit is simply a review of the procedures used by an organization to obtain and protect its intellectual property, and protect the organization from the intellectual property of others, rather than any attempt to evaluate, or determine defects, in existing intellectual property assets.

## **Purpose of the Intellectual Property Audit**

**A. Modifications of Policies.** One primary purpose of the Intellectual Property Audit is to review the intellectual property policies and procedures of an organization, evaluate those policies and procedures and suggest modifications to:

1. Better identify intellectual property, e.g., identifying inventions, trade secrets and trademarks;
2. Better screen intellectual property to be protected, e.g., trademarks, invention evaluation process;
3. Modify processes to better retain rights to intellectual property, e.g., consultant agreements, licensing procedures, patent maintenance, docketing processes for renewal of trademarks and copyrights;
4. Identify types of intellectual property currently protected and institute new procedures for protecting other types of intellectual property, e.g., non-compete agreements, employment agreements, trade secret protection;
5. Make the intellectual property processes run more effectively and efficiently;
6. Make the intellectual property processes used by an organization more satisfying to inventors and authors;
7. Encourage inventors to participate in the intellectual property processes of the organization, especially recalcitrant inventors and authors, who many times are the most inventive, or can produce the most valuable intellectual property for the organization.
8. Provide better policies to protect the organization from the intellectual property of others.

**B. Education of Management.** Another purpose of the Intellectual Property Audit is to educate the management and staff as to the value of intellectual property to the organization. In that regard, the Intellectual Property Audit can help in educating the management and staff regarding procedures for protecting intellectual property, and to alert them to the potential upside that can result from following simple and straightforward procedures. Overall, the results of the Intellectual Property Audit, after implementation, will hopefully maximize the value of the intellectual work performed by the employees of an organization.

**C. Potential Problems Resulting from Failure to Use Proper Intellectual Property Procedures.** In conducting the Intellectual Property Audit, it can be helpful if the IP auditor

explains that many organizations squander their intellectual property assets, which can have various negative effects on the organization. Not only may squandered assets present a lost opportunity for the organization in areas such as licensing revenue, partnering agreements, etc., but, more seriously, it can result in the loss of the tools needed for protecting the organization from attacks from other organizations. Even more seriously, an organization's rights may be prejudiced by the actions of the employees if proper procedures are not established, or properly communicated, to employees. For example, if proper procedures for handling confidential information are not in place, an organization may be contaminated with the confidential information of others so that independent development in a particular technology cannot proceed. As another example, I am aware of situations where engineers have copied a process from a patent of another organization and included that process in a product. An explanation to management of the potential severity of such problems that can be created by either not following established procedures, or not having properly established procedures, can be of great value in communicating the need for an Intellectual Property Audit.

### **An Example Of How An Intellectual Property Can Be Conducted**

#### **A. Stage One**

1. **Scope of Audit.** First, it is helpful to determine the scope of the intellectual property audit to be performed. For example, consideration should be given as to what organizations or business units should be covered by the intellectual property audit, or what technology should be covered. Also, a determination should be made as to what areas of intellectual property should be covered, i.e., all areas of intellectual property, or some subset, such as patents and trade secrets, only. Also, the scope of procedures to be covered should be determined. For example, should all procedures within a particular area of intellectual property such as patents be covered, or just a subset such as the invention submission procedure and the invention evaluation process? With regard to copyrights, the scope of the audit may be limited to the review of the establishment of the procedures for a Publications Committee that might consider processes for placing copyright notices on published materials, or establishing guidelines for registrations of copyrights. Such a Publication Committee could also consider issues such as the process for recording security interests in copyrights and processes for preventing disclosure of trade secrets.

2. **Options.** Next, the attorney conducting the intellectual property audit should discuss certain options with the individual in the organization that is authorizing the intellectual property audit. An important item for discussion is cost. The IP auditor should have an idea of the variation in cost of the audit based on the size of the organization, the number of patents, copyrights, trade secrets and trade marks involved, the type of technology and the history of the intellectual property activity of the organization. The individual responsible for authorizing the audit may be the in-house patent counsel, the CEO, or other business person. A clear decision should be reached with this person as to the exact scope of the audit and the cost involved.

3. **Form of Results.** Another factor that should be discussed is the form in which the results will be presented. Normally, the intellectual property audit results are presented in a report outlining the current procedures, the suggested modifications to the current procedures, an explanation of the reasons for these modifications and a review of the step by step process, in detail, of how the procedure should operate with the proposed modifications. Some organizations memorialize these processes in documents such as "Attorney Guides" or other process review documents. Such Attorney Guides provide a detailed outline of procedures, explanations of reasons for the procedures and tips for implementing the procedures. This is a handy way of memorializing corporate knowledge in a particular area. The use of Attorney Guides may be an appropriate method for an organization to record the established intellectual property procedures in any particular area. Another alternative is to place the procedures in employee manuals that are distributed to all employees.

