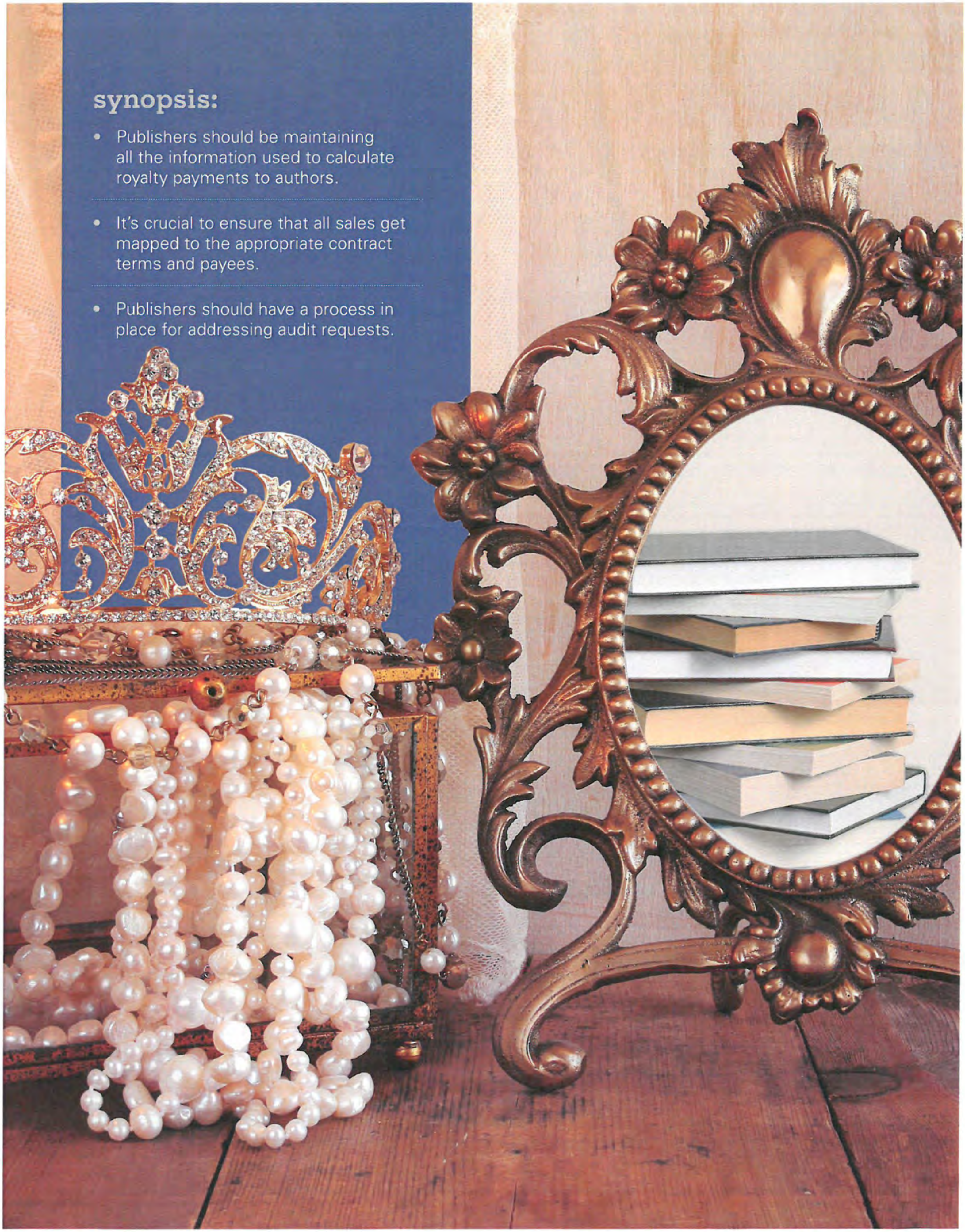
synopsis:

- Publishers should be maintaining all the information used to calculate royalty payments to authors.
- It's crucial to ensure that all sales get mapped to the appropriate contract terms and payees.
- Publishers should have a process in place for addressing audit requests.



