Financial Review

Limitations

Pursuant to the requirements of the Chief Financial Officer's Act of 1990, the financial statements which follow the financial review have been prepared to report the financial position and results of operations of the Patent and Trademark Office (PTO). The fiscal year 1995 financial statements consist of the Statement of Financial Position; Statement of Operations and Changes in Net Position; Statement of Cash Flows; and the Statement of Budgetary Resources and Actual Expenses. The following limitations apply to the preparation of the fiscal year 1995 financial statements:

> While the statements are prepared from the books and records of the entity in accordance with the formats prescribed by the Office of Management and Budget (OMB), the statements vary from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.
>
> The statements should be read with the realization that they are for a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than contracts can be abrogated by the sovereign entity.

A Message From the Chief Financial Officer

The Patent and Trademark Office remains focused on continuous improvement and innovative leadership in the arenas of intellectual property protection and customer service. This commitment is carried out at all levels of the organization, starting with our Commissioner. Our financial management organization supports these goals through our emphasis on sound financial management practices, a progressive focus on enhancing our technological capabilities, and our ongoing commitment to achieving improved results.

We have made strides toward achieving a stronger financial management organization. A Comptroller was selected to fill the position created in the last fiscal year. The Comptroller provides strong leadership and coordination for the financial management activities of Budget, Finance, and Procurement. We have implemented continuing professional education programs and they are being fulfilled by our accountants and budget analysts. We are also encouraging our financial management personnel to take full advantage of the PTO University program to obtain college credits in both undergraduate and graduate programs. The office has recently completed a business process reengineering analysis of the current budget and planning process, developed a framework for a new process, and is developing a transition plan for implementing the new process. An additional project includes development of resource management information.

We continue our advancements on the technological front as well, to achieve our goal of providing an integrated financial management system that provides accurate, timely, and accessible financial information. We have upgraded our computerized financial management system and we continue to make progress in the development of the Revenue Accounting and Management System. We are placing an increased emphasis on our automated procurement subsystem in order to move away from paper-based transactions. We have recently implemented an electronic payment system in order to get payments to vendors more efficiently.

My commitment to overall accountability and sound financial management practices remains strong. Our fiscal year 1995 Financial Statements have received an unqualified opinion from the Office of the Inspector General for the Department of Commerce. These Financial Statements include the Statement of Financial Position which shows that assets grew 39% to $467 million and liabilities totaled $293 million, an increase of 25%; the Statement of Operations and Changes in Net Position which indicate revenues of $605 million and expenses of $525 million; the Statement of Cash Flows showing sources and uses of funds; and the Statement of Budgetary Resources and Actual Expenses that reconciles actual expenditures to budgetary resources.

Bradford R. Huther

Bradford R. Huther
Associate Commissioner and
Chief Financial Officer

Financial Review

During the first part of this century, the Patent and Trademark Office (PTO) was virtually self-supporting. As the century progressed, fee receipts, as a percentage of operating costs, declined substantially. By 1982, only 23 percent of total operating costs were offset by fee recoveries. On August 27, 1982, the Patent and Trademark Authorization Act was signed. This act provided for a growing recovery of operating costs from fee income and allowed the PTO to retain the fee income as offsetting collections.

The most recent Congressional act to impact the user fee-funded environment was the Omnibus Budget Reconciliation Act (OBRA) of 1990. Statutory patent fees were increased by 69%. The PTO received only nominal appropriations from general taxpayer revenues in fiscal year 1992. With the start of fiscal year 1993, as stipulated in the OBRA, funding from such appropriations ceased completely. All operating costs are now funded by the collection of user fees. These collections have risen from $413 million in 1992 to $603 million in 1995.

This is the fourth annual financial statement prepared in response to the requirements of the Chief Financial Officer's Act of 1990. These statements have been compiled in accordance with guidance issued by the Office of Management and Budget and the Department of Commerce.

The Office of Inspector General (OIG) audits the Financial Statements of the Patent and Trademark Office. For FY 1993, the Statement of Financial Position was audited and the OIG rendered an unqualified opinion on this statement. In 1995, the OIG audited the FY 1994 Statements of Financial Position, Operations and Changes in Net Position, Cash Flows, and Budgetary Resources and Actual Expenses; the PTO received an unqualified opinion on all of these statements. In their report to the Chief Financial Officer, the OIG made recommendations for improving internal controls and promoting operating efficiencies. Actions have been initiated by the PTO to implement these recommendations.

TRENDS IN INCOME AND EXPENSES

User fees are the source of all revenues earned by the PTO. Customers pay fees in advance of the products and services to be received. A broad spectrum of products and services are provided and sold to the general public, and individual fees are assessed accordingly. Fee collections have continued to climb as the demand for PTO products and services has increased. This has caused the PTO to have unusually large year end balances in our Fund Balance with Treasury; Net Position; and Excess of Revenue and Financing Sources Over Total Expenses. These balances are attributable to several factors.

Incoming workloads (or orders for products and services) have exceeded planned levels. In fiscal year 1995, new patent applications (utility, plant, reissue and design applications) were planned at 208,300. The actual number of new applications received in 1995 was 236,679, which was 14 percent higher than projected. In the trademark area, the PTO received 175,307 new applications in fiscal year 1995 which exceeded plan by 18,307 or 12 percent.

Much of the workload increase in the patents area during fiscal year 1995 was due to a one time influx of applications resulting from the GATT

Uruguay Round Agreements Act. As part of this agreement, the PTO moved from a patent term of 17 years from date of issue to 20 years from date of filing. The agreement was implemented on June 8, 1995, and the number of patent applications filed increased dramatically just prior to that date.