4. **Contacts Within Organizations.** In the meeting with the individual or group within the organization that is responsible for authorizing the intellectual property audit, the IP auditor should solicit views on who should be contacted within the organization to effectively carry out the IP audit. For example, the IP auditor should ask about managers to be interviewed and technical employees that are knowledgeable of the intellectual property processes. Disgruntled inventors or authors may be the most important source of information, since they may have participated in an existing process, have been dissatisfied, and can quickly point to the problems associated with these existing processes. Other employees that can provide important information include the individuals that review publications, such as marketing communications employees. Marketing managers or other employees in the marketing department, who are responsible for selecting trademarks, or who are involved in licensing, should be interviewed. In-house counsel, paralegals or other employees responsible for handling intellectual property matters should also be contacted. Contact with these employees functions to familiarize them with the audit and its purpose, and provides the IP auditor with the best source of information as to how things actually work.

## **B. Stage Two**

1. **Internal Memorandum.** After the IP auditor has determined the scope, cost, the appropriate people to contact, and has discussed the form of the results with the individual authorizing the audit, a memorandum should be prepared by the IP auditor. The memorandum should be distributed under the individual's name who is authorizing the audit, or a business person, such as the CEO, to the list of individuals to be contacted. The memo should briefly explain who will be conducting the audit, a brief explanation of the purpose for the audit and a request for cooperation. Without such a memo, many employees may be reluctant to cooperate. A sample of a memo is attached as Addendum A.

2. **Interviews With Employees Most Knowledgeable of Processes.** The IP auditor can then begin to conduct interviews. The interviews should start with the employees that are most knowledgeable of the processes in the various areas to be investigated. The IP auditor should determine if written materials exist on these processes and review these materials as part of the interview. The IP auditor should determine what each individual knows about the various processes, and determine ~~other~~ the identity of employees who can be contacted that are familiar with the processes.

3. **Interviews With Key Employees.** Next, the IP auditor may wish to interview key employees involved in the intellectual property process. For example, the IP auditor may wish to interview the head of the patent screening committee. This individual is usually the manager involved in making decisions regarding which inventions will be patented. Additionally, the IP auditor may wish to interview the publications manager with regard to publication review and copyright policies, and interview the trademark attorney or paralegal involved in registering trademarks. The IP auditor may also wish to interview the person most knowledgeable of the trade secret policies of the organization, as well as the person responsible for mass work registrations.

4. **Interviews With Users of IP Processes.** After the intellectual property auditor has become familiarized with the processes of the organization in each area of intellectual property to be investigated, the IP auditor may wish to interview users of the system. The purpose of these interviews is to solicit opinions on the system from the users regarding efficiency and effectiveness of the process, improvements that could be made to the process, incentives that could provide more motivation, and impediments to the process. Some impediments may be very minor and easy to correct. For example, access to invention disclosure forms may be corrected by simply placing them on E-mail. Other problems may present a more major problem. For example, the IP audit may reveal that an entirely new invention screening process must be implemented because of a failure of the process to select the most valuable inventions for patenting.

5. **Interviews With Management Staff.** In addition to interviewing users, the IP auditor should interview the management staff to obtain their opinion on the adequacy of the intellectual property procedures that are currently in place. For patents, typically the engineering managers can provide a wealth of knowledge regarding the various patent procedures of the organization.

6. **Review of Documents.** After key employees, users of the system, and the management staff have been interviewed, a representative sample of documents should be reviewed. In this process, a representative sample of patents, trademarks and/or copyrighted materials should be examined closely to determine what problems, shortcomings, etc., exist regarding each item investigated, and a procedure identified that can be modified to correct these problems. For example, it may be determined that a valuable patent expired for failure to pay maintenance fees. This could be the result of the lack of a docketing process for payment of maintenance fees, or that the incorrect person

reviewed the patent and considered it not to be important. Modification of these policies and procedures may be appropriate to insure that valuable patents do not expire.