Getting the Royalty Treatment

The author-publisher relationship is a delicate one. Here are some tips on how to navigate tricky royalty statements.

by Juli Saitz and Steve Gillen

The relationship between publisher and author is an interdependent one. If the author doesn't write well and on schedule, the publisher has nothing to develop, market, and sell. On the other hand, no matter how well an author writes, the author isn't likely to see his or her book reach its full potential without the publisher's marketing savvy and access to distribution channels.

Twice a year, authors get a check, but along with the good news comes a reminder in the form of an opaque and largely indecipherable royalty statement; they are at the mercy of their publishers when it comes to calculating and receiving royalties. Publishers should understand that it only takes suspicion, not proof, to destroy trust. So how do you steer clear of suspicion? Follow our advice, based on extensive experience, for maintaining trust and a healthy publisher-author relationship.

Write a Clear Contract

Make sure your contract clearly and unambiguously explains how you will calculate royalties. If there are different rates for different channels, as is typically the case, make sure you define the channels so they are understandable and distinct. Where you must provide for flexibility, say in allocating sales proceeds across the components of a bundled ▶

What to Include in a Royalty Statement

At a minimum, royalty statements should contain:

- Title of the work (including edition) sold and related ISBN
- Quantity (sold and returned)
- Price (list of sales, depending on contract)
- Royalty rate
- Type of sale (e.g., regular US, foreign, electronic, high discount)
- Date of sale
- Explanation of any deductions and/or adjustments
- Sub-rights information (e.g., country, language)
- Life-to-date sales
- Information as to whether product was sold as a standalone item or part of a bundled package

Information that is compiled and created in response to an audit request is subject to higher scrutiny by an auditor.

product, base your allocation decisions on objectively measurable, verifiable metrics (such as relative page counts, list prices, or digital file sizes).

Capture Necessary Data

Generally speaking, publishers should be maintaining all the information used to calculate royalty payments to authors. The vast majority of publishers have this information somewhere within their enterprise-wide reporting and/or royalty systems. However, smaller publishers may not readily have access to the information that will be requested by an auditor. Information should be kept for the period of the relevant statute of limitations, and publishers should be careful to note that this period varies from state to state and contract to contract.

The following is the type of information that a publisher should be maintaining:

- **Publishing contracts** – This includes all original contracts, amendments, addenda, and side letters. This type of information can be voluminous for a particular author; good practice dictates keeping all contracts in one place and maintaining a listing or map of all contract documents along with their date and notations of major contract changes.
- **Detailed sales records** – Detailed sales records should contain the customer's name, product sold, date of sale, invoice number, quantities sold, and sales price. This information allows the auditor to trace reported sales on the royalty report back to underlying contemporaneous sales data that will then be used to ensure that all sales have been properly reported.
- **Invoices** – Invoices arguably contain the most reliable and contemporaneous sales data in any organization. Auditors will typically ask for a sample of invoices to ensure that sales records are accurate.
- **Adjusting calculations** – Certain publishing agreements provide for calculations that cannot be handled or automated by a publisher's regular royalty reporting system. In this case, any manual calculations that are done by the publisher should be maintained and kept readily available as support for its royalty calculations.
- **Sub-rights contracts and payments** – The maintenance and tracking of sub-rights contracts is the bane of existence for many royalty departments. However, a good system should be in place for tracking the status of such contracts and payments for sub-rights, as many authors commission audits based on sales abroad and not being able to identify a corresponding line in their royalty statements.
- **Inventory reports** – Inventory records, while critical to running a business, are also relevant to auditors in determining the accuracy of royalty reporting. These records should show the number of books printed, sold, transferred, or otherwise disposed of. Sales figures on inventory records should closely match those on sales records. Underpaid royalties may be found through an analysis of inventory records. For example, a particular edition of a book with a new ISBN is likely to be reflected on the inventory records. If that ISBN does not also make its way into the publisher's royalty reporting system, royalties will not be paid.
- **Bill of materials records** – Depending on the type of book, these records are critical to maintain in order to

cooperate with an audit. For books that are only sold on a standalone basis, these records are nonexistent or of little use to an auditor. However, for books packaged with other books, ancillary materials or products (e.g., textbooks, children's books, collections), the bill of material information is necessary for one to determine the proper allocation of royalty-bearing revenue among various pieces of a package. Publishing agreements often have clauses as to how allocations should be made, and the only way to determine if the allocations being made are in compliance with the contract terms is via an analysis of the bill of materials.