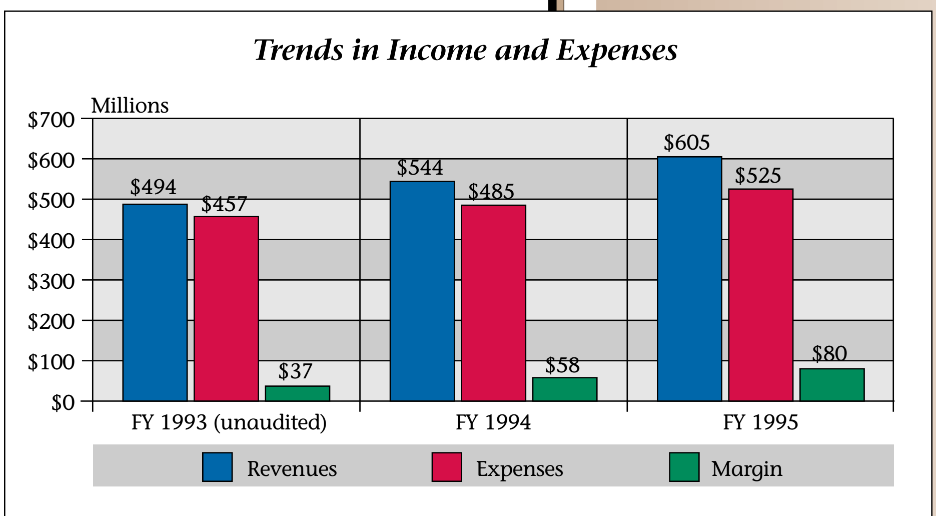
The PTO also collects fees for the maintenance of issued patents over the life of the patent. Maintenance fees are collected in three stages. Maintenance fees were planned based upon an anticipated renewal rate of 80 percent at the first stage (at the end of the third year after a patent is issued); 57 percent at the second stage (at the end of the seventh year after a patent is issued); and 25 percent at the third stage (at the end of the eleventh year after a patent is issued). Actual renewal rates were higher than planned for third stage collections. Since the maintenance fee for the third stage is the largest of the maintenance fees, the greater collection rate at this stage had a significant impact. The PTO will continue to monitor its estimates, but the decision to renew a patent or not is entirely up to the patent owner and is thus not under the control of the PTO.

The net result of higher than planned incoming workloads and payment of patent maintenance fees resulted in fee collections greater than our plan. These amounts totaled nearly $56 million in fiscal year 1995. The above figures indicate that the Patent and Trademark business is prospering. The increased workload does have its downside, including the fact that the PTO is often unable to immediately respond to the increases; the examination processes rely heavily upon trained and experienced patent examiners and trademark attorneys, the majority of whom are hired as recent college and university graduates. Fortunately, advanced fee payments may be carried over from one year to the next while the PTO expands its operational capacity to address growing inventories of unexamined patent and trademark applications.

Also included in the year end balances are fees that have been collected but are not available for the PTO's use. The Omnibus Budget Reconciliation Act of 1990, as amended in 1993, imposed a surcharge upon specific patent fees. These surcharges, to be collected by the PTO and deposited to the Treasury, require appropriation by the Congress in order to be available to the PTO. In fiscal year 1995, the PTO deposited $107 million in surcharge fees. The Congress appropriated approximately $83 million. The difference for FY 1995, approximately $24 million, was not made available to the agency. The cumulative total of surcharge funds, remitted to the PTO by the public for patent examination, that have not been appropriated back to the PTO is approaching $60 million.

At the end of fiscal year 1995, the Patent and Trademark Office had Cumulative Results of Operations totaling approximately $109 million. The Office also had deferred revenue for work yet to be performed of approximately $173 million. As noted above, patent applications experienced a one-time surge in fiscal year 1995 due to a change in law. Those applications which were received in fiscal year 1995 will be processed and examined in fiscal year 1996. The current patent fee structure allows for lower initial fees which are supplemented by income from other sources, such as maintenance fees, to cover the full cost of the patent examination and issuance process as well as other PTO operations such as patent documentation and quality review. The Office has approximately $156 million in undelivered orders, (i.e., outstanding purchase orders and contracts) for goods and services that are not reflected in the financial statements. No funds have been reserved for the personnel costs related to the processing of applications received in fiscal year 1995 or before. In addition, the Office has an Annual Leave liability of approximately $16 million and an actuarial liability of approximately $2.5 million that are covered by available budgetary resources but for which no funds have been obligated. In fiscal year 1995, the PTO experienced a permanent cancellation/rescission of available funds for approximately $6 million. For fiscal year 1996 an estimated $29 million in fee collections is expected to be withheld by Congress.

PTO analysts, on a daily, weekly, and monthly basis, compare fee plans to actual revenue received, project income using regression analyses and economic models, and adjust projections accordingly. Despite application of financial tools, the PTO operates in a business-government mix. Like a business, the PTO is dependent upon the revenue from its products and services. Unlike a business, it must operate within Federal guidelines. In fiscal year 1995, patent applications exceeded plan by approximately 28,000 cases and for trademarks, applications exceeded plan by approximately 18,000 applications. In the patent area, the PTO received an unexpected surge of patent applications due to enactment of pending legislation. Unfortunately, the PTO could not respond immediately to these fluctuations. For example, not only is recruitment of patent examiners and trademark attorneys cumbersome but Government-wide restrictions on personnel ceilings prohibited additional hiring to address the new work. In a similar vein, commitments to vendors and to contractors were delayed due to the continuing resolution. In 1995, the lag between obligations (contracts with vendors) and outlays (actual payments) grew. A majority of PTO contract actions for 1995 were awarded late in the fiscal year either due to scheduled renewal dates, delays attributable to Federal procurement regulations, or to change in PTO plans attributable to changing external factors. Hence, contractor billings for expenses in fiscal year 1995, were considerably less than the incurred obligation amount.



The end result is that the PTO experienced a growth in its revenues over expenses. The PTO is undertaking or proposing actions to enhance, and to place more on a business-like footing, its financial management services. The Congress, with the concurrence of the President, has recently introduced legislation to convert the PTO to a performance-based federal corporation. Federal corporation status will provide the PTO with a flexibility to manage its resources more effectively: business-type budgets; ability to hire personnel based upon workload growth; streamlined procurement systems; and borrowing and investment authorities. The PTO is also reengineering its planning, budgeting, and execution systems; its cost management systems, and its human resources and procurement system, using private sector experiences as models. For example, a cost accounting system will be operational in fiscal year 1997. A new fee accounting system is expected to be installed in December 1996. The PTO is already using a new procurement desktop module to expedite procurement actions, has employed oral presentations for expedited procurement negotiations, and is a regular user of electronic commerce. Lastly, the PTO will soon secure a cadre of financial specialists to enhance its resource management capabilities. The net result of these actions will be a more robust, better managed financial management system.