### C. Stage Three - Analysis

1. **Recordation of Results.** The results of the interviews and document review process should be recorded by the IP auditor in a simple, terse and easy to understand manner. The IP auditor should record current processes used by the organization, specifying the processes by intellectual property category and listing the processes in a simple step-by-step fashion. A list should then be made of the suggestions gathered from employees regarding ways to improve these processes. Each of these suggestions should refer to a specific step listed. The list of processes used by the organization should then be compared with a comprehensive list of processes for each intellectual property category. Addendum A provides a sample (noncomprehensive) list of processes that could be employed as a checklist for a patent procedures review program.

2. **Best Practices.** The IP auditor should then prepare a list of best practices for this particular organization to be included in the final report. Best practices may vary with the type of technology, the corporate culture, the size of the organization and monetary constraints. Very careful consideration should be given to this portion of the IP audit, since a list of best practices will vary from organization to organization. The IP auditor needs to carefully analyze the entire situation in developing a best practices list. Of course, it is best if the IP auditor is familiar with the business of the organization and the manner in which it conducts business. The IP auditor should consider reviewing materials such as organizational charts, annual reports, corporate brochures, marketing materials and product data sheets. It may also be helpful to view demonstrations of the company's products, to obtain familiarity with those products.

3. **Literature References.** Preparation of the best practices list is the area in which the expertise of the IP auditor can be very valuable. For example, the IP auditor should have a sound knowledge of the law, and an understanding of the various processes that can be implemented. This understanding can come from experience in doing audits, having worked in various corporate environments, and working with different organizations as clients. There is a dearth of information in the literature on intellectual property procedures and processes employed by corporations to establish adequate protection of intellectual property assets. Several papers relating to IP audits however, do touch on this subject. "The Fundamentals of Intellectual Property Rights and the Significance of the Audit Function" by Ann S. Jordan, Practising Law Institute; Patents, Copyrights, Trademarks and Literary Property Course Handbook Series, February 1995, discloses fundamental aspects of conducting an intellectual property audit. "Performing an Intellectual Property Audit of Copyrights" by David L. Haynes, Practising Law Institute; Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series, February 1995, together with "Acquiring and Protecting Technology: The Intellectual Property Audit" by David L. Hayes, Computer Lawyer, April, 1991, are comprehensive articles relating to auditing the copyright

processes of a corporation. "Conducting an Intellectual Property Audit for Contractual Matters" by John F. Pinheiro, Practising Law Institute; Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series, February 1995, also provides an in-depth analysis of issues to be considered in auditing the licensing and contractual procedures of an organization. "Spotting Issues Before They Become Problems: The Intellectual Property Audit" by John R. Kettle III, The New Jersey Lawyer, February 6, 1995, reviews fundamental aspects of intellectual property audits in each of the areas of intellectual property law. "Intellectual Property Audits 'Part Deux': Central Issues in the Acquisition of Intellectual Property Rights" by Christopher P. Bussert, Practising Law Institute; Patents, Copyrights, Trademarks and Literary Property Course Handbook Series, February 1995, discloses valuable information regarding issues to be considered in an intellectual property due diligence process.

#### **D. Preparation of the IP Audit Report**

**1. Submission of Draft.** It is recommended that a draft of the intellectual property audit report be presented to the person authorizing the intellectual property audit for review prior to presentation to management. Since the intellectual property audit may address areas of sensitivity in the organization that relate to the manner in which employees perform their job, review of this draft is essential.

**2. Contents of Report.** The report should include a list of the current processes in a simple step-by-step format. It should then include a list of the modifications that should be made to the current processes, specifically referring to the particular steps listed. Each of the modifications should be followed by an explanation of the reasoning for making the modifications. Reference to specific case law may be appropriate. The report should then provide a full listing of the new suggested process that includes every step of the process. The report should also provide suggestions of ways of implementing these processes. For example, it may be desirable to memorialize the process steps in a comprehensive Attorney Guide. Implementation of the processes should include suggestions with regard to educating employees, and making these processes available to the appropriate people within the organization.

**3. Presentation of Report.** The report should then be presented to the management staff. One of the primary purposes of the presentation of the report to the management staff is to solicit questions and explain the importance of changes to processes as well as the implementation of new process steps. A clear explanation of the potential positive results of such changes should be presented in this meeting.

#### **Summary**

With the increasing importance of intellectual property as an asset for organizations, it is important that processes and procedures be established to acquire, enforce and protect the intellectual property of the organization, and to protect the organization from the

intellectual property of others. This paper defines and describes an Intellectual Property Audit, identifies the purpose for the Intellectual Property Audit and provides an example of how an Intellectual Property Audit can be conducted. The Intellectual Property Audit is an important process that organizations should consider as part of an overall objective of maximizing valuable intellectual property assets and protecting the organization from the intellectual property of others.



