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The University of Texas at Austin
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This report has been distributed to Internal Audit Committee members, the Legislative Budget Board, the State Auditor’s Office, the Sunset Advisory Commission, the Governor’s Office of Budget and Planning, and The University of Texas System Audit Office for distribution to the Audit, Compliance, and Management Review Committee of the Board of Regents.

Intercollegiate Athletics Business Office Contract - Fanatics
Project Number: 16.023
August 11, 2017

President Gregory L. Fenves
The University of Texas at Austin
Office of the President
P.O. Box T
Austin, Texas 78713

Dear President Fenves,

We have completed our audit of the Athletics Business Contract with Fanatics. Our scope included the Agreement with Fanatics for the period of July 1, 2015 – June 30, 2016 and the May 25, 2014 one-time royalty reconciliation payment.

Based on the audit procedures performed, we conclude that Athletics and Fanatics are generally compliant with the basic terms of the Agreement; however, five opportunities for improvement were noted regarding controls and procedures related to monitoring the Agreement with Fanatics. Our audit report provides detailed observations for each area under review. Suggestions are offered throughout the report for improvement in the existing control structure.

We appreciate the cooperation and assistance of Intercollegiate Athletics and Fanatics staff throughout the audit and hope that the information presented herein is beneficial.

Sincerely,

Michael W. Vandervort, CPA
Chief Audit Executive

cc: Institutional Audit Committee Members
Mr. Michael Perrin, Men’s Athletic Director, Intercollegiate Athletics
Ms. Christine Plonsky, Women’s Athletics Director and Executive Senior Associate Athletics Director for External Services, Intercollegiate Athletics
Ms. Lori Hammond, Associate Athletics Director, Risk Management and Compliance Services, Intercollegiate Athletics
Mr. Craig Westemeier, Sr. Associate Athletics Director, Business Development, Intercollegiate Athletics
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EXECUTIVE SUMMARY

Conclusion
Based on our review of the Trademark and Domain Name License Agreement (Agreement) with Fanatics Group Chicago, Inc. (Fanatics), the Office of Internal Audits (Internal Audits) concludes that The University of Texas Intercollegiate Athletics (UT Athletics) and Fanatics are generally compliant with the basic terms of the Agreement. Recommendations were made to improve web accessibility to those with disabilities and improve controls and procedures related to monitoring the Agreement with Fanatics.

Summary of Recommendations
Each issue has been ranked according to The University of Texas System Administration Audit Issue Ranking guidelines. Please see the Appendix for ranking definitions. Internal Audits identified two notable issues leading to the following recommendations:

- UT Athletics management should work with the UT Austin Accessibility Coordinator to periodically test the online store website EIR’s, provide test results to Fanatics, and ensure Fanatics takes appropriate action to bring the website into compliance with web accessibility requirements. *(Audit Issue Ranking: High)*
- UT Athletics management should ensure that Fanatics has obtained required insurance coverage on an annual basis. *(Audit Issue Ranking: High)*

Three additional recommendations are provided, but are considered minor in significance.

Audit Scope and Objective
The scope of this audit included the Agreement with Fanatics for the period of July 1, 2015 – June 30, 2016, to cover the contract year as described in the Agreement. In addition, the scope also included the May 25, 2014, one-time royalty reconciliation payment. The audit objective is to determine whether Fanatics and UT Austin are upholding the terms and conditions in the Agreement.

Background Summary
The Agreement between the Board of Regents of the University of Texas System on behalf of UT Austin and Fanatics went into effect July 1, 2012, and is scheduled to continue through June 30, 2019. Fanatics is a multi-channel retailer of licensed sports apparel and merchandise. The Trademark and Domain Name License Agreement grants Fanatics the use of UT Austin Designated Marks and Domain Name in connection with the operation of an online retail store and brick and mortar retail stores. In exchange, Fanatics pays royalty payments to UT Austin over the term of the agreement.
BACKGROUND

Fanatics Group Chicago, Inc. (Fanatics) is a multi-channel retailer of licensed sports apparel and merchandise. Fanatics powers the e-commerce sites of all major professional sports leagues, major media brands and over 200 collegiate and professional team properties.¹

The University of Texas at Austin (UT Austin) is using certain trademarks worldwide and has obtained a U.S. Trademark Registration covering those words and designs (collectively, Designated Marks). In addition, UT Austin owns the rights to the Domain Name shop.texassports.com for use on the internet and is the registered owner of the Domain Name.²

