NIKE Trademark License Agreement Compliance Audit

Report FY20 - #02
September 30, 2021

Submitted to:

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Internal Audit Department
NIKE Trademark License Agreement Compliance Audit

Summary

Our audit of the NIKE Trademark License Agreement was included in the approved Fiscal Year (FY) 2020 Audit Plan. This was the first time this agreement had been audited. This strategic partnership agreement with NIKE supported the University of Arizona (the University) Institutional Excellence strategic pillar by providing royalty revenue to the University and the Department of Intercollegiate Athletics (ICA) to support their mission, athletes, and teams.

Background: To support and enhance student programs and campus life, the University entered into the NIKE Trademark License Agreement in 1998. In 2006, the agreement was fully redrafted and amended in 2009, 2010, and 2015. The current agreement is in effect until June 30, 2025.

The agreement’s primary purpose is to provide revenue to the University and ICA, through the manufacture and supply of the product, production and sale of replica apparel, and payment of royalties according to the trademark and licensing guidelines. ICA is responsible for overall management of the agreement with the University of Arizona Office of Trademarks & Licensing (UAOTL) being responsible for the royalty payment and trademark usage aspects.

Audit Objective: Our audit objective was to evaluate process controls and compliance with the terms of the executed agreement.

Scope: Our audit included controls as of May 2021 for the 2006 NIKE Trademark License Agreement and the three subsequent amendments.

Methodology: Our audit objective was accomplished by performing the following:

- testing to determine correct royalty rates were utilized and payments were accurate;
- reviewing the trademark usage and approval process;
- determining the correct additional retail product amounts were received;
- reviewing processes for new coaches to enter NIKE endorsement agreements;
- verifying NIKE provided intern opportunities;
- reviewing the NIKE Trademark License Agreement;
- corresponding with the University representatives from ICA, UAOTL, and the Office of the General Counsel;
- gaining an understanding of key processes; and
- reviewing applicable University policies and procedures.

1 The University also entered into the NIKE Sponsorship Agreement at this time. The sponsorship agreement was covered under the NIKE Sponsorship Agreement audit (Report FY20 - #01).
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Conclusion: During the audit we noted several areas that were effectively functioning. First, due to the sheer size and presence of NIKE on campus, overall awareness of the NIKE Trademark License Agreement by ICA management and staff was strong. This lessened the likelihood of non-NIKE apparel making it onto the sports fields or to media events. Second, both base and academic support payments were being made accurately and timely. However, Audit was not provided the information necessary to substantiate the royalty rates and royalty payments reviewed. This issue and one other opportunity for improvement are outlined beginning on page 4. We also identified several minor issues that were provided to management verbally during the audit.

According to the Institute of Internal Auditors International Professional Practices Framework, an organization is expected to establish and maintain effective risk management and control processes. These control processes are expected to ensure, among other things, that:

- the organization’s strategic objectives are achieved;
- financial and operational information is reliable and possesses integrity;
- operations are performed efficiently and achieve established objectives;
- assets are safeguarded; and
- actions and decisions of the organization are in compliance with laws, regulations, and contracts.

Our assessment of these control objectives as they relate to the NIKE Trademark License Agreement compliance is presented on the following page.
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<table>
<thead>
<tr>
<th>General Control Objectives</th>
<th>Control Environment</th>
<th>Audit Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Achievement of the Organization's Strategic Objectives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Strategic objectives were supported through the manufacture, supply, and sale of apparel along with payment of royalties for the use of the University trademarks.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>Reliability and Integrity of Financial and Operational Information</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Correct royalty rates were used in royalty payment calculations.</td>
<td>Opportunity for Significant Improvement</td>
<td>1 4</td>
</tr>
<tr>
<td>Effectiveness and Efficiency of Operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• NIKE provided intern opportunities.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>• Annual base payments were made timely and accurately.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>• Academic support payments were made timely and accurately.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>• New coaches entered into NIKE endorsement agreements.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>• Correct additional retail product amounts were received.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>Safeguarding of Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• NIKE received approval prior to the use of the University trademarks.</td>
<td>Opportunity for Improvement</td>
<td>2 6</td>
</tr>
<tr>
<td>Compliance with Laws and Regulations</td>
<td>Not Applicable</td>
<td></td>
</tr>
</tbody>
</table>

We appreciate the assistance of ICA and UAOTL employees during this audit.