Addendum A  
INTERNAL  
MEMORANDUM

Confidential

TO : [Employees to be contacted during IP Audit]  
FROM: [Person Authorizing IP Audit] [Date]  
RE : IP Audit

The management has decided to conduct an Intellectual Property Audit and will soon begin a review of the intellectual property programs of the company with a view toward evaluating the strengths of such programs and identifying areas for possible improvement.

This "technology audit" will be carried out beginning on \_\_\_\_\_ by William W. Cochran of the law firm of Holland & Hart, who specializes in intellectual and industrial property matters. The audit will involve an evaluation of: (a) the Company's policies and procedures for the protection and management of new technologies and inventions; (b) the understanding on the part of the Company's business and technical personnel of the principles governing the protection of intellectual property; (c) the motivation on the part of technical employees to make inventions; and (d) the Company's technology licensing policies and programs.

All recipients of this memorandum are invited to suggest additional topics for the audit and to identify perceived areas for further improvement in the protection and management of the Company's intellectual property assets. It is important that you give this matter your full attention because of its great importance to the company. Anyone wishing to discuss specific matters should notify the undersigned so that appointments can be arranged.

\_\_\_\_\_  
[Name]  
[Person Authorizing the IP Audit]

## Addendum B

Checklist of Procedures for Patents (this list is not intended to comprehensively cover all issues)

- I. Invention Recordation Procedures
  - A. Inventor Notebooks
  - B. Invention Disclosure Forms
- II. Invention Reporting Incentives
  - A. Plaques
  - B. Money
  - C. Availability of Invention Disclosure Forms
  - D. Simplicity of Invention Disclosure Forms
- III. Employment Agreement
  - A. Hired to invent clause
  - B. Scope of duties clause
  - C. Requirement to promptly disclose inventions
  - D. Assignment of rights clause
    - 1. Breadth of clause
    - 2. Controlled by state law and special rules in certain states.
- IV. Consultant Agreements
  - A. Adequacy of assignment clause
  - B. Consistency in procedure of having consultants sign
- V. Invention Review Process
  - A. Criteria for screening
  - B. Parties involved in screening
  - C. Consideration for alternative procedures to patenting, such as publication or trade secret protection
- VI. Assignment Procedures for Preparation of Applications
  - A. Timing
  - B. Familiarity of patent attorney with:

1. Technology
  2. Other related inventions of the company
  3. Products of company
- VII. Availability of Documented Processes of Company Relating to the Patenting Process of the Company
- VIII. Frequency and Effectiveness of Educational Programs for Employees Relating to the Patenting Process of the Company
- IX. Education of In-House Counsel Regarding Changes in the Law
- X. Patent Preparation Procedures
- A. Checklist for preparing an application
    1. Questions for inventors regarding statutory bars
    2. Questions for inventors regarding best mode
    3. Questions for inventors regarding enablement
    4. Submission of material prior art - etc.
  - B. Other quality control issues, e.g., review process before filing
- XI. Patent Prosecution Procedures
- A. Submission of art
  - B. Scope of arguments made during prosecution
  - C. Other quality control issues
- XII. Maintenance of Patents
- A. Procedures for making maintenance decisions
    1. Competitive data
    2. Technical input on technological value of invention
- XIII. Reissue
- A. Docketing for review after 1.5 years
  - B. Business and technical input regarding breadth of invention
- XIV. Re-examination
- A. Established process if prior art found after issuance
  - B. People involved in decision making process

- XV. Docketing Procedures
  - A. Responses
  - B. Maintenance Fees
  - C. Issue Fees
  
- XVI. Right to Use Searches (Product Clearances)
  - A. When necessary
  - B. Procedure used
  
- XVII. Licensing Procedures for Patents
  
- XVIII. Indemnification from Vendors
  
- XIX. Processes for Considering Potential Infringement Situations
  - A. Threats of infringement
  - B. Offers for license
  
- XX. Processes for Writing Opinions
  - A. When necessary
  - B. Who can write
  
- XXI. Processes used to threaten others with infringement or other license
  - A. Laches
  - B. Estoppel
  
- XXII. Acquisitions
  - A. IP Due Diligence Procedures
  - B. IP Evaluation Procedures
  
- XXIII. Outside Inventor Submissions
  
- XXIV. Patent Marking Procedures
  
- XXV. Crosslicensing Procedures
  
- XXVI. Archiving of Patent Licenses
  - A. Making information available regarding patent licenses through a database.

B. Docketing actions for renewal

**XXVII. Generation of Effective Patent Prosecution Forms**