The Board of Regents of The University of Texas System on behalf of UT Austin entered into The Trademark and Domain Name Agreement (Agreement) with Fanatics on July 1, 2012. The Agreement will continue through June 30, 2019, and grants Fanatics the use of Designated Marks and the Domain Name in connection with the operation of an online retail store and brick and mortar retail stores. Fanatics provides management, labor, equipment, goods, services, and supplies necessary to develop, operate, and maintain the stores. In exchange, Fanatics pays several categories of royalty payments to UT Austin over the term of the agreement including:

- Guaranteed royalty installments,
- Earned royalty (calculated as the aggregate sum of the royalty percentage for each sales category multiplied by the total adjusted gross revenue for that sales category),
- One-time royalty reconciliation payment compensating UT Austin for amounts due from agreement effective date until June 30, 2014, not previously paid, and
- Performance-based enhancement payments in the form of a bonus when a men’s football, basketball, or baseball team win a national championship or reach a certain level of NCAA postseason games.

SCOPE, OBJECTIVES, AND PROCEDURES

The scope of this audit included the Agreement with Fanatics for the period of July 1, 2015 – June 30, 2016, to cover one contract year as described in the Agreement, and the May 25, 2014, one-time royalty reconciliation payment.

The audit objective was to determine whether Fanatics and UT Austin are upholding the terms and conditions in the Agreement.

¹ Fanatics website located at http://www.fanaticsinc.com/about.
² Trademark and Domain Name License Agreement between the Board of Regents of The University of Texas System, on behalf of The University of Texas at Austin and Fanatics Retail Group Chicago, Inc.
To achieve the objective, the Office of Internal Audits (Internal Audits):

- Reviewed the executed agreement and associated exhibits,
- Tested web accessibility requirements related to the online store,
- Reviewed royalty payments for accuracy and timeliness,
- Conducted a physical walkthrough of the brick and mortar retail stores, and
- Reviewed relevant financial documents and reports.

UT Athletics requested this audit as an agreed-upon procedures audit and we conducted the audit in accordance with the *International Standards for the Professional Practice of Internal Auditing* and with *Government Auditing Standards*.

**AUDIT RESULTS**

Based on our review of the Agreement with Fanatics, Internal Audits concludes that UT Athletics and Fanatics are generally compliant with the basic terms of the Agreement. Recommendations were made to improve web accessibility to those with disabilities and improve controls and procedures related to monitoring the Agreement with Fanatics.

The following recommendations were made to improve compliance with Agreement terms. Each issue has been ranked according to The University of Texas System Administration (UT System) Audit Issue Ranking guidelines. Please see the Appendix for ranking definitions.

**Online Retail Store Uniform Resource Locator (URL) not Compliant with Accessibility Requirements**

**Audit Issue Ranking: High**

Fanatics URLs (Fanatics, Fanatics-Texas Longhorns, and Texas Sports Shop), do not comply with Texas Administrative Code\(^3\), Title I, section 206 and 213 related to state web sites and Electronic and Information Resources (EIR). Based on a report from the EIR Accessibility Coordinator with the Office of the Chief Information Officer at UT Austin, Texas Sports Shop URL scored 8%, Fanatics URL scored 1%, and Texas Longhorns URL scored 0%, while a good web site score would be at least 90%.

It appears that Fanatics was not aware that the URLs were not in compliance and UT Athletics did not test Fanatics URLs periodically for compliance with the terms of the Agreement. When the websites do not comply with the terms of the Agreement regarding

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\(^3\) The Texas Administrative Code (TAC) is a compilation of all state agency rules in Texas. There are 16 titles in the TAC. Each title represents a subject category and related agencies are assigned to the appropriate title. For more information see https://www.sos.state.tx.us/tac/index.shtml
EIRs, there is a risk of lawsuits, damage to UT Austin reputation, and hindered web access for people with physical, sensory, or cognitive disabilities.

The Agreement, Section 19.3 that corresponds to accessibility requirements states "The websites, electronic and information resources and all associated information, documentation, and support that Licensee uses to operate the Online Store (collectively, the "EIRs") will comply with the applicable requirements set forth in Title 1, Chapters 206 and 213 of the Texas Administrative Code that apply to Licensee ...".

**Recommendation 1:** UT Athletics management should work with the UT Austin Accessibility Coordinator to periodically test the online store website EIR’s, provide test results to Fanatics, and ensure Fanatics takes appropriate action to bring the website into compliance with web accessibility requirements.