The PTO is a provider of services, and, as such, personnel costs represent the single greatest expense. In fiscal year 1995, salaries and benefits accounted for 62 percent of operating expenses. Investments in new automation technology are also continuing to increase as some processes are transformed from paper-based to electronic systems. One of the PTO's largest automation efforts is the deployment of the Automated Patent Search (APS) system. A portion of the costs associated with deploying the APS are capitalized and depreciated over the useful life of the system. As a result, the Statement of Operations includes all APS costs expensed in fiscal year 1995 and the annual depreciation recognized on the capitalized assets.

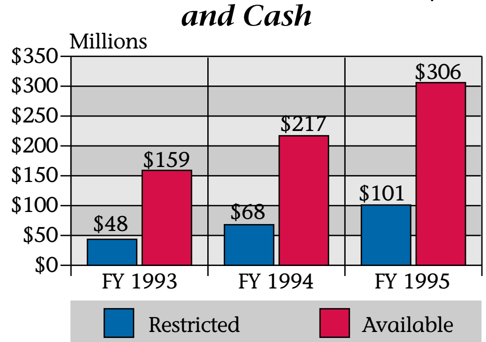
CHANGES IN PRINCIPAL ACCOUNTS

The bulk of the assets managed by the PTO are comprised of cash and capital equipment. This equipment includes hardware, software, and assets under capital lease. To expedite the collection and deposit of cash assets, various mechanisms are used which provide customers with several options for remitting fees. These include payment by mail, payments by electronic transfer, and payments to cashiers located in the PTO office complex.

Customers may also establish deposit accounts with the PTO. These monies are paid to the PTO in anticipation of a future demand for services. When a service request is received from a customer maintaining a deposit account, the appropriate fee is deducted from the pertinent account. Monthly statements are provided to deposit account customers.

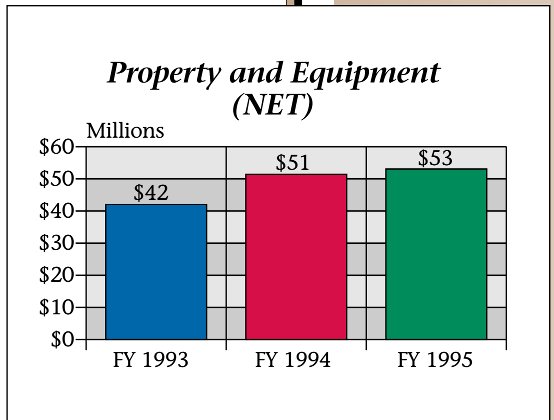
A comparison of selected ending balances for fiscal years 1993 through 1995, as reflected in the Statement of Financial Position, is displayed in the following charts. The graphs presented do not display ending balances by line item. Also, it is important to note that the restricted fund balances and equity segments associated with patent surcharge fees are not available for use without additional appropriations by the Congress.

Fund Balances with Treasury and Cash

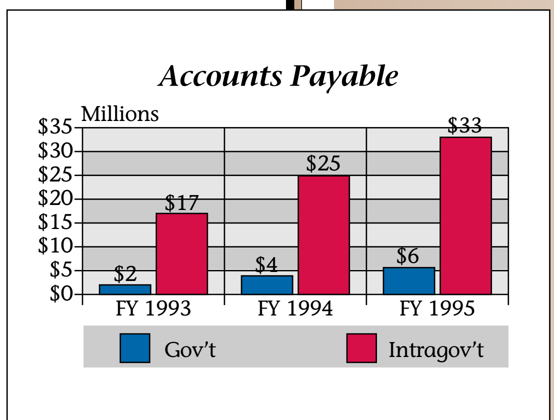


FUND BALANCES WITH TREASURY AND CASH include available and restricted amounts. Funds which are restricted include advance payments by customers, surcharge fees which were collected but not appropriated for use, and non-entity fund balances which are permanently cancelled/ rescinded and are due to Treasury. At the end of fiscal year 1995, available fund balances and cash were $306 million, an increase of approximately 41 percent above 1994 and includes approximately $42 million in fees received but not yet deposited. For the same period, funds which were restricted increased by 49 percent to a total of $101 million. Approximately $156 million of the available balances are earmarked for the payment of outstanding obligations.

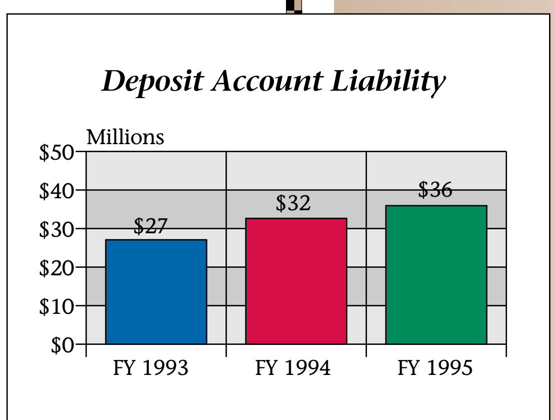
PROPERTY AND EQUIPMENT is stated at net book value of approximately $53 million, which is the original acquisition cost of $121 million less the total accumulated depreciation of $68 million. At September 30, 1995, the balance consisted of hardware, software, furniture, and office equipment.



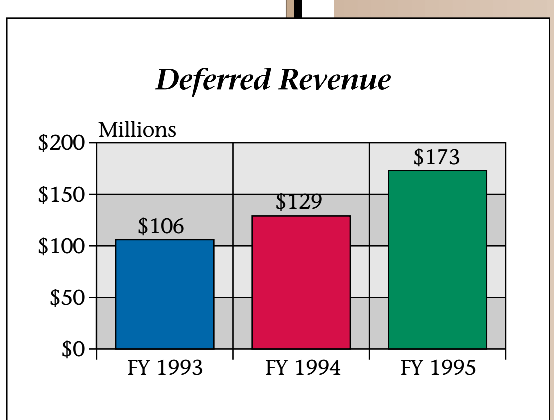
ACCOUNTS PAYABLE balances shown include Federal and non-Federal accounts payable. These are monies owed for goods and services that have been received but for which payment has not yet been made. At the end of the 1995 fiscal year, payments due to other Federal agencies (intragovernmental) were approximately $6 million and approximately $33 million was owed to non-Federal entities (governmental).

