Management Discussion and Analysis

FISCAL YEAR 1999 FINANCIAL HIGHLIGHTS

Our customers and stakeholders must be confident that we place the highest priority in using the resources entrusted to us effectively and efficiently. Therefore, we continually strive to realize our vision

> *"To design an integrated planning, budgeting, evaluation, and cost management process where managers and employees are empowered and held responsible for making efficient and cost-effective decisions that foster innovation and risk-taking and where a strategic, comprehensive, and integrated approach to planning and resource management is in place."*

Of course, sound planning and effective use of resources is dependent on the availability of accurate financial data. A national independent public accounting firm contracted by the U.S. Department of Commerce (DOC) Office of Inspector General (OIG) audited the PTO's fiscal year 1999 financial statements. The auditors, as they have done in the previous six years, issued an unqualified opinion that the financial statements are fairly presented and are in conformance with the Federal government's accounting and reporting standards. Routinely, in their Report on Internal Control auditors have suggested recommendations for improving internal control and operating efficiencies. However, we are pleased to announce that as a result of the PTO's success in implementing corrective actions this year, no material weaknesses or reportable conditions in the PTO's internal control were identified. This report clearly demonstrates that we place high priority on the accuracy, validity, and usefulness of our financial data.

We continue to improve and upgrade financial management systems and practices to support the evolving business environment as we move into the 21st Century. Because of the continuing pursuit of greater global intellectual property rights, the public and our customers will be increasing their demand for access to patent and trademark data, products, and services. Our response to this increased demand will be an escalated commitment to implementing new technology that will provide users faster access to more timely data and new services.

We must continue to modernize our financial management systems and information technology infrastructure to take advantage of the global information infrastructure and to achieve our vision of the future electronic workplace. We will focus on identifying and producing measurable business improvements by applying sophisticated risk management principles. Throughout this discussion and analysis we will highlight our significant fiscal year 1999 resource management achievements and will discuss future plans to achieve our vision.

Leveraging Information Technology

We are proud to have been the first Federal agency to convert a paper check into an electronic debit transaction at the point of sale. As a pilot with the U.S. Department of the Treasury (Treasury), Financial Management Service, point of sale check conversion (POSCC) project, we are able to process and settle checks electronically. The use of electronic cash settling will result in improved funds availability, reduced check processing time, better cash forecasting, and lower risk of fraud. Customers will experience streamlined checkout, a receipt as an immediate record of the purchase, and more detailed information on their monthly statements. Private merchants using the POSCC process have reported very high levels of consumer acceptance.

Starting in October 1998 customers were able to use the Trademark Electronic Application Submission (TEAS) system. TEAS has secure payment capabilities that allow trademark customers to submit applications using credit cards to pay filing fees on-line. Trademark customers filed more than 20,000 trademark applications online, representing over $5.2 million of trademark application fee revenue for fiscal year 1999.

This year we also introduced around-the-clock document ordering with our online Order Entry Management System (OEMS). OEMS provides a secure online environment for processing and validating customer credit card information. Online customers can choose from various pricing arrangements and delivery options, place orders, and then pay for a wide range of official PTO documents. In September 1999 the next generation of OEMS was installed, and now customers can also check the status of their orders online and receive many products electronically.

During the next year we will continue to expand online services to provide better service to customers and to reduce fee collection costs. We will be accepting online credit card payment for filing and maintenance fees, as well as for deposit account replenishments. Customers will also be able to use the PTO website to request a form for changing entity status and to view their deposit account information and balances and the payment window dates for maintenance fees.

Resource Management

We were one of the first Federal agencies to successfully implement an enterprise-wide activity-based cost (ABC) accounting system. The incremental deployment of ABC began in fiscal year 1998 and will continue through fiscal year 2001. By using ABC, we are able to collect and analyze the costs associated with processes and services provided to internal and external customers on a PTO-wide basis. This information is an important tool for improving cost and for resource management.

During fiscal year 1999, we began leveraging our ABC system to provide activity-based management (ABM). ABM can provide for better management and control of costs against revenue, enable more effective decision-making, and provide greater accountability over incurred costs. A logical next step in the ABC/ABM evolution is to link cost accounting information to the budget process by using data from our ABC/ABM model to create performance-based budgets and strategic plans for fiscal years 2001 and beyond.

We have become a government leader in ABC/ABM and have received recognition from numerous sources. *Government Executive* magazine cited the PTO for cost accounting excellence and identified the ABC project as a "Best Practice" in Federal financial management. Also, the Consortium for Advanced Manufacturing–International, the inventors of ABC, invited the PTO to speak at its annual conference.

The enterprise-wide data warehouse (EDW) is another tool we use to manage PTO funds. The EDW is an extensive database that delivers integrated information from a number of systems to end-users for decision support. EDW contains several years of financial, patent, and cost accounting data grouped by business unit. Built-in security rules enforce confidentiality of data among users. Future enhancements are planned to deploy the executive information system (EIS) component of the EDW in addition to adding new data on human resource, corporate planning, trademarks, and information dissemination. EIS will contain high-level aggregated data in a summarized format that will assist an executive in strategic and tactical decision-making. Any web browser can be used to access EIS, and no additional software is needed. The information will be available in various hierarchies with drill-down capabilities and will be updated on a daily basis.

Accounting for our Resources

In keeping with the evolving business environment, we are moving the core accounting system to a client server platform. Program Office Desktop (POD) was implemented PTO-wide during fiscal year 1999. POD is a state-of-the-art, commercial off-the-shelf add-on to our core financial system. It enables our program offices to relate financial accounting functions through monitoring of budgets and plans, common postings, funds control, and workflow processes. POD is fully integrated with industry standard word processing, spreadsheet packages, and document imaging to facilitate management, storage, and routing of information among users. Both a Budget Formulation Module and a Fixed Asset Module are also being considered as enhancements to POD. The Budget Formulation Module would provide program office managers with effective tools for robust planning and budget execution. The Fixed Assets Module would continue to support the main functions of inventory management and would track the status of fixed assets.

The emergence of electronic commerce continues with the implementation of our Internet Purchasing Application (IPA). The IPA accomplishes simplified purchasing transactions on the Internet that only pre-qualified vendors can use. IPA Requests for Quotes (RFQ) are issued and IPA vendors receive an automatic e-mail notification informing them that an RFQ has been posted on our Internet home page. IPA vendors create and submit quotes on the Internet in response to our RFQ, and the quotes are populated in quote sheets in our automated procurement system, which interfaces with POD. Once quotes have been evaluated and an award made, an award notification is posted to our home page. IPA offers significant advantages over traditional simplified purchasing methods. We can expedite the simplified acquisition process; achieve DOC initiatives for acquisition streamlining and socio-economic goals for awards to small businesses; and provide savings from lower prices through increased competition. All of those advantages greatly benefit our customers.

We also plan to implement Travel Manager to automate the travel process and to provide electronic storage of travel-related documents. Travel Manager will provide many benefits to our office and internal travel customers by providing greater efficiency in processing, improved accountability and greater data integrity.

Another example of leveraging information technology is automating the Public Transportation Subsidy (PTS) Program. For the first time ever, all PTO employees are eligible to participate in the PTS Program. In previous years approximately 900 MetroChek® cards were manually mailed on a quarterly basis. During fiscal year 1999 approximately 2,200 MetroChek® cards were mailed each quarter. Because of the increased number of employees now receiving the cards, we discovered there was a need for an automated system. We are now developing an automated database to manage the program while providing a means to accept employee re-certifications over the Intranet.

Management Controls

For fiscal year 1999, we provided reasonable assurance of compliance with the provisions of the Federal Managers' Financial Integrity Act. This assurance of compliance is based on continued efforts to improve all systems of internal accounting and administrative controls. Assurance indicates that our management controls are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, are consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards; assets are properly acquired and used and are safeguarded to deter theft, accidental loss, unauthorized disposition, or fraud; and performance measurement information is adequately supported.

During its audit of the fiscal year 1998 financial statements, the DOC OIG reported that management controls surrounding the Revenue Accounting and Management (RAM) system should be improved. During fiscal year 1999 corrective action was successfully implemented to substantially eliminate this control weakness.