**Management’s Response and Corrective Action Plan:**
Texas Athletics has scheduled an August 1, 2017 call with the EIR Web Accessibility Coordinator, Jennifer Maedgen, and appropriate personnel from Fanatics to outline noncompliance issues. A plan will be developed to address those matters as soon as possible, as well as, ensuring compliance in the future. In addition, a calendar will be created for periodic follow-ups to ensure steps toward compliance. Texas Athletics will ask EIR Web to run a test on the online store website to verify compliance following implementation of all recommended changes.

**Responsible Person:** Craig Westemeier (Senior Associate Athletics Director for Trademark Licensing, Texas Athletics) & Erick Avila (Manager for Team Shop, Fanatics)

**Planned Implementation Date:** September 1, 2017 for development of plan to address identified noncompliance issues; Following the August 1, 2017 phone call, we may have a better gauge on the implementation timeline for full compliance. It is likely that updates will continue throughout the fall semester until all issues are addressed. We will coordinate with Senior Associate Athletics Director Mike Bos, who oversees Texas Athletics IT, on this matter as to compliance progress.

**Post Audit Review:** Internal Audits will follow-up in the first quarter of FY18.

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**Inadequate Insurance Coverage**

**Audit Issue Ranking:** High

Fanatics did not have appropriate Commercial General Liability insurance coverage relating to medical expenses for any one person. Our review of the two Commercial General Liability insurance certificates covering our audit period found that one of the insurance certificates indicated medical expense coverage of $5,000 for any one person.
The other insurance certificate met coverage requirements of $10,000 for any one person. Because Fanatics did not acquire and file adequate insurance coverage and Athletics did not properly verify that adequate coverage was in place, Fanatics was underinsured.

According to Section 17.1.2 of the Agreement, Fanatics must obtain Commercial General Liability Insurance with a medical expense limit of not less than $10,000 for any one person.

**Recommendation 2:** UT Athletics management should ensure that Fanatics has obtained required insurance coverage on an annual basis.

**Management's Response and Corrective Action Plan:**
Craig Westemeier has followed up with Erick Avila of Fanatics regarding the need for Fanatics to provide the required $10,000 insurance coverage. Erick is working with Fanatics executive leadership to ensure that the coverage is added will provide Texas Athletics with a new certificate with the correct amount of coverage.

**Responsible Person:** Craig Westemeier (Senior Associate Athletics Director for Trademark Licensing, Texas Athletics) & Erick Avila (Manager for Team Shop, Fanatics)

**Planned Implementation Date:** September 1, 2017

**Post Audit Review:** Internal Audits will follow-up in the first quarter of FY18.

**Discounts on Purchases from Fanatics Retail Store**

**Audit Issue Ranking:** Medium

Per the Agreement, UT Athletics did not use a 30% discount on certain purchases made from the Retail Store. Six (24%) of 25 of the transactions tested did not have the discount applied. UT Athletics management may not be monitoring every purchase made from Fanatics for discounts applied. Without monitoring the purchases made from Fanatics, UT Athletics is paying more than the agreed amount for some purchases made at Fanatics retail store.

Exhibit C, Section 6.2 of the Agreement that corresponds to UT Athletics discount states "Licensee will sell Retail Store Merchandise to Athletics Department at a thirty percent (30%) discount off of Licensee's regular retail selling price for each Retail Store Merchandise item sold to Athletics Department".

**Recommendation 3:** UT Athletics management should ensure the appropriate discount is used for purchases made from Fanatics retail store and check the purchase transactions for the discounts.
Management’s Response and Corrective Action Plan:
Senior Associate Athletics Director For Trademark Licensing communicated with the business office regarding store purchasing procedures. Plans are to communicate to all full-time Texas Athletics staff regarding the discount and to create a back-end ‘check’ while processing payments for store purchases to ensure the discount was applied.

Responsible Person: Craig Westemeier (Senior Associate Athletics Director for Trademark Licensing, Texas Athletics) & Jon Payne (Associate Athletics Director/CFO)

Planned Implementation Date: September 1, 2017; A staff reminder will be sent at the start of each academic year.

Post Audit Review: Internal Audits will follow-up in the first quarter of FY18.