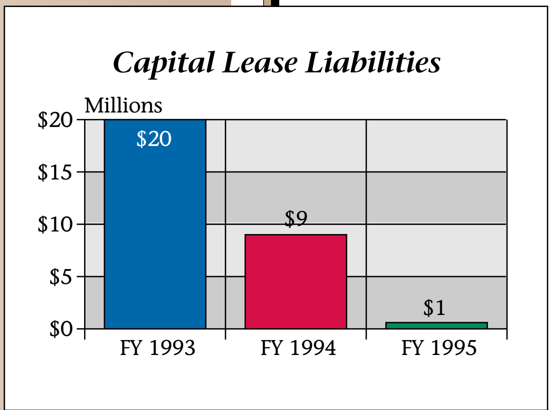


DEPOSIT ACCOUNTS are maintained by the PTO as a service to our customers. The associated liability results from advance payments made by customers in anticipation of a future demand for services. At the end of fiscal year 1995, the total liability was approximately $36 million. There was a slight increase in the balance as the result of a net increase in the number of accounts as well as the amount of funds deposited by customers.



DEFERRED REVENUE represents fees received but not earned until the related service is provided and checks undeposited at year-end. Total deferred revenue as of September 30, 1995 was approximately $173 million. The increase in deferred revenue was a result of an increase in applications received as well as a processing backlog.



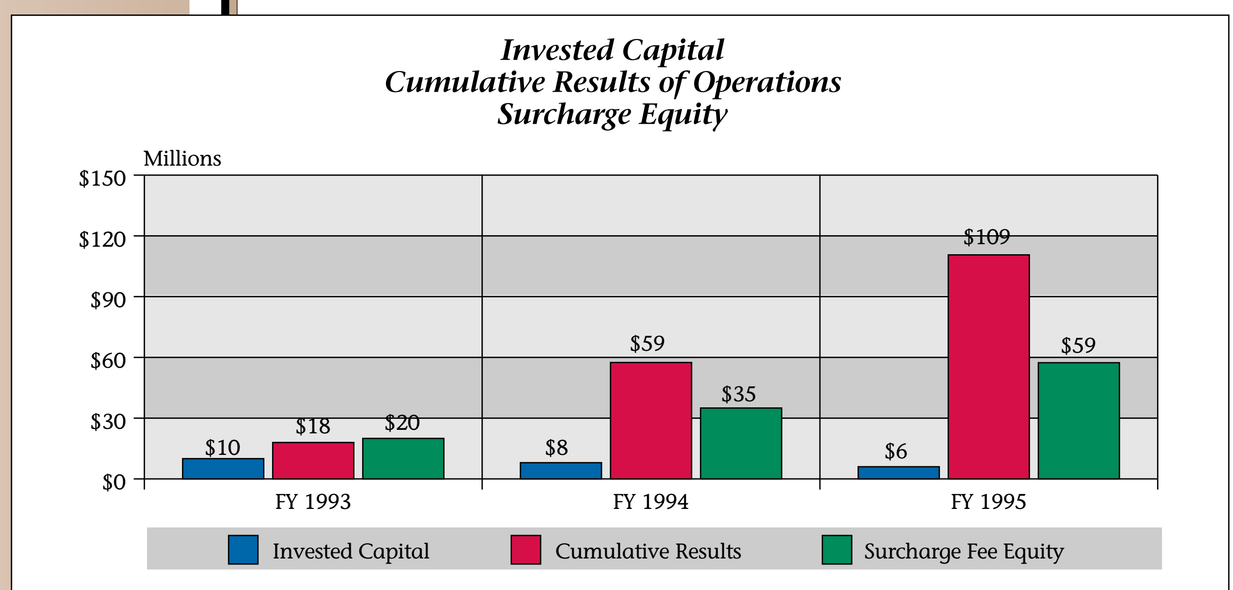


CAPITAL LEASE LIABILITIES represent future payments owed for capital lease transactions. The lease total for future payments decreased by 93 percent due to the purchase of previously leased hardware used in connection with the Patent and Trademark Office's Local Area Network (PTONet) and the Automated Patent Search (APS) system. The only remaining Capital Leases are those for reproduction equipment leases which have a duration of three to five years. With the exception of reproduction equipment, the current policy of the PTO is to purchase rather than lease capital assets. At the end of fiscal year 1995, the total liability was approximately $1 million.

INVESTED CAPITAL is the net book value of capitalized fixed assets which were purchased with appropriations from general taxpayer revenue. Since the PTO is no longer funded from taxpayer revenues, this account balance will decrease each year as depreciation expense is realized. The balance in this account was $6 million on September 30, 1995, a decrease of 25 percent from the balance of $8 million on September 30, 1994.

CUMULATIVE RESULTS OF OPERATIONS represents the total unrestricted net operating gain which has been realized over the years. The balance in this account does not include surcharge fees which have been earned but not appropriated for use. The equity position associated with the surcharge fees is shown separately. This account does not reflect charges for outstanding purchase orders valued at $156 million.

SURCHARGE FEE EQUITY is a segment of net position. This portion of the equity position is segregated due to restrictions associated with the availability of the surcharge fees. Although these fees were earned, additional action by Congress is required to make these balances available for use by the PTO. Total surcharge fee equity reached $59 million at the end of FY 1995.



SIGNIFICANT ACTIONS, ACCOMPLISHMENTS AND RESULTS

FINANCIAL MANAGEMENT: Quantitative indicators, as prescribed by the Office of Management and Budget (OMB), monitor progress towards improved financial management. The following chart depicts the goals or target performance established by OMB for fiscal year 1995 and the performance of the PTO during that period.

MEASURE	TARGET PERFORMANCE	PTO PERFORMANCE
Percent of Timely Vendor Payments	95%	99%
Percent of Payroll by Electronic Transfer	90%	96%
Percent of Treasury's Agency Locations Fully Reconciled	95%	100%
Timely Posting of Inter-agency Charges	30 days	26 days
Timely Reports to Central Agencies	95%	100%
Timely Travel Payments Avg. Processing Time	15 days	2 days
Audit Opinion on FY 95 Financial Statement	Unqualified	Unqualified
Material Weaknesses Reported by Auditor	None	Two

FINANCIAL SYSTEMS: Prior to October 1, 1991, the majority of the accounting activities were performed by an administrative center within the National Oceanographic and Atmospheric Administration (NOAA). At the beginning of FY 1992, the PTO implemented the Federal Financial System (FFS) and assumed responsibility for all accounting records. Software and hardware support for the core system are supplied via a cross-servicing arrangement with the U. S. Geological Survey of the Department of the Interior.