Financial Management

The Office of Management and Budget (OMB) prescribes the use of quantitative indicators to monitor improvements in financial management. The table below shows the PTO's performance during fiscal year 1999 against the target performance established by the OMB:

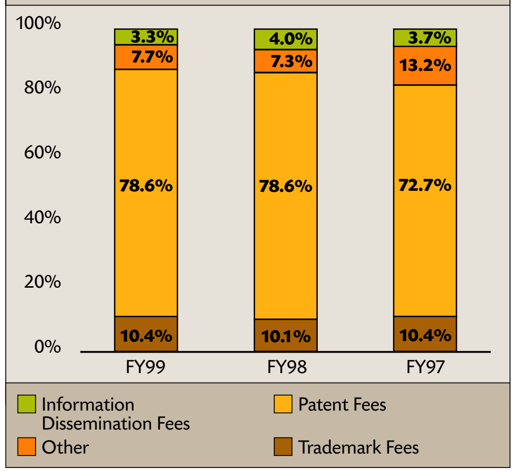
Financial Performance Measure	**Fiscal Year 1999 Performance**	**Fiscal Year 1999 Target**
Percentage of Timely Vendor Payments	99%	95%
Percentage of Payroll by Electronic Transfer	97%	90%
Percentage of Treasury Agency Locations Fully Reconciled	100%	95%
Timely Posting of Inter-Agency Charges	18 days	30 days
Timely Reports to Central Agencies	100%	95%
Average Processing Time for Travel Payments	2 days	15 days
Audit Opinion on Fiscal Year 1999 Financial Statements	Unqualified	Unqualified
Material Weaknesses Reported for Fiscal Year 1999	None	None

BUDGETARY RESOURCES

The enactment of the Omnibus Budget and Reconciliation Act (OBRA) of 1990, as amended in 1993, enabled the PTO to finance the costs of operations from user fees rather than through appropriations from taxes paid into the general fund of the Treasury. As a result, we are a fully customer-funded Federal agency operating much like a commercial enterprise. Nonetheless, as an U.S. Government entity, we remain subject to Federal appropriations laws and are not authorized to freely invest cash and fund balances. We have no investment authority, no borrowing authority, and no lines of credit. To obligate a dollar, we must have already collected that dollar. By the end of each fiscal year, the fees collected and deposited in the Fund Balance with Treasury account must cover all outstanding obligations for goods or services ordered but not yet delivered.

Our budgetary resources come from patent fees, which, traditionally, have represented about three quarters of total budgetary resources; trademark fees, which have represented approximately one tenth; information dissemination fees; and other sources, which include carryover of prior year customer fee collections in excess of those authorized for spending in a particular year, unspent resources from the previous year, and prior year obligations no longer appropriate and therefore recovered for use in the current year, up to a specified limit authorized by the Congress. Any fluctuation experienced in patent fees or the patent industry will have a significant impact on budgetary resources.

Source of Budgetary Resources



In previous years, we were also subject to a patent fee surcharge established by the OBRA legislation. The OBRA required us to deposit specified amounts of surcharge fees into a special fund receipt account at Treasury each year. By the end of fiscal year 1998, we had deposited $233.5 million. Although these fees have been earned and collected, the Congress controls their use. Budget authority is required to use these funds, and the entire amount remains restricted until appropriated.

The OBRA expired at the end of fiscal year 1998 and the *U.S. Patent and Trademark Office Reauthorization Act, Fiscal Year 1999* was enacted on November 10, 1998, providing a modest reduction—approximately 6 percent—in patent fees beginning in fiscal year 1999. The PTO is authorized by 35 U.S.C. 41(f) and 15 U.S.C. 1113(a) to adjust certain fees annually to reflect fluctuations in the Consumer Price Index (CPI). No CPI adjustment was made to fees for fiscal year 2000. However, we are considering legislative changes to adjust certain patent and trademark fees to reflect changes in costs among business line activities, products, and services, and the changes could become effective in fiscal year 2000.

FINANCIAL INDICATORS

As was discussed previously, although we are fully customer-funded, we remain a U.S. Government agency subject to appropriations laws and congressional control. As such, our main objective is to maximize the use of our budgetary resources to provide a needed economic service, which is the protection of intellectual property rights. In contrast, a commercial business's objective in the private sector is to earn a profit and to enhance the return on investment. Accordingly, when using standard private-sector financial ratios to measure our financial performance, the results do not necessarily have the same meaning as they would for a private-sector business. Nonetheless, certain financial ratios can assist us in understanding the PTO's financial performance. To demonstrate the surcharge's effect on financial performance, the financial ratios that follow are presented, in total, and net of the OBRA surcharge.

	1999	1998	1997	1996	1995	1994
Financial Ratios						
Return on Net Position	19%	19%	30%	17%	46%	57%
Total Assets Turnover	1.14	0.99	1.09	1.09	1.30	1.61
Cash Flow Return on Assets	15%	24%	25%	24%	33%	31%
Operations Index	1.75	2.81	1.91	3.71	1.91	1.76
Current Ratio	1.60	1.62	1.55	1.44	1.50	1.27
Financial Ratios, Net of Surcharge						
Return on Net Position	53%	-16%	23%	6%	49%	65%
Total Assets Turnover	1.59	1.22	1.27	1.23	1.43	1.75
Cash Flow Return on Assets	21%	18%	21%	22%	32%	29%
Operations Index	1.75	-4.94	3.27	13.94	2.30	2.02
Current Ratio	1.01	1.05	1.14	1.17	1.26	1.09

Return on Net Position: Measures management performance and operating effectiveness in terms of results of operations per dollar of net position. In a private-sector business higher returns typically reflect higher performance and effectiveness. Over the past six years, as the cumulative surcharge component of our net position has grown significantly, return on net position has steadily declined. A view of the return on net position net of the surcharge reveals the significant effect that the surcharge has had on operations, particularly in the most recent years (fiscal years 1998, 1997, and 1996), as the annual OBRA surcharge grew considerably.

Total Assets Turnover: Measures operating efficiency in terms of total revenue per dollar of total assets. Higher turnover ratios reflect greater ability in using total assets to generate revenue. Over the past six years, our total assets turnover has declined markedly, going from 1.61 five years ago down to 1.14 in fiscal year 1999. However, the major impetus for the decline is inclusion of the surcharge amounts in the calculation. Without the surcharge amounts, our total assets turnover has only declined slightly, going from 1.75 five years ago down to 1.59 in fiscal year 1999.

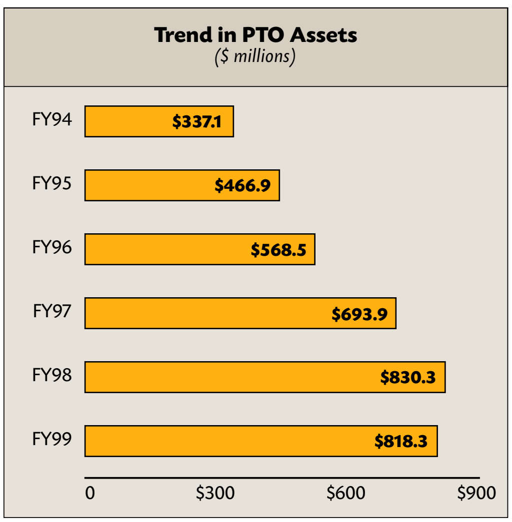
Cash Flow Return on Assets: Measures operating effectiveness in terms of cash generated from operations per dollar of total assets. Higher cash flow returns reflect greater operating performance. For fiscal year 1999, our cash flow return on assets was 15 percent. Over the five previous years, our return remained in the 24 to 33 percent range, however this includes the OBRA surcharge amounts in the calculation. This year, without the surcharge, our cash flow return on assets is actually higher, whereas in previous years our cash flow return on assets computed out higher without the surcharge amounts in the calculation. It is also significant to note that as the surcharge amounts have grown significantly in recent years, the differences between the two calculations of this ratio have also grown broader.

Operations Index: Measures operating effectiveness in terms of cash generated from operations per dollar of results of operations. A higher index reflects greater operating performance. At first glance, our operations index appears to indicate that we have been generating between $1.75 and $3.71 of cash for each dollar of net results of operations. When the effects of the surcharge are removed from this computation, the cash generated from operations range goes from $(4.94) up to $13.94, revealing the OBRA surcharge's significant effect on our operations.

Current Ratio: Measures the adequacy of resources in terms of current assets per dollar of current liabilities. Ratios of greater than 1.0 indicate that current assets are sufficient to cover current liabilities. At first glance, it appears that there has been sufficient coverage over the past six years, but this is due to the restricted surcharge cash being included in our current assets. Without the surcharge, our current ratio is just slightly over 1.0 for each of the past six years presented.

