

***U.S. DEPARTMENT OF COMMERCE***  
***Office of Inspector General***

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***PATENT AND TRADEMARK OFFICE***

*New Cost Accounting System Appropriately  
Considers Reporting Requirements*

*Audit Report No. FSD-10782-8-0001 / June 1998*

*Office of Audits, Financial Statements Audit Division*





**UNITED STATES DEPARTMENT OF COMMERCE**  
**The Inspector General**  
Washington, D.C. 20230

June 30, 1998

MEMORANDUM FOR: Edward R. Kazenske  
Acting Associate Commissioner and  
Chief Financial Officer  
Patent and Trademark Office

FROM: Johnnie E. Frazier  
Acting Inspector General

SUBJECT: PTO's New Cost Accounting System  
Appropriately Considers Reporting Requirements  
Audit Report No. FSD-10782-8-0001

In conjunction with the Patent and Trademark Office's (PTO) cost management initiative, the Office of Inspector General has conducted an audit of the methodologies used by PTO's contractor to develop PTO's cost accounting system. We have made certain observations and recommendations based on our review of the contractor's final report, dated February 2, 1998; supporting documentation; and discussions with PTO and contractor personnel.

The issues and recommendations have been reviewed with your staff during the audit, and we have incorporated their comments, as appropriate. Based on our mutual agreement, we are issuing this report as final.

As required by DAO 213-5, please provide an audit action plan within 60 days of the date of this memorandum. If you have any questions regarding the contents of this report, please contact George E. Ross, Assistant Inspector General for Auditing, on (202) 482-1934.

We appreciate the cooperation and courtesies extended to us by your staff, as well as the contractor personnel, during the audit.

## **BACKGROUND**

PTO provides patent and trademark protection to inventors and businesses for their inventions and corporate and product identifications. It examines applications and grants patents on inventions, publishes and disseminates patent information, maintains search files of U.S. and foreign patents for public use, and supplies copies of patents and official records to the public. It performs similar functions for trademarks.

Unlike most government agencies, PTO is funded entirely by user fees, charging set fees for the aforementioned services that are provided to the public. Most of these fees are set by statute and may be increased only through changes in the Consumer Price Index or by congressional approval.

In order to establish fees sufficient to cover the full costs of PTO's operations, as well as be in compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA), PTO implemented a cost accounting system. FFMIA requires an entity to be in compliance with all standards issued by the Federal Accounting Standards Advisory Board (FASAB). FASAB issued the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards*, effective October 1, 1997, which requires Federal agencies, such as PTO, to accumulate costs through the use of either cost accounting systems or cost finding techniques.

Specifically, SFFAS No. 4 requires management to:

1. Define and establish responsibility segments. Managerial cost accounting should be performed to measure and report the costs of each segment's outputs. Special cost studies, if necessary, should be performed to determine the costs of outputs.
2. Report full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (a) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (b) the costs of identifiable supporting services provided by other responsibility segments within an agency and other reporting entities.
3. Incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services through billing or other advice.

## **PURPOSE AND SCOPE OF AUDIT**

The OIG was requested to perform a review of PTO's activity-based cost accounting system. This audit was performed as a separate task from the annual audit of PTO's financial statements. Our fieldwork was conducted in accordance with generally accepted government auditing standards. As a limited scope review, we did not evaluate internal controls, test compliance with significant laws and regulations, or evaluate controls over computer generated data. The limited scope review was performed under the authority of the Inspector General Act of 1978, as

amended, and Department Organization Order 10-13, dated May 22, 1980. The scope of our work entailed the following:

- Determining whether the activity-based cost methodology is appropriately applied;
- Assessing the appropriateness of the defined responsibility segments;
- Determining the appropriateness of PTO's allocation patterns;
- Assessing the sufficiency of PTO's reconciliation between its inputs and the output (e.g., whether total resources equal total activities equal total cost objects);
- Determining if the data is supported by an appropriate source; and
- Determining the sufficiency of the PTO cost accounting system to meet minimum federal cost accounting reporting requirements.

### **CURRENT STATUS OF PTO'S EFFORTS**

In 1996, PTO hired a contractor to perform an agency-wide cost management initiative. The objective of this initiative was to implement an activity-based cost accounting system throughout PTO. Through this process, models were developed for the three business lines -- Patents, Trademarks, and Information Dissemination -- as well as the In-Support-Of or corporate organizations. Cost objects, or products, were identified for each model, which included the total cost of servicing clients and producing products.

The cost accounting system was used to provide expenses by program in the Supplemental Information section of PTO's fiscal year 1997 financial statements. Although this information was not audited, it was reconciled to the total expenses reported in the audited Statement of Operations and Changes in Net Position. Since that time, modifications have been made to the model to incorporate any organizational changes as well as changes in resource and activity drivers and activities. These modifications enhance the accuracy of the financial data, and provide management with the ability to make key decisions relating to setting fees, recovering full costs, and improving customer satisfaction. Data from the cost accounting system will be used to create the fiscal year 1998 financial statements.