Other improvements and planned enhancements to PTO's financial management system include: 1) minor enhancements to the procurement subsystem; 2) improvements to the travel subsystem; 3) the redevelopment of the revenue accounting system; 4) implementation of the re-engineered budget process; 5) the implementation of the system to monitor Position and Full Time Equivalent (FTE) levels; 6) an interface of the property subsystem to the core financial system; 7) the development of Electronic Commerce capabilities; 8) the deployment of the executive information system; 9) enhancements to the Budget Formulation Module for preparing budget estimates; and 10) enhancements to the Budget Allocation Module for preparing operating plans after budget enactment.

MANAGEMENT CONTROLS: For fiscal year 1995, the PTO provided reasonable assurance of compliance with the provisions of the Federal Managers Financial Integrity Act. As required by OMB circular A-130, weaknesses in existing subsystems were identified in prior years and reported to the Department of Commerce. The implementation of compensating management controls allowed the PTO to provide the assurance referenced above. No additional material deficiencies were identified or reported in FY 1994 or FY 1995 by the PTO, and progress continues to correct weaknesses identified in earlier years. Reported weaknesses and anticipated dates for full correction follow.

SECTION 2 MATERIAL WEAKNESSES	CORRECTION DATE
System Security Weaknesses in the Cash Receipts/Deposit Accounts System (A Privacy Act Records System)	1997

SECTION 4 MATERIAL NON CONFORMANCE	CORRECTION DATE
Violation of Financial Information Standards in Cash Receipts/Deposit Accounts System	1997

DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
Statement of Financial Position

As of September 30, 1995 and 1994

	1995	1994
ASSETS		
Entity Assets:		
Intragovernmental Assets:		
Fund Balance With Treasury (note 2)	$359,358,239	$242,729,233
Accounts Receivable	5,809,818	0
Advances and Prepayments	521,649	937,610
Governmental Assets:		
Accounts Receivable	472,603	499,227
Cash	41,594,809	41,476,912
Property and Equipment, Net (note 3)	53,206,340	51,436,575
Total Entity Assets	460,963,458	$337,079,557
Non-Entity Assets		
Intragovernmental Assets		
Fund Balance With Treasury (note 2)	5,920,000	0
Total Non-Entity Assets	5,920,000	0
Total Assets	$466,883,458	$337,079,557
LIABILITIES		
Liabilities Covered by Budgetary Resources:		
Intragovernmental Liabilities:		
Accounts Payable	$5,625,633	$3,993,132
Other Liability Due to Treasury (note 8)	5,920,000	0
Governmental Liabilities:		
Accounts Payable	32,987,092	24,991,865
Accrued Payroll & Benefits	20,036,570	18,398,354
Actuarial Liability (note 4)	2,486,292	2,356,889
Customer Deposit Accounts	35,809,058	32,421,236
Deferred Revenue (note 5)	173,388,906	129,095,599
Capital Leases (note 6)	625,314	9,435,323
Accrued Annual Leave	15,780,258	14,205,493
Total Liabilities Covered by Budgetary Resources:	292,659,123	234,897,891
Total Liabilities	$292,659,123	$234,897,891
NET POSITION		
Balances:		
Invested Capital	$6,157,345	$8,327,877
Cumulative Results of Operations	108,961,991	58,748,790
Surcharge	59,104,999	35,104,999
Total Net Position	174,224,335	102,181,666
Total Liabilities and Net Position	$466,883,458	$337,079,557

The accompanying notes are an integral part of these statements.

DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
Statement of Operations and Changes in Net Position

For the years ended September 30, 1995 and 1994

	1995	1994
REVENUES AND FINANCING SOURCES		
Revenues from Sales of Goods and Services		
To the Public	$602,721,847	$541,593,879
Intragovernmental	281,615	11,338
Appropriated Capital Used	2,170,532	2,116,362
Total Revenues and Financing Sources	605,173,994	543,721,579
EXPENSES		
Program or Operating Expenses (note 7)	502,305,392	469,147,924
Depreciation and Amortization	22,605,998	16,889,332
Change in Actuarial Liability (note 4)	129,403	(604,882)
Total Expenses	525,040,793	485,432,374
Excess of Revenues and Financing Sources Over Total Expenses	$80,133,201	$58,289,205
Net Position, Beginning Balance, as Previously Stated	102,181,666	48,970,594
Cumulative Effect of a Change in Accounting Principle (note 4)	0	(2,961,771)
Net Position, Beginning Balance, as Restated	102,181,666	46,008,823
Excess of Revenues and Financing Sources Over Total Expenses	80,133,201	58,289,205
Decrease in Invested Capital	(2,170,532)	(2,116,362)
Decrease due to Permanent Cancellation/Rescission (note 8)	(5,920,000)	0
Net Position, Ending Balance	$174,224,335	$102,181,666

The accompanying notes are an integral part of these statements.

DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
Statement of Cash Flows (indirect)

For the years ended September 30, 1995 and 1994

	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess of Revenues and Financing Sources over Total Expenses	$80,133,201	$58,289,205
Adjustments Affecting Cash Flow:		
Appropriated Capital Used	(2,170,532)	(2,116,362)
Increase in Accounts Receivable	(5,783,194)	(422,981)
(Increase) Decrease in Prepayments	415,961	(1,380)
Increase in Accounts Payable	9,627,728	9,727,734
Increase in Other Liabilities	55,239,345	33,343,063
Decrease in Capital Lease Liability	(8,810,009)	(10,974,833)
Depreciation and Amortization	22,605,998	16,889,332
Increase in Accrued Annual Leave	1,574,765	1,079,863
Change in Actuarial Liability	129,403	(2,961,771)
Total Adjustments	72,829,465	44,562,665
Net Cash Provided by Operating Activities	152,962,666	102,851,870
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of Property and Equipment	(24,375,763)	(26,130,567)
Net Cash Used in Investing Activities	(24,375,763)	(26,130,567)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Permanent Cancellation/Rescission	(5,920,000)	0
Net Cash Used by Financing Activities	(5,920,000)	0
Net Cash Provided by Operating, Investing and Financing Activities	122,666,903	76,721,303
Fund Balances with Treasury and Cash, Beginning	284,206,145	207,484,842
Fund Balances with Treasury (Entity and Non-Entity) and Cash, Ending	$406,873,048	$284,206,145

The accompanying notes are an integral part of these statements.