LIQUIDITY AND CAPITAL RESOURCES

Examining our total asset balance over the past six years reveals a steady pattern of growth through fiscal year 1998. Cash and Fund Balance with Treasury along with property and equipment continue to represent approximately 99.0 percent of total assets. The OBRA surcharge on patent fees collected each year was the contributing factor to the consistent growth in assets. The funds collected from the patent surcharge were deposited into the Fund Balance with Treasury special fund receipt account. The fiscal year 1999 decline in assets stemmed primarily from remitting $71.0 million from the PTO's Fund Balance with Treasury account to the general fund of the Treasury in the first quarter of the year, and then remitting another $1.0 million at the end of the year.

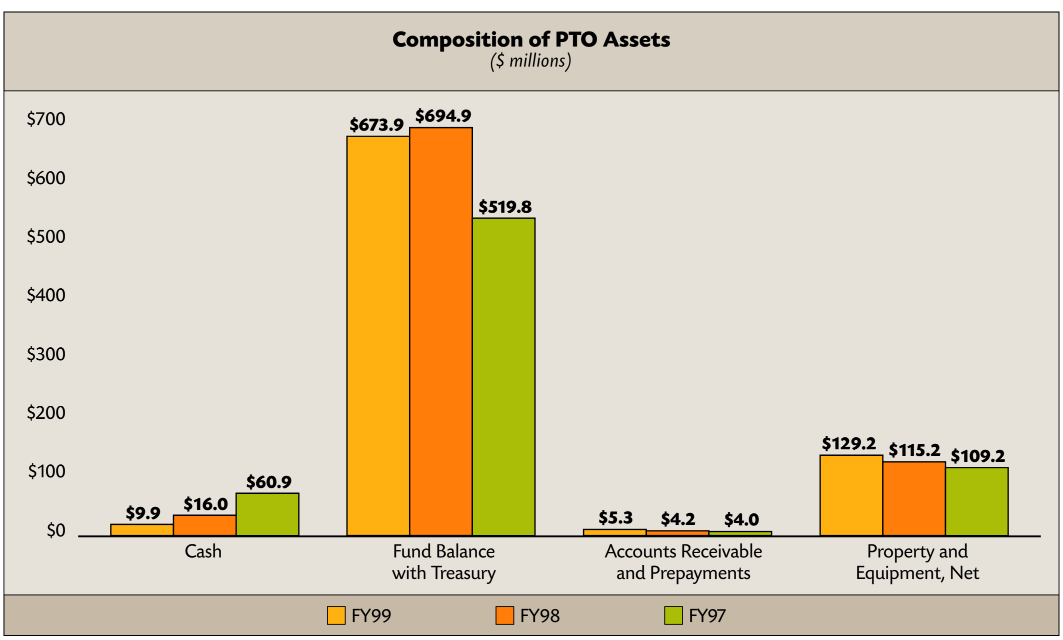


Cash and Fund Balance with Treasury

During fiscal year 1999, we generated a net of $122.3 million in cash from patent and trademark fees and other operating activities, a decrease of $76.0 million, or 38.3 percent, from the $198.3 million generated during fiscal year 1998. The primary causes for the fiscal year 1999 decrease were the elimination of the OBRA patent fee surcharge and the modest reduction in patent fees that became effective during the first quarter of fiscal year 1999. The fiscal year 1998 net cash from operations included $92.0 million in patent fee surcharge collections that were not collected in fiscal year 1999.

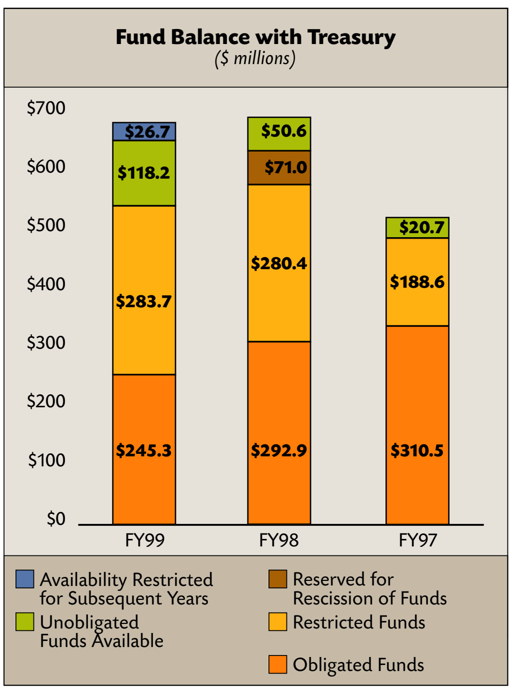
Of the $122.3 million generated from operating activities during fiscal year 1999, $77.4 million was invested in new property and equipment, principally automation technology. This amount represents an increase of $9.3 million, or 13.7 percent, from the $68.1 million of net cash invested in property and equipment during fiscal year 1998.

After funding fiscal year 1999 investments in automation technology, the net cash provided by our operating and investing activities was $44.9 million.



However, $72.0 million in rescissions of funds left us with negative cash flow, which is a $27.1 million net use of cash for the year. This represents a decrease of 120.8 percent from the $130.3 million in cash provided during fiscal year 1998.

Fiscal year 1999 ended with a total of $683.8 million in cash accounts and Fund Balance with Treasury, a 3.8 percent decline from the fiscal year 1998 balance. The financial statements, if interpreted on a cash-basis, may lead one to presume that the entire cash and Fund Balance with Treasury are funds available for spending rather than funds previously obligated that will be used to liquidate current outstanding obligations. Of the total $683.8 million, $245.3 million was set aside for the payment of existing obligations,



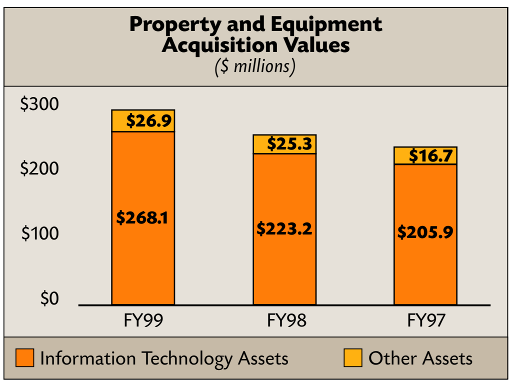
$233.5 million continues to be restricted as required by the OBRA, $9.9 million represented cash or checks in transit, and $50.2 million represented moneys held on deposit in trust for customers. Clearly, private-sector businesses would not have the $245.3 million in funds dedicated for outstanding obligations displayed outside of the liabilities in the financial statements. Therefore, after considering the restricted and obligated funds, only $144.9 million remains in the Fund Balance with Treasury. This ending balance includes $26.7 million of restricted fees not available for use until subsequent fiscal years. Only $2.2 million, or 0.3 percent, was available to meet fiscal year 1999 patent and trademark needs with an additional $116.0 million, or 17.0 percent, available to meet remaining patent and trademark program needs arising in fiscal year 2000.

Property and Equipment

At the end of fiscal year 1999, we held a net book value of $129.2 million in property and equipment (P&E) representing the original acquisition value of $295.0 million less accumulated depreciation of $165.8 million. The net book value increased $14.0 million, or 12.2 percent, over the fiscal year 1998 balance of $115.2 million. The increase reflects the substantial and sustained commitment to automation technology.

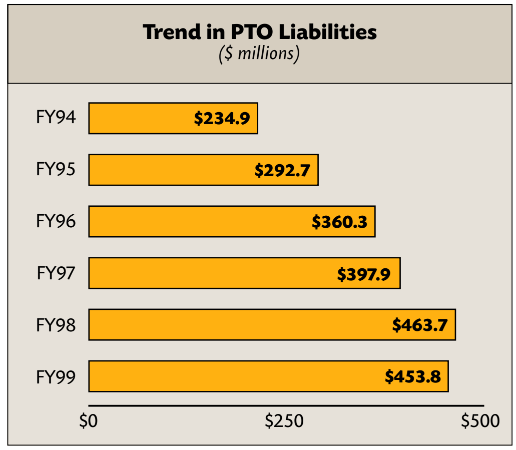
P&E is one of our largest owned assets. Investment in automation technology has increased substantially in recent years, and continues to be a high priority. Technological advancements provide new opportunities to modernize and streamline operations. These advancements will provide the most accessible means to a wide variety of data and will also help reduce the flow of paper and the storage required to house paper documentation. Further, it will maintain the integrity of data files and the ability to retrieve those files efficiently. The benefits of electronic data capture, data searching, and retrieval of patent and trademark information are clear.