Report Receipt Dates
Audit Issue Ranking: Medium
UT Athletics did not document the receipt dates of periodic statements related to the retail operations of the stores and year-end reports substantiating the royalty payable. UT Athletics retained and made available for our review the periodic statements and year-end reports received form Fanatics. However, the current process does not include documenting the receipt dates of the statements and reports. Lack of documentation regarding the receipt date of the statements and reports makes it difficult to substantiate whether Fanatics was timely in providing reports to UT Athletics, in compliance with the terms of the Agreement. Untimely reporting will diminish the operational usefulness of the statements and reports.

The Agreement, Section 15.5 that corresponds to year-end reports states, "Within thirty (30) days after the last day of each Contract Year, Licensee will prepare and provide to University a report ...". The Agreement further states in Section 16.2 corresponding to the periodic statements "Within thirty (30) days after the end of each Accounting Period during the Term, Licensee will submit ..."

Recommendation 4: UT Athletics management should established a procedure to document the receipt date of reports from Fanatics. This will provide evidence regarding Fanatics complying with the terms of the Agreement.

Management’s Response and Corrective Action Plan:
This information has been forwarded from Fanatics to Craig Westemeier, Senior Associate Athletics Director For Trademark Licensing, via email, at which time it is date stamped. Craig Westemeier will maintain a file that includes email with date stamp in pdf format for future reference.
Responsible Person: Craig Westemeier (Senior Associate Athletics Director for Trademark Licensing)

Planned Implementation Date: Immediately; Craig Westemeier also will reconcile receipts of reports from the 2016-17 year.

Post Audit Review: Internal Audits will follow-up in the first quarter of FY18.

Royalty Payments Received after Due Date
Audit Issue Ranking: Medium
The one-time royalty reconciliation payment due on or before May 25, 2014, was received 38 days after the due date and three out of four guaranteed royalty installments during the contract year were received two to three days after their due dates. UT Athletics is not monitoring the royalty payment(s) receipt dates. Without monitoring the due dates for Fanatics payments, UT Athletics could encounter extended periods between the date payments are due and the date payments are made.

The Agreement, Section 15.1 that corresponds to royalty reconciliation payment due states "In accordance with Section 15.4, on or before, May 25, 2014, Licensee will pay University ... as a royalty reconciliation payment"

The Agreement, Section 15.2 that corresponds to guaranteed royalty and guaranteed royalty installments payment due states-"...The Guaranteed Royalty will be paid by Licensee to University in installments of ... within three (3) days after the beginning of each Accounting Period"

Recommendation 5: UT Athletics management should monitor the royalty payment dates and ensure that Fanatics deliver the payments on time according to the terms of the Agreement.

Management's Response and Corrective Action Plan:
The Texas Athletics Business Office already implemented a process with reminders 30 days prior to due date and a follow-up five days prior to due date. The staff confirms the incoming checks and follows up if payment is not received.

Responsible Person:
Jon Payne (Associate Athletics Director/CFO), Kendal Carrillo (Financial Analyst/Receivables), Megan Helwagen (Accountant I)

Planned Implementation Date: Immediately

Post Audit Review: Internal Audits will follow-up in the first quarter of FY18.
CONCLUSION

Based on our review of the Agreement with Fanatics, Internal Audits concludes that UT Athletics and Fanatics are generally compliant with the basic terms of the Agreement. Recommendations were made to improve web accessibility to those with disabilities and improve controls and procedures related to monitoring the Agreement with Fanatics.

In accordance with directives from The University of Texas System Board of Regents, the Office of Internal Audits will perform follow-up procedures to confirm that audit recommendations have been implemented.
APPENDIX

Audit Issue Ranking

Audit issues are ranked according to the following definitions, consistent with UT System Audit Office guidance. These determinations are based on overall risk to UT System, UT Austin, and/or the individual college/school/unit if the issues are left uncorrected. These audit issues and rankings are reported to UT System directly.

- **Priority** – A Priority Issue is an issue that, if not addressed immediately, has a high probability to directly impact achievement of a strategic or important operational objective of UT Austin or the UT System as a whole.
- **High** – An issue that is considered to have a medium to high probability of adverse effects to UT Austin either as a whole or to a significant college/school/unit level.
- **Medium** – An issue that is considered to have a low to medium probability of adverse effects to UT Austin either as a whole or to a college/school/unit level.
- **Low** – An issue that is considered to have minimal probability of adverse effects to UT Austin either as a whole or to a college/school/unit level. Issues with a ranking of “Low” are reported verbally to the unit and are not included in the final report.