DEPARTMENT OF COMMERCE
PATENT AND TRADEMARK OFFICE
Statement of Budgetary Resources and Actual Expenses

For the year ended September 30, 1995

	BUDGET			ACTUAL
		OBLIGATIONS		
	Resources	Direct	Reimbursed	Expenses
Salaries & Expense and Surcharge	$663,770,530	$82,129,000	$507,024,659	$525,040,793

Budget Reconciliation:		
Total Expenses	$525,040,793	
Add:		
Capital Acquisitions	24,375,763	
Accounts Receivable	5,766,955	
Capital Lease Payments	3,742,369	
Less:		
Depreciation and Amortization	22,605,998	
Net effect of current and prior year accruals	2,506,875	
Annual Leave Expense	1,574,765	
Premium on Lease Buyouts	700,754	
Change in Actuarial Liability	129,403	
Accrued Expenditures	531,408,085	
Less: Reimbursements	(539,574,786)	
Accrued Expenditures, Direct	($8,166,701)	

The accompanying notes are an integral part of these statements.

For the year ended September 30, 1994

	BUDGET			ACTUAL
		OBLIGATIONS		
	Resources	Direct	Reimbursed	Expenses
Salaries & Expense and Surcharge	$569,159,702	$88,329,000	$442,556,936	$485,432,374

Budget Reconciliation:		
Total Expenses	$485,432,374	
Add:		
Capital Acquisitions	26,130,567	
Capital Lease Payments	11,468,295	
Change in Actuarial Liability	604,882	
Less:		
Fiscal Year 1994 Capital Lease Acquisitions	505,778	
Depreciation and Amortization	16,889,332	
Annual Leave Expense	1,079,863	
Other	29,805	
Accrued Expenditures	505,131,340	
Less: Reimbursements	(443,964,722)	
Accrued Expenditures, Direct	$61,166,618	

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. Summary of Significant Accounting Policies

Basis of Presentation
As required by the Chief Financial Officers Act of 1990, these financial statements have been prepared to report the financial position and results of operations of the Patent and Trademark Office (PTO) of the United States. The books and records of the PTO have served as the source of the information contained herein. The Financial Statements have been prepared in accordance with the guidance specified by the Office of Management and Budget (OMB) in Bulletin 94-01, as well as the accounting policies of the PTO; therefore, they may differ from other financial reports submitted pursuant to OMB directives for the purpose of monitoring and controlling the use of the PTO's budgetary resources.

Reporting Entity
The Patent and Trademark Office is a program of the U.S. Department of Commerce (DOC) which administers the Nation's patent and trademark laws. Since the passage of the Omnibus Budget Reconciliation Act of 1990 (OBRA), the program has been funded almost entirely by user fees. Prior to fiscal year 1993, the appropriated funds from general taxpayer revenue gradually decreased until PTO became fully fee funded in fiscal year 1993. The bulk of the fees collected are offsetting collections which are retained by the PTO until expended; however, the surcharge imposed on statutory patent fees with the enactment of the OBRA constitute offsetting receipts. These offsetting receipts are deposited into a restricted account at the U.S. Treasury. The PTO is only authorized to use monies from this account to the extent appropriated by Congress. Thus, the U.S. Treasury makes these funds available to the PTO by the issuance of a warrant each month to the extent such funds were authorized for use. The excess monies are not available to the PTO and are retained in a restricted receipt account by the U.S. Treasury. Any authorized funding which is not expended during a given fiscal year is carried forward for use in the following fiscal year.

The accompanying financial statements include the accounts for salaries and expense (13X1006), surcharge (13X5127), and customer deposits (13X6542) appropriations, which are under the control of the PTO. The PTO has no lending or borrowing authority.

Budgets and Budgetary Accounting
In fiscal years 1993 through 1995, all funding was received through the collection of user fees. User fee rates are established by rule and law.

Surcharges on patent statutory fees were established by the OBRA. Subsequent pieces of legislation removed the reference to a specific surcharge of 69%, required the PTO to deposit exact amounts of surcharges, and extended the surcharge through the end of fiscal year 1998. These represent offsetting receipts and are available to the entity only to the extent appropriated by Congress. All surcharge fees collected are recorded as revenue. However, any surcharge fees collected by the PTO, but not appropriated by Congress for use, are maintained by the U.S. Treasury as restricted funds.

Fees other than the surcharge fees referenced above are offsetting collections and are available to the PTO until expended. Funds authorized but not used in a given fiscal year are carried forward for use in future periods.

Basis of Accounting
Transactions are recorded on the accrual basis of accounting as well as on a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to the receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The accompanying financial statements are presented on the accrual basis of accounting.

Revenues and Other Financing Sources
In fiscal years 1993 through 1995, the majority of revenues were derived from the collection of user fees. Appropriations expended in prior years for the purchase of property and equipment are recognized as revenues as the assets are consumed in operations.

Advance payments which are made by customers are recorded as a liability until the related service is rendered. Fees which are remitted with initial applications are recorded as deferred revenue until the processing of the application actually begins.

Although not material in amount, some financial gifts and gifts-in-kind are received from anonymous donors. Most gifts-in-kind are used for official travel to further the attainment of the mission and management objectives of the PTO. The results of these transactions are not reflected in the PTO statements, but are included in the consolidated Gifts and Bequests Fund statements prepared by the Department of Commerce.

Funds with the U.S. Treasury
Commercial bank accounts are maintained to deposit revenues collected. All monies maintained in such accounts are transferred to the Federal Reserve Bank on the next business day following the day of deposit. In addition, some customer deposits are wired directly to the Federal Reserve Bank. All banking activity is conducted in accordance with the directives issued by the Financial Management Service of the U.S. Treasury Department. With the exception of those which are restricted, funds with the U.S. Treasury and cash are available to pay current liabilities and to finance duly authorized purchases. All disbursements are processed by the Philadelphia Regional Finance Center of the U.S. Treasury Department.

Accounts Receivable
Governmental accounts receivable represents amounts due from non-federal entities, the majority of which are due from former employees for the reimbursement of education expenses. Intragovernmental accounts receivable represents amounts due from other federal entities, of which $3.9 million is due to a financing agreement made in fiscal year 1995 to the Department of Commerce to fund the Commerce Acquistion Management System.