We have not automated without a well thought-out plan, nor have we automated simply for the sake of automation. To meet the challenges of the future, we have developed an ambitious strategic agenda to help position the PTO to operate more successfully and efficiently in the 21st century. Our agenda is documented in the five-year Strategic Information Technology Plan that is updated annually to deliver these automation benefits in a pragmatic and timely manner. An important component of our agenda is "leveraging information technology." This corporate strategic response enables us to maintain current production levels, improve and enhance current business operations, and add new capability by migrating automated information systems to operate on an evolving information technology infrastructure. This will bring us closer to goals for reductions in patent and trademark cycle times, elimination of paper-based processing, and evolution of the businesses from manual to electronic commerce and an electronic workplace.



Liabilities

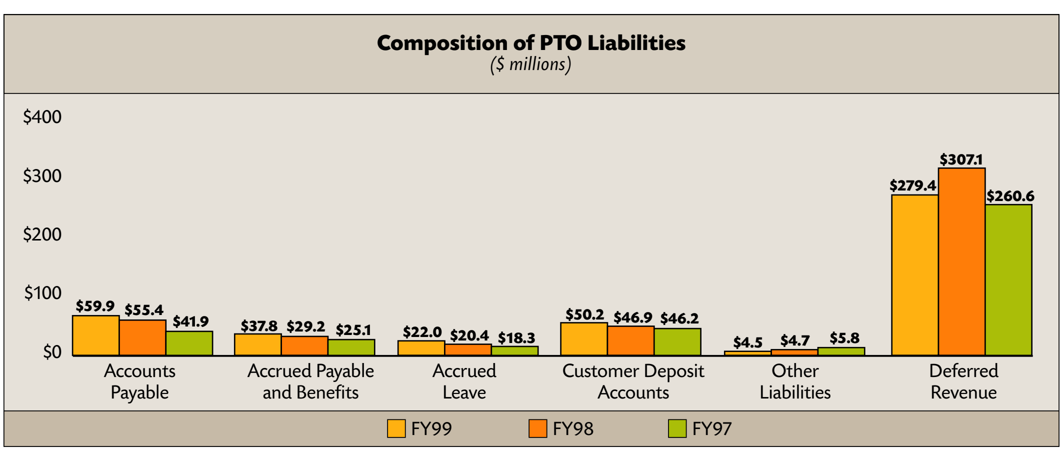
Examining our total liability balance over the past six years reveals a steady incline through fiscal year 1998, with a slight decline in fiscal year 1999. Deferred revenue, amounts payable to vendors for goods and services, amounts payable for employee salaries and benefits, and accounts held on deposit for customers represent approximately 94.0 percent of total liabilities.



The largest of the liabilities is deferred revenue. Even though fees have risen, workloads have also increased, causing longer cycle times and deferred revenue to increase as well, from $129.1 million in fiscal year 1994 to $307.1 million in fiscal year 1998, with a slight decline to $279.4 million in fiscal year 1999. Further, as additional people are employed to address growth, liabilities for salaries and benefits increase. Likewise, as workloads increase and the economy continues to flourish, more inventions and trademarks are encouraged, which in turn increases the amounts of funds customers are requesting to be held on deposit for their use.

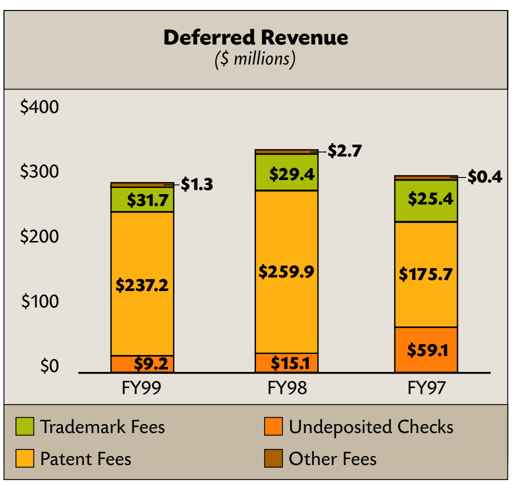
Deferred Revenue

Revenue is deferred from fees received for services requested but not fully provided and earned; that is, the undeposited checks at year-end and calculations for recognizing income for fees collected as patent and trademark applications pass through the various examination and processing stages.



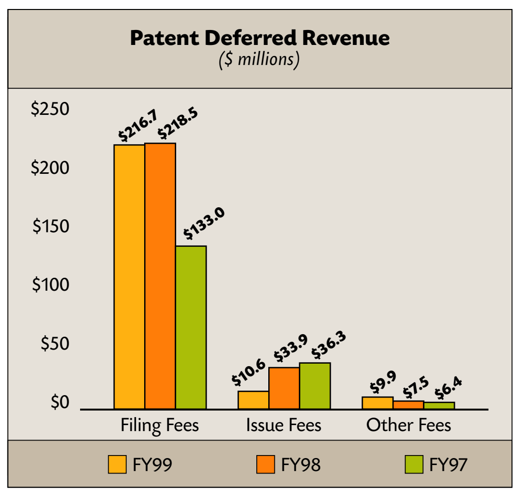
Total deferred revenue at the end of fiscal year 1999 was $279.4 million, a decrease of $27.7 million, or 9.0 percent from the fiscal year 1998 balance of $307.1 million. Unearned patent fees at the end of fiscal year 1999 decreased $22.7 million, or 8.7 percent, from the prior year while unearned trademark fees increased $2.3 million, or 7.8 percent. Other unearned PTO fees (recording, printing, and copying) decreased $1.4 million, or 51.9 percent, from fiscal year 1999 to 1998.

The decline in total deferred revenue is due in part to a significant decrease in the undeposited checks component of the liability, which decreased 39.1 percent from $15.1 million at the end of fiscal year 1998 to $9.2 million at the end of this year. This decrease in undeposited checks is attributable to improvements in the patents pre-examination process and an agency-wide effort to reduce the fee-processing backlog of undeposited checks. The revenue deferred from cash and checks received, but not yet deposited, decreased from approximately 15 days of fee deposits in fiscal year 1997 to approximately two days of fee deposits in fiscal year 1999.



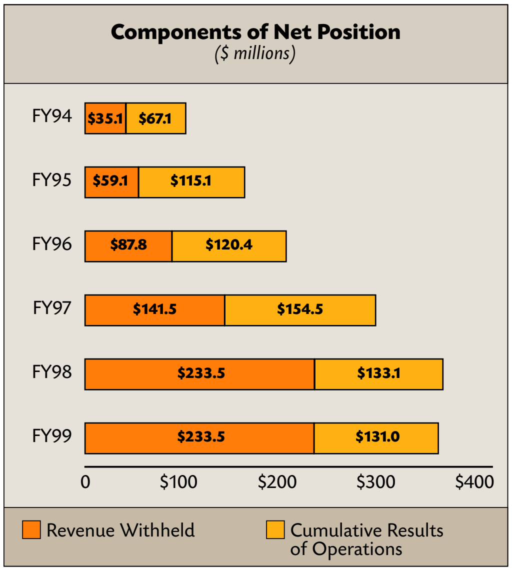
An additional contributing factor for the decrease in total deferred revenue is a change in workflow patterns for the patent issue process. A large portion of the initial data capture and building of a patent issue now occurs before receiving the fee instead of after receiving the fee, as in prior years. Unearned patent issue fees at the end of fiscal year 1999 were $10.6 million, a decrease of $23.3 million, or 68.7 percent from the fiscal year 1998 balance of $33.9 million.

At first glance it might appear that the stability in revenue deferred for patent filing fees is due to controlling the workload or cycle time. However, despite the fact that revenue deferred for patent filing fees has remained relatively constant in the past two fiscal years, workloads have increased, exceeding the growth in patent production. The plateau is attributable to the modest reduction in patent fees for fiscal year 1999 offset with the increase in cycle time.



Net Position

We capture and maintain the net position in two components: cumulative results of operations and revenue withheld. The net position section of the balance sheet is the residual interest in assets after deducting liabilities.



Examining the total net position over the past six years reveals a steady pattern of growth through fiscal year 1998, with a slight decline in fiscal year 1999. Like total assets, the primary contributor to the growth in total net position was the OBRA patent fee surcharge collected each year and deposited into the restricted special fund receipt account at the Treasury (revenue withheld). This restricted revenue withheld in prior years currently represents 64.1 percent of total net position. Total net position at the end of fiscal year 1999 was $364.5 million, a decrease of $2.1 million from the fiscal year 1998 total of $366.6 million. The fiscal year 1999 decline in net position stemmed primarily from the decline in our cumulative results of operations, which was affected by the $72.0 million rescissions of funds during the year. However, it should be noted that as the revenue withheld balance has been increasing, the cumulative results of operations balance has been decreasing.