### **ISSUES OF CONCERN**

We recognize the significant effort that PTO has undertaken in the development and implementation of its cost accounting system. We also believe PTO has taken the necessary steps to begin effectively identifying and managing costs related to its specific business lines. As

a result of our review, we identified the following areas for improvement that should be addressed by PTO management to enhance the accuracy and reliability of PTO's financial data:

- Program codes. Program codes are used by PTO employees to identify specific tasks completed. These program codes were not originally designed to assign costs to specific products, therefore it is necessary to map program codes to specific activities. The mapping process aligns costs residing in the program codes to the activities that make up the cost objects, or products. This process is also referred to as direct cost tracing. With the development of new program codes, and the modification of existing program codes, it is necessary to closely monitor these program codes to ensure they meet the objective of modifying or adding the code (i.e., the program codes can be directly traced to an activity). It is also important that all employees are properly trained on the implementation of any program code changes.

SFFAS No. 4 states, "direct cost tracing applies to specific resources that are dedicated to particular outputs, and this method often minimizes distortion and ensures accuracy in cost assignments. Direct tracing should only be applied to items that account for a substantial portion of the cost of an output."

- Time Reporting. PTO must rely on its employees to accurately report their time. Currently there are limited controls in place to prevent or detect inaccurate reporting of time. For example, an employee may incorrectly input time related to Project A when in fact the time related to Project B. These types of inaccuracies could be minimized through a formal review process by supervisors. If proper controls surrounding the time reporting process are not implemented, the data used in the cost model may be inaccurate and lead to inadequate pricing of products. These controls should be clearly documented and monitored to ensure they are operating effectively.

OMB Circular No. A-123, *Management Accountability and Control*, states "transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

- Documented Procedures. Specific policies and procedures surrounding the newly implemented cost system were not documented in a manual, handbook, or guidebook. Although the software used, HyperABC, is documented in a manual, the manual does not incorporate the procedures necessary to prepare and input data unique to PTO into HyperABC. Although the deliverables prepared by the contractor outline the processes, detailed information is not available to guide PTO personnel to effectively utilize the cost system.

Specifically, SFFAS No. 4 states, “All managerial cost accounting activities, processes, and procedures should be documented by a manual, handbook, or guidebook of applicable accounting operations. This reference should outline the applicable activities, provide instructions for procedures and practices to be followed, list the cost accounts and subsidiary accounts related to the standard general ledger, and contain examples of forms and other documents used.”

- Integrated Interfaces. Under the current implementation, the cost accounting system is not integrated with financial and non-financial systems, such as the Federal Financial System (FFS). Information from external systems must be modified and entered into HyperABC manually. Though it is expected that the data interfaces will eventually be automated, this is not anticipated to occur before the end of the current fiscal year.

In accordance with the Joint Financial Management Improvement Program’s *System Requirements for Managerial Cost Accounting*, “managerial cost accounting systems should be fully integrated with other agency systems, that is, designed to eliminate unnecessary duplication of transaction entry and share data elements without rekeying or reformatting.”

- Data Presentation. We reviewed PTO’s draft financial statements for the six months ended March 31, 1998, to determine the presentation of the Consolidating Statement of Net Cost, which is supported by the data provided by PTO’s cost accounting system. We noted that the presentation of programs is inconsistent with the *Department’s Preliminary Guidance for FY1998 Financial Statements*, dated May 8, 1998. Although we recognize that the draft financial statements were prepared prior to receiving this guidance, PTO should ensure that the Consolidating Statement of Net Cost links the major programs and activities to PTO’s goals and objectives identified in the Department’s Strategic Plan.

The Department of Commerce Preliminary Guidance also states that “the major programs and activities list on the Statement of Net Cost should link directly to the entity’s goals and objectives in the Department’s Strategic Plan.”

## RECOMMENDATIONS

We recommend that the Acting Associate Commissioner and Chief Financial Officer ensures that:

1. Newly designed program codes are properly mapped to activities to facilitate direct input into the cost system.

2. Proper controls (i.e., preventive and detective) are in place and monitored regularly to validate the integrity of the time and attendance data.
3. The procedures surrounding the implementation and use of the cost accounting system (HyperABC) are adequately documented.
4. The cost accounting system is in compliance with the Joint Financial Management Improvement Program's *System Requirements for Managerial Cost Accounting*. Specifically, the system should be fully integrated with other agency systems to allow information to be drawn directly from other financial/non-financial systems.
5. PTO's Consolidating Statement of Net Cost is prepared in accordance with the guidance issued by the Department by linking the major programs and activities to PTO's goals and objectives identified in the Department's Strategic Plan.