Advances and Prepayments
Payments made in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses when the related goods and services are received. Prior to fiscal year 1995, the PTO rendered prepayments to the U.S. Geological Survey; these prepayments were made in anticipation of services to be provided under a cross-service agreement relating to the Federal Financial System.

Cash
The majority of the cash balance consists of checks not yet deposited at the U.S. Treasury Department which are a result of fees collected by the PTO

that have not been processed due to the lag time between receipt and initial review. Small cash balances are also held outside the U.S. Treasury Department that are not material and are used as imprest funds to facilitate small purchases, local travel, and emergency salary advances. The cash balance includes undeposited checks of $41,579,809 and $41,461,912 in fiscal years 1995 and 1994, respectively, and an imprest fund of $15,000 in both years.

Property and Equipment
The buildings in which the PTO operates are leased from private concerns by the General Services Administration (GSA). Long-term leases are negotiated by GSA and appropriate rent charges are levied. The rental rates assessed by GSA and paid by the PTO approximate the market rates for similar commercial properties.

Automated data processing software purchased "off the shelf" with an estimated service life of two years or greater are capitalized when the cost exceeds $25,000.

The costs for developing custom software are capitalized when incurred for creating the detailed design, coding, and final testing of the software.

Bulk purchase costs of furniture, with an estimated service life of two years or greater are capitalized when the total monetary value of the purchase order/delivery order equals or exceeds $50,000 (including shipping and installation).

APS Hardware, equipment and other assets with an individual unit cost of $5,000 or greater (including shipping and installation) and an estimated service life of two years or greater are capitalized. In instances other than those listed above, the entire cost is recorded as an expense upon receipt of the equipment or other asset, with the following exceptions:

(1) The total amount of the order, including shipping and installation, is capitalized if the equipment procured is made via a major contract.

(2) The total amount of the order, including shipping and installation, is capitalized if the procurement represents the initial purchase of equipment in connection with the installation of a major system.

(3) If the procurement represents the purchase of additional items for an existing major system, only those items with an individual unit cost of $5,000 or greater will be capitalized.

Depreciation is calculated using the straight line method over the following service lives: APS equipment 3-10 years, APS software 3-11 years, PTONet Equipment 3-5 years, Furniture 5 years, ADP equipment 3-5 years, ADP software 3 years, Equipment 3-5 years and Assets under Capital Lease 3-5 years.

Liabilities
Liabilities represent the amount of monies or other resources that are likely to be paid by the PTO as the direct result of an event that has already occurred. All such liabilities recognized in fiscal years 1993 through 1995 have been fully funded. However, no liability can be paid by the PTO unless appropriate funding is available. Also, liabilities of the PTO arising from other than contracts can be abrogated by the government acting in its sovereign capacity.

Annual, Sick, and Other Leave
Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. An appropriate adjustment is made at the end of each fiscal year to ensure that the balance in the accrued annual leave account reflects current pay rates. Accrued annual leave is reported as covered by budgetary resources for financial statement presentation only. No portion of this liability has been obligated. To the extent current or prior year funding is not available to cover annual leave earned but not taken, funding will be obtained from future financing sources.

Sick leave and other types of non-vested leave are expensed as taken. Any liability for sick leave that is accrued by an individual but not taken is transferred to the Office of Personnel Management upon the retirement of that individual.

Retirement Plan
The PTO employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The FERS was established by the enactment of Public Law 99-335. Pursuant to this law, most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, can elect to join either FERS and Social Security or remain in CSRS.

For those employees covered by the CSRS, the PTO makes contributions equivalent to seven percent of the employee's pay. For those covered by the FERS, the PTO makes contributions equal to approximately 13 percent.

All employees are eligible to contribute to a thrift savings plan. For those employees participating in the FERS, a thrift savings plan is automatically established, and the PTO makes a mandatory one percent contribution to this plan. In addition, PTO makes matching contributions, ranging from one to four percent, for FERS eligible employees who contribute to their thrift savings plans. No matching contributions are made to the thrift savings plans established by CSRS employees.

FERS employees and certain CSRS reinstatement employees are eligible to participate in the Social Security Program after retirement. In these instances, the PTO remits the employer's share of the required contribution.

The financial statements of the PTO do not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to its employees. Such reporting is the responsibility of the Office of Personnel Management.

As required by the Federal Workforce Restructuring Act of 1994, the PTO made a contribution in fiscal year 1995 of $407,600, calculated at $80 per position on the roles as of March 31, 1995, to the Civil Service Retirement and Disability Fund.

Comparative Data
1994 Financial Statements were reclassified and restated to conform with the 1995 presentation.

Note 2. Fund Balance with Treasury

Fund Balance with Treasury consisted of the following as of September 30, 1995:

	Available	Restricted	1995	1994
Appropriated Funds	$264,444,182	$0	$264,444,182	$175,202,998
Deposit Accounts	0	35,809,058	35,809,058	32,421,236
Surcharge	0	59,104,999	59,104,999	35,104,999
Non-Entity Funds (note 8)	0	5,920,000	5,920,000	0
Total Fund Balances	$264,444,182	$100,834,057	$365,278,239	$242,729,233

Deposit Account balances represent advance payments by customers for future services.
Surcharge represents fees earned but not available for use.

Note 3. Property and Equipment

Property and Equipment consisted of the following as of September 30, 1995:

	Service Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Classes of Fixed Assets				
APS Equipment	3-10	$45,667,899	$32,284,610	$13,383,289
APS Software	3-11	22,754,455	12,460,550	10,293,905
ADP Equipment	3-5	30,301,044	14,612,765	15,688,279
ADP Software	3	6,825,181	2,135,841	4,689,340
Equipment	3-5	4,051,106	1,634,624	2,416,482
Assets Under Capital Lease	3-5	1,693,138	807,897	885,241
Furniture	5	6,179,017	2,191,062	3,987,955
PTONET	3-5	3,542,741	1,680,892	1,861,849
Total		$121,014,581	$67,808,241	$53,206,340

Assets Under Capital Lease are for reproduction equipment.