Cumulative Results of Operations

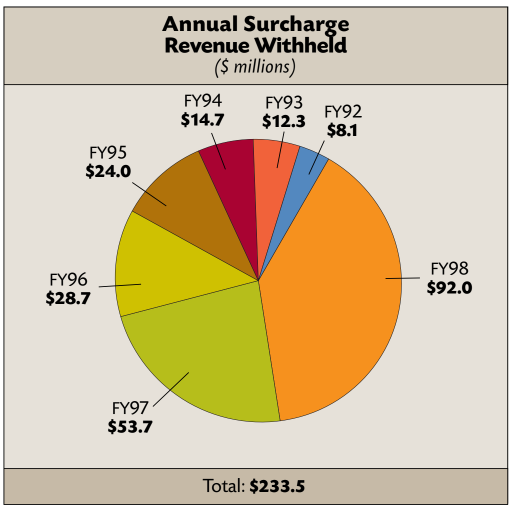
The cumulative results of operations (CRO) is the cumulative unrestricted net operating surplus recognized since inception. In theory, CRO should increase each year by the difference between revenue and financing sources and total expenses. In practice, less than the entire operating surplus has been added to CRO, because of the diversion to revenue withheld. This revenue withheld is considered an offset for spending in other Federal programs, which reduces our budget authority and restricts our ability to spend all of the customer fees to accomplish patent and trademark program objectives.

At the end of fiscal year 1999, CRO was $131.0 million, comprising net P&E in the amount of $129.2 million and non-cash assets totaling $5.3 million, leaving the remaining interest in the cash and fund balance as negative $3.5 million.

The negative $3.5 million interest in cash and the fund balance is calculated on a financial accounting basis and does not reflect the impact of our obligations for $162.8 million in unpaid undelivered orders (goods and services ordered, but not yet received) less $1.5 million in advances that provide budgetary resources on the appropriation accounting basis. The negative interest in the fund balance cannot liquidate any portion of commitments for those unpaid undelivered orders. Future funding requirements in the amount of $164.8 million will have to be earned, or surcharge revenue withheld will need to be appropriated, to liquidate unpaid undelivered orders and to meet liabilities, both funded and unfunded, at September 30, 1999.

Revenue Withheld

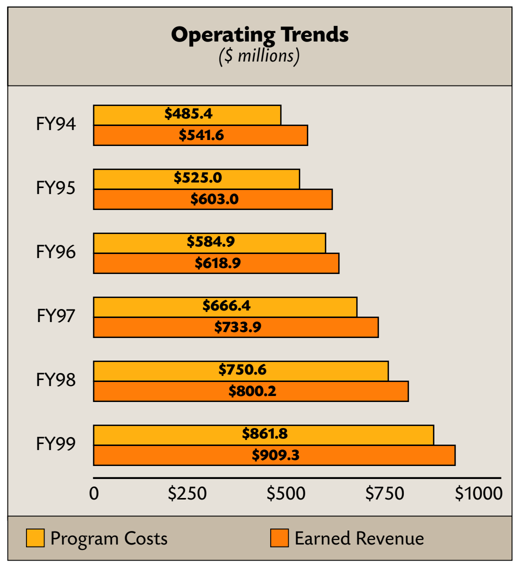
Revenue withheld is segregated as a portion of net position because the OBRA restricts its availability. Although customer-paid fees are earned, the fees can be made available for use only on the authorization of the Congress. From fiscal year 1992 through fiscal year 1998, increasing amounts of our customer fees were withheld. Initially, the surcharge amounts were small when compared with revenue, but the amounts increased over time. Annual amounts withheld ranged from $8.1 million in fiscal year 1992 to $92.0 million in fiscal year 1998, reaching a balance of $233.5 million at the end of fiscal year 1998.



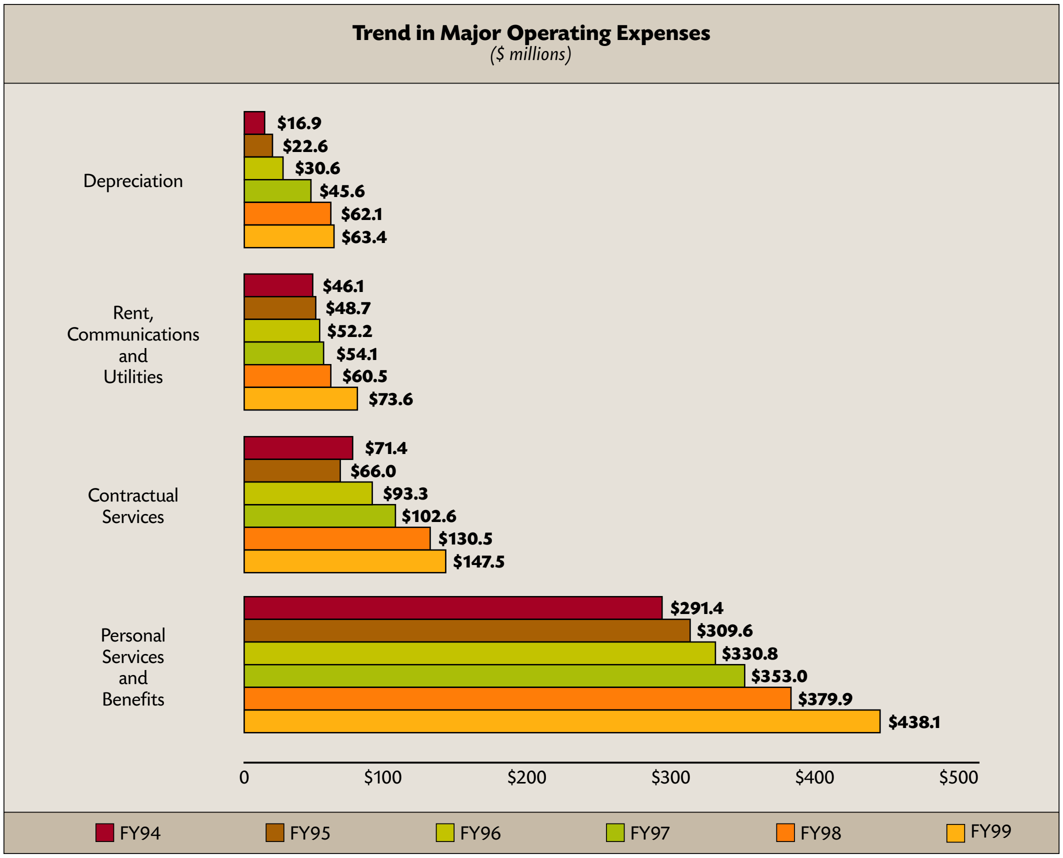
During fiscal year 1999, there was no additional fee revenue withheld, because the OBRA surcharge requirement expired at the end of fiscal year 1998. Although no additional funds were deposited into the restricted account during fiscal year 1999, the entire fund balance of $233.5 million remains unavailable for use until the Congress appropriates it.

RESULTS OF OPERATIONS

Earned revenue increased at rates significantly larger than program costs during fiscal years 1995 and 1997, causing large increases in net income from operations. However, the fiscal years immediately following those increases saw program costs increasing at rates significantly higher than earned revenue as is evident in the decline in net income from operations during fiscal years 1996 and 1998. Although earned revenue reached an all time high, in fiscal year 1999, unfortunately, we did not experience the same rebound in net income from operations that occurred during fiscal years 1995 and 1997.



Instead, net income from operations remained relatively stable with program costs and earned revenue growing at approximately the same rate. Total program costs for fiscal year 1999 were $861.8 million, a 14.8 percent increase over total program costs of $750.6 million in fiscal year 1998. Total earned revenue for fiscal year 1999 was $909.3 million, a 13.6 percent increase over total earned revenue of $800.2 million in fiscal year 1998. The higher rate of increase in program costs over earned revenue caused our net income from operations to decrease 4.2 percent from $49.6 million during fiscal year 1998 to $47.5 million during fiscal year 1999.



The PTO is a service organization and production is directly related to the personnel examining patent applications and registering trademarks. Accordingly, personal services and benefits costs traditionally represent over one-half of total costs. Any change or fluctuation in our staffing patterns directly affects the change in total program costs. Total personal services and benefits costs increased 15.3 percent from $379.9 million during fiscal year 1998 to $438.1 million during fiscal year 1999. This change drove the 14.8 percent increase in total program costs.