Information, whenever possible, should be the form of a report that can be quickly generated from the publisher's royalty reporting system. Information that is compiled and created in response to an audit request is subject to higher scrutiny by an auditor. For example, sales records that are produced by querying the publisher's royalty reporting system will be viewed as more reliable than sales data compiled in a spreadsheet by an individual.

Questions to Consider

How should a publisher ensure that all sales get mapped to the appropriate contract terms and payees?

The importance of having a robust and reliable royalty reporting package goes without saying. However, despite all the automated capabilities, there is still a great deal of human input required in properly calculating and paying author royalties. This presents unique challenges for organizations. When setting up manual overrides in the royalty reporting system, the publishing contract should be reviewed carefully. Publishers should test the system and compare the results with manual calculation to ensure that the royalty reporting system is able to handle unique calculations.

All employees within the royalty reporting and accounting functions should be properly trained to understand the process flow of the royalty reporting system and its limitations. Others—such as those in acquisitions, editorial, and marketing—should also ▶

have a general understanding of the sales and royalty reporting functions. Authors often go to their first point of contact within the publisher, and this is usually someone in editorial, not accounting.

Any individual who works on reporting royalties for a particular author should have a copy of the relevant royalty contracts in his or her files and refer to it as necessary. Any calculations that need to be done manually should be reviewed by at least one other individual within the publisher

Finally, an ounce of prevention is worth a pound of cure. By way of example, we recently went through an audit with a mid-sized publisher and, after an extraordinarily long wait for the most basic sales documents, asked what the problem was. We learned that the publisher had two authors with the same name and thus no way to query their systems to obtain information by author. While foresight can prove elusive, a unique identifier, such as a middle initial, would have prevented extra work on the part of the publisher and additional mistrust on the part of the author.

Publishers [should] perform an internal royalty audit function. Performing these types of reviews will reveal weaknesses within their own systems and problems with royalty reporting.

before statements are generated. Training is key; large audit findings are often the result of human error and a lack of understanding by the individual generating royalty statements.

Publishers are well-advised to perform an internal royalty audit function with respect to their royalty calculations and reporting. Performing these types of reviews will reveal weaknesses within their own systems and problems with royalty reporting for particular authors.

Additionally, the publisher should maintain a listing of all ISBNs associated with each author along with an indication as to whether they are royalty bearing or not. Relevant contract terms or notations should be made on the report. This simple listing will prove invaluable to all parties when trying to go back to ever-changing contract terms and countless ISBNs.

What are the potential consequences of doing a poor job on this?

At best, poor record keeping on behalf of a publisher will lead to an enormous use of internal resources to compile the information needed to respond to an audit request, diverting employees from performing their regular, day-to-day duties. In some cases, a third party consulting firm will need to be engaged by the publisher to assist in gathering relevant records. This will likely cost the publisher more than what may be uncovered during the course of an audit.

At worst, if records are not maintained or are not made reasonably available, an author may find it necessary to resort to litigation or arbitration, with all the attendant risk, expense, and disruption, to get some comfort that the publisher is holding up its end of the bargain.

How can a publisher prepare so that audits are less burdensome?

By maintaining the types of information listed in this article in a readily accessible format, publishers are much better positioned to respond to an audit request in an efficient fashion. A dedicated individual within the royalty or accounting department should be assigned in advance to addressing audits or, in the case of larger publishers, responsible for certain authors. Publishers should also have a process in place for addressing audit requests. This process should include a tracking system to capture all auditor requests and dates when responses are provided. Finally, publishers should have a standard nondisclosure agreement for outside auditors and authors to sign at the outset of an audit and a process in place for dealing with requested changes to such agreements.

The more successful you are with your list, the more you will spend on royalties—that's a good thing. But account for them poorly and all that money will buy you is suspicion and ill will. Far better to be diligent and transparent in your royalty reporting so the money you spend there will earn you the trust and loyalty of your authors. •

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