Property and Equipment consisted of the following as of September 30, 1994:

	Service Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Classes of Fixed Assets				
APS Equipment	3-10	$39,795,517	$26,967,133	$12,828,384
APS Software	3-11	19,471,225	10,018,233	9,452,992
ADP Equipment	3	19,386,929	7,449,855	11,937,074
ADP Software	3	1,558,658	850,975	707,683
Equipment	3	1,300,999	411,303	889,696
Assets Under Capital Lease	3-7	18,502,153	9,447,666	9,054,487
Furniture	5	3,851,148	1,244,505	2,606,643
APS Software in Progress		2,218,125	0	2,218,125
PTONET	3	2,089,788	348,297	1,741,491
Total		$108,174,542	$56,737,967	$51,436,575

Assets Under Capital Lease are for APS hardware, PTONET hardware, and reproduction equipment.

NOTE 4. Actuarial Liabilities

The Federal Employees Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for Patent and Trademark Office (PTO) employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the PTO. These future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability was determined using the paid losses extrapolation method calculated over the next 23-year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. In 1994, these annual benefit payments were discounted to the present value using a discount rate of 7%. The discount rates were revised in 1995 to 7.10% for year one, 6.60% in year 2, and 7.00% thereafter. Based on information provided by the Department of Labor, the Department determined that the estimated liability of the PTO as of September 30, 1995, 1994, and 1993 was $2,486,292, $2,356,889, and $2,961,771, respectively. Prior to fiscal year 1994, the PTO recorded these compensation benefits on a cash basis. The PTO has recorded the estimated liability for claims incurred as of September 30, 1994, as the effect of a change in accounting principle. The effect of the decrease in the estimated liability of $604,882 was reflected as a change in actuarial liability on the Statement of Operations and Changes in Net Position. The increase in the estimated liability for 1995 of $129,403 is reflected in the Operating Expenses on the Statement of Operations and Changes in Net Position. These amounts are expected to be paid in future periods.

NOTE 5. Deferred Revenue

Deferred revenue represents fees received but not yet earned until the related service is provided. Two types of deferred revenues are recorded. The first type results from checks received but not deposited. Unearned fees amounted to $41,204,361, and $40,499,742 as of September 30, 1995 and 1994, respectively.

The second type of deferred revenue relates to fees received on applications which underwent the initial processing phase but were not reviewed by a patent examiner or a trademark attorney. Revenues are recognized to the extent of costs incurred in the initial processing phase. The balance of the fees received is considered unearned and amounted to $132,184,545 and $88,595,857 as of September 30, 1995 and 1994, respectively.

NOTE 6. Leases

Capital Leases:
In FY 1995, PTO had commitments under leases for reproduction equipment. These leases are 36-60 months in duration. The future payments due as of September 30 are as follows:

Fiscal Year	
1996	$374,032
1997	164,374
1998	86,568
1999	73,098
2000	9,539
Total Future Lease Payments	707,611
Imputed Interest	82,297
Total Capital Lease Liability (Funded)	$625,314

Operating Leases:
The buildings in which PTO operates are leased by the General Services Administration (GSA), and PTO is charged rent intended to approximate commercial rental rates. The majority of PTO's lease agreements will expire in early fiscal year 1997. The PTO and GSA are currently involved in negotiations for future space requirements.

Fiscal Year	
1996	$45,000,000
1997 (estimate)	55,100,000
1998 (estimate)	56,700,000
1999 (estimate)	58,300,000
2000 (estimate)	60,000,000
Total Future Lease Payments	$275,100,000

Rent expense was $38,255,285 and $39,018,347 in fiscal years 1995 and 1994, respectively. The PTO will be acquiring an additional 240,000 square feet of leased space in fiscal year 1997.

NOTE 7. Program/Operating Expenses

For the Years Ended September 30

	1995	1994
Operating Expenses by Object Classification		
Personal Services and Benefits	$309,640,671	$291,386,886
Travel and Transportation	1,286,538	830,595
Rental, Communication and Utilities	48,674,938	46,070,894
Printing and Reproduction	31,465,962	30,326,630
Contractual Services	66,025,572	71,382,620
Supplies and Materials	8,128,731	7,464,602
Equipment not Capitalized	5,711,426	5,931,758
Insurance Claims and Indemnities	42,800	13,785
Other:		
(a) Other services	8,625,483	6,356,131
(b) Training	6,163,940	3,811,531
(c) Maintenance and Repair	16,539,331	5,572,492
Total Expenses by Object Class	$502,305,392	$469,147,924

An in-depth analysis of the classification of expenses between Contractual Services and Maintenance and Repair, in conjunction with a review of other budget object code classifications, was performed in 1995. This analysis resulted in differences between those expense classifications.

NOTE 8. Permanent Cancellation/Rescission of Funds

In accordance with P.L. 103-317, PTO fee collections were subject to $5,725,000 of permanent cancellations of funds during fiscal year 1995. Of the $5,725,000, the use of $2,195,000 and $3,530,000 was permanently canceled to cover GSA rent and procurement savings reductions, respectively. In addition, PTO was subject to a rescission in funds of $195,000 for administrative and travel savings in accordance with P.L. 104-19.

As of September 30, 1995, these funds had not been returned to the Department of Treasury and were included in PTO's Treasury Fund Balance. Accordingly, a non-entity asset and a corresponding liability were recorded for a total of $5,920,000.

All permanently canceled and rescinded funds were taken from fees available for use by PTO until a determination is made on whether these reductions can be deducted from restricted surcharge funds.

NOTE 9. Commitments and Contingencies

A. Commitments
In addition to future lease commitments discussed in Note 6, PTO is committed under obligations for goods and services which have been ordered but not yet received (undelivered orders) at fiscal year end. Total undelivered orders for all PTO activities amounted to $156,333,013 and $102,380,157 as of September 30, 1995 and 1994, respectively.

B. Contingencies
The PTO has not been billed by one of its contractors for personal property tax, on previously leased equipment. PTO's contractor has filed a lawsuit against the localities assessing these taxes, contesting the valuation method used in the tax calculation and corresponding tax amount due. The amount of taxes owed cannot be currently estimated, but they are not expected to be material to PTO's financial statements.

The PTO is a party in various administrative proceedings, legal actions, and claims brought by or against it, which may ultimately result in settlements or decisions adverse to the federal government. Although the ultimate disposition of these proceedings is not presently determinable, management does not expect that any liability that might ensue would be material to PTO's financial statements.