Rent, communications, utilities, contractual services, and depreciation costs traditionally comprise an additional 30.2 percent of total program costs each year. Rent, communications, and utilities tend to increase as we expand and grow. Likewise, as workload increases, additional outside contractors are needed to focus our efforts on the processing backlog. Contractor support was also needed to address the year 2000 issue and to continue improving automation technology to keep pace with the electronic workplace. Information technology research and development and systems analysis, documentation, and design are included as a component of contractual services. Depreciation costs rise as well with our growing investments in information technology.

Progress with enterprise-wide ABC accounting has allowed the PTO to move from managing program costs at a PTO-wide level to a business-line level. The costs for a particular program provide better information about specific operations. We compare trends in the PTO-wide costs to trends in the program or business-line costs to determine unusual fluctuations. As we continue to enhance and refine the ABC model, we become more adept at decreasing our traditionally indirect costs by obtaining a better understanding of a given activity and recording costs in the core accounting system at a more specific level. For example, during fiscal year 1999, as a result of refining the cost accounting methodology, we increased the amount of information technology costs attributable to specific business lines, and decreased such indirect costs not specifically connected to a business line. This more precise driving of costs to the benefiting business line is the result of greater scrutiny of the cost activities and related drivers as information regarding business operations improves. A discussion of the operations in each of our four business lines follows.

Patent Operations

Despite a modest reduction of about six percent in patent fees, earned patent revenue for fiscal year 1999 reached an all-time high of $777.6 million, a 12.5 percent increase over patent fee income of $691.3 million in fiscal year 1998. Fiscal year 1999 patent maintenance fees accounted for $257.6 million, or 33.1 percent of total patent fee revenue. Patent maintenance fees have traditionally been the largest category of patent fee income. Therefore, fluctuations in rates of renewal can significantly affect patent revenue. There can be no assurance that we will be able to sustain or improve on historic or current renewal rates in future years. Renewal rates are currently 83.1 percent at the first stage (at the end of the third year after a patent is issued), 57.9 percent at the second stage (at the end of the seventh year after a patent is issued), and 37.7 percent at the third stage (at the end of the eleventh year after a patent is issued).

Total program costs relating to the patents business line for fiscal year 1999 were $680.5 million, a 14.0 percent increase over total patents program costs of $597.1 million in fiscal year 1998. The increase in total patents program costs was primarily driven by increases in personal services and benefits, contractual services, automation technology and printing expenses. In fiscal year 1999, personal services and benefits directly attributable to the patents program area were $329.2 million, an increase of 15.2 percent over the fiscal year 1998 total of $285.7 million. This increase is primarily due to hiring 800 patent examiners during fiscal year 1999. The additional examiners were brought on board to address the growing patent workload. In fiscal year 1999, outside contractual services relating to the patents program area were $37.6 million, an increase of 7.7 percent over the fiscal year 1998 total of $34.9 million. Likewise, automation technology expenses supporting the patents business line, which was widely supported by contractors, were $92.2 million, a increase of 18.2 percent over the fiscal year 1998 total of $78.0 million. In addition, as a result of issuing a larger number of patents, printing expenses increased 15.5 percent from $36.2 million in fiscal year 1998 to $41.8 million in fiscal year 1999.

Trademark Operations

Earned revenue from trademark fees for fiscal year 1999 was $98.2 million, a 25.2 percent increase over trademark fee income of $78.4 million in fiscal year 1998. Total program costs relating to the trademark business line for fiscal year 1999 were $109.4 million, a 26.2 percent increase over total trademarks program costs of $86.7 million in fiscal year 1998. In fiscal year 1999, personal services and benefits directly attributable to the trademarks program area were $45.1 million, an increase of 27.8 percent over the fiscal year

1998 total of $35.3 million. This rise is primarily due to increasing trademark examining attorneys by 86 during fiscal year 1999. In fiscal year 1999, contractual services relating to the trademarks program area were $6.4 million, an increase of 25.5 percent over the fiscal year 1998 total of $5.1 million, which is in line with the increase in personal services and benefits. Because of the increase in staff required to decrease the workload backlog, additional support services were necessary. In fiscal year 1999, automation technology expense supporting the trademarks business line area was $23.6 million, an increase of 44.8 percent over the fiscal year 1998 total of $16.3 million.

Information Dissemination Organization Operations

Earned revenue from the sale of information dissemination products for fiscal year 1999 was $33.5 million, a 9.8 percent increase over information dissemination income of $30.5 million in fiscal year 1998. Total program costs relating to the information dissemination business line for fiscal year 1999 were $56.7 million, a 12.3 percent increase over the fiscal year 1998 total of $50.5 million. In fiscal year 1999, personal services and benefits relating to the information dissemination program area were $10.2 million, an increase of 3.0 percent over the fiscal year 1998 total of $9.9 million. In fiscal year 1999, contractual services relating to the information dissemination program area were $10.0 million, an increase of 26.6 percent over the fiscal year 1998 total of $7.9 million. In fiscal year 1999, automation technology supporting the information dissemination business line was $9.3 million, an increase of 69.1 percent over the fiscal year 1998 total of $5.5 million. This large increase in automation technology was offset by a 25.0 percent decrease in printing costs from $2.4 million in fiscal year 1998 to $1.8 million in fiscal year 1999.

Intellectual Property Policy Operations

Our intellectual property policy program area does not generate any revenue. Total program costs relating to the intellectual property policy program area for fiscal year 1999 were $15.2 million, a 6.8 percent decrease from the fiscal year 1998 total of $16.3 million. In fiscal year 1999, personal services and benefits relating to the intellectual property policy program area were $6.5 million, an increase of 6.6 percent over the fiscal year 1998 total of $6.1 million.

LIMITATIONS

We have prepared our fiscal year 1999 financial statements in accordance with the requirements of the OMB Bulletin Number 97-01, *Form and Content of Agency Financial Statements*, and supplementary guidance provided by the DOC. OMB Bulletin Number 97-01 incorporates the concepts and standards contained in the Statements of Federal Financial Accounting Concepts (SFFAC) and the Statements of Federal Financial Accounting Standards (SFFAS) recommended by the Federal Accounting Standards Advisory Board (FASAB) and approved by the Secretary of the Treasury, the Director of the OMB, and the Comptroller General. On October 19, 1999 the American Institute of Certified Public Accountants Council designated the FASAB as the accounting standards-setting body for Federal government entities. Therefore, the SFFAS constitute generally accepted accounting principles (GAAP) for the Federal government. These concepts and standards have been set by FASAB to help Federal agencies comply with the requirements of the Chief Financial Officers Act of 1990 as amended by the Government Management and Reform Act of 1994. These two acts demand greater financial accountability from Federal agencies and require the integration of accounting, financial management, and cost accounting systems.

The financial statements that follow have been prepared in accordance with GAAP. Our financial statements consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources, the Statement of Financing, and the Statement of Cash Flows. The following limitations apply to the preparation of the financial statements:

- The financial statements have been prepared to report the PTO's financial position, net cost of operations, budgetary resources, and cash flows pursuant to the requirements of 31 U.S.C. 3515 (b).
- While the statements are prepared from our books and records in accordance with the formats prescribed by the OMB, the statements are in addition to 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 the PTO is a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

In addition, certain information contained in this discussion and analysis and in other parts of this report may be deemed forward-looking statements regarding events and financial trends that may affect our future operating results and financial positions. Such statements may be identified by words such as "estimate," "project," "plan," "intend," "believe," "expect," "anticipate," or variations or negatives thereof, or by similar or comparable words or phrases. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. Such risks and uncertainties include, but are not limited to, the following: changes in U.S. or international intellectual property laws; changes in U.S. or global economic conditions; the availability, hiring and retention of qualified staff employees; management of patent and trademark growth; government regulations; disputes with labor organizations; and deployment of new technologies. We undertake no obligation to publicly update these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of unanticipated events.

United States Patent and Trademark Office

Consolidated Balance Sheets

As of September 30, 1999 and 1998

(Dollars in thousands)	**1999**	**1998**
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	$ 673,902	$ 694,954
Accounts Receivable	1,545	2,353
Advances and Prepayments (Note 3)	753	1,463
Total Intragovernmental Assets	676,200	698,770
Cash	9,912	15,980
Accounts Receivable, Net	626	363
Advances and Prepayments (Note 3)	2,338	7
Property and Equipment, Net (Note 4)	129,180	115,159
Total Assets	$ 818,256	$ 830,279
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$ 4,189	$ 4,541
Accrued Payroll and Benefits	4,563	2,745
Accrued Postemployment Compensation	806	917
Customer Deposit Accounts (Note 2)	2,784	1,497
Total Intragovernmental Liabilities	12,342	9,700
Accounts Payable	55,728	50,800
Accrued Payroll and Benefits	33,255	26,497
Accrued Leave	21,981	20,352
Customer Deposit Accounts (Note 2)	47,423	45,424
Deferred Revenue (Note 6)	279,357	307,131
Actuarial Liability (Note 7)	3,699	3,797
Total Liabilities (Note 5)	453,785	463,701
NET POSITION		
Cumulative Results of Operations	130,942	133,049
Revenue Withheld	233,529	233,529
Total Net Position	364,471	366,578
Total Liabilities and Net Position	$ 818,256	$ 830,279

The accompanying notes are an integral part of these financial statements.