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Audit Results, Recommendations, and Responses

1. Quarterly royalty rates could not be verified.

Condition: Management advised that they were not verifying that correct royalty rates were being applied to the quarterly royalty payments received. In addition, Audit’s attempt to reconcile 8 quarterly royalty payments and subsequent UAccess Financials entries, which are the basis for the revenue allocations made to ICA, revealed the following:

- UAOTL failed to provide NIKE sales dollars and the “other royalty” amounts necessary to allow a recalculation of the royalty percentages and a reconciliatiation of the total royalty payments received.
- 6 (75%) payments contained deductions totaling $397,288 without invoice support and for which UAOTL did not provide an explanation; and
- 1 (13%) payment received was $1,396 higher than Audit’s calculation.

Criteria: Good business practices suggest that royalty rates should be verified.

2006 NIKE Trademark License Agreement Paragraph 6(c) states: “The royalty rates payable by NIKE on Licensed Product sold under the Retail License ... shall be ... percent ...”

2015 NIKE Trademark License Amendment states: “Paragraph 6(c) shall be deleted in its entirety and replaced with the following: "The royalty rate payable by NIKE on Licensed Product sold under the Retail License ... shall be ... percent ...”

Cause: UAOTL management relied on a third-party vendor to use the correct royalty rates and calculate the correct royalty amounts.

Effect: Potentially incorrect royalty payments made to the University, unsubstantiated UAccess Financials postings, and/or lower than expected revenue allocations to ICA based on the agreement.

Recommendations:

UAOTL should:

1. Create a process to obtain the sale amounts and verify the percentages used in the quarterly payment calculations match the royalty rates in the agreement. This process should also include providing all invoices and support documents to accounting for all royalty deductions; and

2. Reconcile the one payment noted and explain any variances.
Management Response:

Target Implementation Date: December 31, 2021.

UAOTL will meet with CLC to have a Nike sales report generated so that we can confirm royalty rates are correct and have been correctly reported for that quarter.

UAOTL moved from an internal business officer to a shared business services department. Since that change, documentation is supplied and accounted for all royalties received. Moving forward all variances are corrected in real time and wire transfers are only accepted when money has been verified. Management will attempt to reconcile previous royalty payments, but all payments moving forward have been 100% verified.
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2. University logos on NIKE gear and uniforms were not receiving UAOTL review or approval.

Condition: University logos on NIKE gear and uniforms were not going through UAOTL for review and approval as required. Rather, the gear/uniforms were reviewed by an ICA approval committee which did not contain a UAOTL representative.

Criteria: The University of Arizona policy titled Product Licensing and Trademark Usage (UR-101) states: “Products bearing University Trademarks and distributed for resale, as premiums, or for any other purpose are subject to the licensing requirements of this Policy.” Further it states: “The use of any trademark that identifies, or is associated with, the University of Arizona, may not be used without the prior express written authorization of the University of Arizona’s Trademarks & Licensing Office.”

Cause: ICA management advised the auditor that they thought approval by the committee was sufficient and were unaware of the policy requirement.

Effect: Logos on apparel that are potentially not up to current University standards.

Recommendation: Include UAOTL representatives in the review and approval process for the NIKE gear and uniforms.

Management Response:

Target Implementation Date: July 31, 2022.

ICA Equipment Team will create an internal process to document approval of new uniforms and gear before the items are created and ordered. This process will include documentation of the internal ICA approval and approval by UAOTL.
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