United States Patent and Trademark Office

Consolidating Statement of Net Cost

For the years ended September 30, 1999 and 1998

	1999					1998
(Dollars in Thousands)	**Patents**	**Trademarks**	**Information Dissemination**	**Intellectual Property Policy**	**Total**	**Total**
PROGRAM						
Advancement of Commerce and Trade						
With the Public	$ 522,843	$ 84,038	$ –	$ 11,717	$ 618,598	$ 545,689
Intragovernmental	157,690	25,352	–	3,534	186,576	154,374
Total Program Cost	680,533	109,390	–	15,251	805,174	700,063
Earned Revenue	(777,668)	(98,208)	–	–	(875,876)	$ (769,736)
Net Program (Income)/Cost	(97,135)	11,182	–	15,251	(70,702)	(69,673)
Collection, Analysis, and Dissemination of Statistical and Technical Information						
With the Public	–	–	43,519	–	43,519	41,052
Intragovernmental	–	–	13,152	–	13,152	9,469
Total Program Cost	–	–	56,671	–	56,671	50,521
Earned Revenue	–	–	(33,479)	–	(33,479)	(30,441)
Net Program Cost	–	–	23,192	–	23,192	20,080
Net (Income)/Cost from Operations	$ (97,135)	$ 11,182	$ 23,192	$ 15,251	$ (47,510)	$ (49,593)
TOTAL ENTITY						
Total Program Cost (Notes 10 and 11)	$ 680,533	$ 109,390	$ 56,671	$ 15,251	$ 861,845	$ 750,584
Earned Revenue	(777,668)	(98,208)	(33,479)	–	(909,355)	(800,177)
Net (Income)/Cost from Operations	$ (97,135)	$ 11,182	$ 23,192	$ 15,251	$ (47,510)	$ (49,593)

The accompanying notes are an integral part of these financial statements.

United States Patent and Trademark Office

Consolidating Statement of Changes in Net Position

For the years ended September 30, 1999 and 1998

	1999					1998
(Dollars in Thousands)	**Patents**	**Trademarks**	**Information Dissemination**	**Intellectual Property Policy**	**Total**	**Total**
Net Income/(Cost) from Operations	$ 97,135	$ (11,182)	$ (23,192)	$ (15,251)	$ 47,510	$ 49,593
Other Financing Sources:						
Imputed Financing (Note 9)	18,462	2,671	954	345	22,432	20,901
Net Increase/(Decrease) in Cumulative Results of Operations	$ 115,597	$ (8,511)	$ (22,238)	$ (14,906)	69,942	70,494
Non Operating Change–Rescissions					(72,049)	–
Increase/(Decrease) in Net Position					(2,107)	70,494
Net Position, Beginning Balance					366,578	296,084
Net Position, Ending Balance					$ 364,471	$ 366,578

The accompanying notes are an integral part of these financial statements.

United States Patent and Trademark Office

Consolidated Statement of Budgetary Resources

For the years ended September 30, 1999 and 1998

(Dollars in thousands)	**1999**	**1998**
Budgetary Resources		
Budget Authority	$ (1,049)	$ 27,000
Unobligated Balances—Beginning of Period	121,579	20,684
Spending Authority from Offsetting Collections	888,213	772,797
Adjustments (Note 12)	(202,927)	3,719
Total Budgetary Resources	$ 805,816	$ 824,200
Status of Budgetary Resources		
Obligations Incurred	$ 803,571	$ 702,621
Unobligated Balances—Available	2,245	13,263
Unobligated Balances—Not Available	–	108,316
Total Status of Budgetary Resources	$ 805,816	$ 824,200
Outlays		
Obligations Incurred	$ 803,571	$ 702,621
Spending Authority from Offsetting Collections and Adjustments	(898,969)	(776,516)
Obligated Balance, Net—Beginning of Period	292,940	310,584
Obligated Balance, Net—End of Period	(245,253)	(292,940)
Total Net Collections	$ (47,711)	$ (56,251)

The accompanying notes are an integral part of these financial statements.

United States Patent and Trademark Office

Consolidated Statement of Financing

For the years ended September 30, 1999 and 1998

(Dollars in thousands)	**1999**	**1998**
Obligations and Nonbudgetary Resources		
Obligations Incurred	$ 803,571	$ 702,621
Spending Authority from Offsetting Collections and Adjustments	(898,969)	(776,516)
Appropriation Collected	–	(27,000)
Financing Imputed for Cost Subsidies	22,432	20,901
Exchange Revenue not in the Budget	(308)	(92,167)
Total Obligations, as Adjusted, and Nonbudgetary Resources	(73,274)	(172,161)
Resources Not Funding Net Cost of Operations		
Change in Amount of Goods, Services, and Benefits		
Ordered but not yet Received or Provided	58,283	34,398
Costs Capitalized on the Balance Sheet	(77,440)	(68,059)
Financing Sources that Fund Costs of Prior Periods	(1,970)	(538)
Financing Sources that Fund Costs of Future Periods	68,716	90,588
Total Resources not Funding Net Cost of Operations	47,589	56,389
Net Costs Not Requiring or Generating Resources		
Depreciation	63,419	62,136
Revenue not Generating Resources	(90,588)	–
Other Costs not Requiring Resources	12	–
Total Net Costs not Requiring or Generating Resources	(27,157)	62,136
Financing Sources yet to be Provided	5,332	4,043
Net Income from Operations	$ (47,510)	$ (49,593)

The accompanying notes are an integral part of these financial statements.

United States Patent and Trademark Office

Consolidated Statement of Cash Flows (Indirect Method)

For the years ended September 30, 1999 and 1998

(Dollars in thousands)	**1999**	**1998**
		(Unaudited)
Cash Flows from Operating Activities		
Net Increase in Cumulative Results of Operations	$ 69,942	$ 70,494
Adjustments Affecting Cash Flow:		
Decrease in Accounts Receivable	545	1,292
Increase in Advances and Prepayments	(1,621)	(1,463)
Increase in Accounts Payable	4,576	13,477
Increase in Accrued Payroll and Benefits	8,576	4,137
Increase in Accrued Leave and Postemployment Compensation	1,518	2,023
Increase in Customer Deposit Accounts	3,286	758
(Decrease)/Increase in Deferred Revenue	(27,774)	46,575
Decrease in Actuarial Liability	(98)	(236)
Decrease in Other Liabilities	–	(871)
Depreciation, Amortization or Loss on Asset Dispositions	63,419	62,136
Total Adjustments	52,427	127,828
Net Cash Provided by Operating Activities	122,369	198,322
Cash Flows from Investing Activities		
Purchases of Property and Equipment	(77,440)	(68,059)
Net Cash Used in Investing Activities	(77,440)	(68,059)
Cash Flows from Financing Activities		
Rescissions	(72,049)	–
Net Cash Used in Financing Activities	(72,049)	–
Net Cash (Used)/Provided by Operating, Investing, and Financing Activities	$ (27,120)	$ 130,263
Fund Balance with Treasury and Cash, Beginning	$ 710,934	$ 580,671
Net Cash (Used)/Provided by Operating, Investing, and Financing Activities	(27,120)	130,263
Fund Balance with Treasury and Cash, Ending	$ 683,814	$ 710,934
Fund Balance with Treasury	$ 673,902	$ 694,954
Cash	9,912	15,980
Fund Balance with Treasury and Cash, Ending	$ 683,814	$ 710,934

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The U.S. Patent and Trademark Office (PTO) is a bureau of the U.S. Department of Commerce (DOC) promoting the use of intellectual property rights—patents, trademarks, and copyrights—as a means of achieving economic prosperity. The PTO administers the laws relevant to patents and trademarks and advises the Secretary of Commerce, the President of the United States, and the Administration on patent, trademark, and copyright protection, and trade-related aspects of intellectual property.

The PTO has four core business activities: processing patent applications, registering trademarks, disseminating information about patents and trademarks, and directing intellectual property policy. These activities not only give innovators, businesses, and entrepreneurs the protection and encouragement they need to turn their creative ideas into tangible products, but also provide protection for their inventions and trademarks.

The financial statements include the accounts for salaries and expenses (13X1006), special fund receipts (revenue withheld) (135127), special fund expenditures (13X5127), and customer deposits (13X6542) which are under the control of the PTO. The Federal budget classifies the PTO under the Commerce and Housing Credit (370) budget function. The PTO does not have custodial responsibility, nor does it have lending or borrowing authority.

Basis of Presentation

As required by the Chief Financial Officers Act of 1990 (CFO Act) and 31 U.S.C. 3515 (b), the accompanying financial statements present the financial position, net cost of operations, budgetary resources, and cash flows for the core business activities of the PTO. The books and records of the PTO serve as the source of this information.

These financial statements were prepared in accordance with the guidelines specified by the Office of Management and Budget (OMB) in Bulletin Number 97-01, *Form and Content of Agency Financial Statements*, as well as the accounting policies of the PTO and the DOC. They may therefore 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.

Basis of Accounting

Transactions are recorded on the accrual basis of accounting as well as on a budgetary basis. Budgetary accounting enables compliance with the requirements for and controls over the use of Federal funds. Under the accrual method, revenue is recognized when earned and expenses are recognized when goods or services are received, without regard to the receipt or payment of cash. The accompanying financial statements are presented on the accrual basis of accounting.

Under the authority of the CFO Act, the Federal Accounting Standards Advisory Board (FASAB) was established to recommend Federal accounting principles and standards to the Secretary of the Treasury, the Director of the OMB and the Comptroller General, co-principals of the Joint Financial Management Improvement Program (JFMIP). Specific accounting principles and standards agreed upon by the three co-principals are issued by the Director of the OMB and the Comptroller General. On October 19, 1999 the American Institute of Certified Public Accountants Council designated the FASAB as the accounting standards-setting body for Federal government entities. Therefore, the Statements of Federal Financial Accounting Standards (SFFAS) constitute generally accepted accounting principles (GAAP) for the Federal government.

The accounting principles and standards applied in preparing these financial statements are in accordance with GAAP and the following hierarchy of accounting principles:

- Individual standards agreed to by the Director of the OMB, the Comptroller General, and the Secretary of the Treasury and published by the OMB and the General Accounting Office.
- Interpretations related to the SFFASs issued by the OMB in accordance with the procedures outlined in OMB Circular A-134, *Financial Accounting Principles and Standards*.
- Requirements contained in the OMB's Form and Content Bulletin in effect for the period covered by the financial statements.

Accounting principles published by other authoritative standard-setting bodies and other authoritative sources (a) in the absence of other guidance in the first three parts of this hierarchy, and (b) if the use of such accounting principles improves the meaningfulness of the financial statements.

Budgets and Budgetary Accounting

The PTO has been fully fee-funded since fiscal year 1993. Appropriated funds from general taxpayer revenue were gradually eliminated following the passage of the Omnibus Budget Reconciliation Act (OBRA) in 1990.

The OBRA established revenue withholding on statutory patent fees. Subsequent legislation (a) removed the reference to a specific surcharge withholding of 69 percent, (b) required the PTO to withhold and deposit exact amounts of revenue, and (c) extended the revenue withholding through the end of fiscal year 1998. This withheld revenue constitutes offsetting receipts, and was deposited into a restricted special fund receipt account at the U.S. Department of the Treasury (Treasury). The PTO may use moneys from this account only as authorized by the Congress, and only as made available by the issuance of a Treasury warrant. Excess moneys not appropriated to the PTO by the Congress are retained in the restricted receipt account at the Treasury. During fiscal year 1998, the PTO collected and deposited $92,000 thousand in the restricted special fund receipt account and recognized the entire amount collected as exchange revenue on its Statement of Net Cost. The total fund balance as of September 30, 1998 is $233,529 thousand.

The *U.S. Patent and Trademark Reauthorization Act, Fiscal Year 1999* reset patent statutory fees without the OBRA surcharge. As of September 30, 1999, the PTO has not collected or deposited any additional amounts in the restricted special fund receipt account. The special fund receipt account currently has no liabilities, and the entire fund balance will remain restricted until appropriated.

Fees other than the restricted revenue withholding are offsetting collections subject to an annual congressional limitation, 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.

Revenue and Other Financing Sources

The PTO's user fee rates are established by rule and law and, consequently, in some instances may not represent full cost or market price. Since fiscal year 1993, PTO funding has been primarily through the collection of user fees. Fees that are remitted with initial applications and requests for other services are recorded as exchange revenue when received, with an adjustment at year-end to defer revenue for services that have not yet been performed.

Revenue withheld pursuant to the OBRA is also recognized as exchange revenue. Amounts remitted by customers for services not yet requested are recorded as liabilities in customer deposit accounts until those services are ordered.

The PTO's share of the cost to the Federal government for providing pension and other post-retirement benefits to eligible PTO employees is recognized as an imputed financing source.

The PTO also receives some financial gifts and gifts-in-kind from anonymous donors. All such transactions are included in the consolidated Gifts and Bequests Fund financial statements prepared by the DOC. These gifts are not of significant value and are not reflected in the PTO's financial statements. Most gifts-in-kind are used for official travel to further the attainment of the mission and objectives of the PTO.

Entity/Non-Entity

Assets that an entity is authorized to use in its operations are termed entity assets, while assets that are held by an entity but are not available for the entity's use are termed non-entity assets. With the exception of a portion of the Fund Balance with Treasury, all of the PTO's assets are entity assets and are available to carry out the mission of the PTO within existing budget constraints.

Fund Balance with Treasury

The Financial Management Service (FMS) of the Treasury maintains commercial bank accounts for revenue collected. All moneys maintained in these accounts are transferred to the Federal Reserve Bank on the next business day following the day of deposit. In addition, certain customer deposits are wired directly to the Federal Reserve Bank.

All banking activity is conducted in accordance with the directives issued by the FMS of the Treasury. The amount of unrestricted funds held by the Treasury that are available to pay current liabilities and to finance authorized purchases is limited each year by the Congress in the PTO's annual appropriation. All disbursements are processed by the Treasury.

Accounts Receivable

Intragovernmental accounts receivable represent amounts due from other Federal entities. Of total intragovernmental accounts receivable, $1,543 thousand and $2,315 thousand as of September 30, 1999 and 1998, respectively, are due to a financing agreement that the PTO and the DOC entered into during fiscal year 1995 to fund the Commerce Administrative Management System.

Governmental accounts receivable from the public represent a very small portion of the PTO's assets as the PTO requires payment prior to the provision of goods or services during the course of its core business activities. Therefore, governmental accounts receivable are comprised of amounts due from (a) former employees for the reimbursement of education expenses; (b) Patent and Trademark Depository Libraries; and (c) the European Patent Office (EPO) and the Japanese Patent Office (JPO) in accordance with a fiscal year 1999 trilateral agreement.

The PTO recorded a $12 thousand and $182 thousand allowance for uncollectible amounts to reduce the gross amount of its governmental accounts receivable to its net realizable value as of September 30, 1999 and 1998, respectively.

Advances and Prepayments

On occasion, the PTO prepays amounts in anticipation of receiving future benefits. Although a payment has been made, an expense is not recorded until goods have been received or services have been performed. The PTO also advances funds to personnel for travel costs and expenses these amounts after travel has occurred.

Cash

Most of the PTO's cash balance consists of undeposited checks for fees that were not processed at the balance sheet date due to the lag time between receipt and initial review. All such undeposited cash amounts are considered to be cash equivalents. Cash is also held outside the Treasury to be used as imprest funds for small purchases, local travel, and emergency salary advances. As of September 30, 1999 and 1998 the cash balance includes undeposited checks of $9,897 thousand and $15,965 thousand, respectively. An impress fund of $15 thousand was also held for each year.

Property and Equipment

The PTO's capitalization policies are summarized below:

Classes of Property and Equipment	Capitalization Threshold for Individual Purchases	Capitalization Threshold for Bulk Purchases
ADP Equipment	$25 thousand or greater	$500 thousand or greater
Software	$25 thousand or greater	Not applicable
Software in Progress	$25 thousand or greater	Not applicable
Furniture	$25 thousand or greater	$ 50 thousand or greater
Equipment	$25 thousand or greater	$500 thousand or greater

Contractor costs for developing custom software are capitalized when incurred for the design, coding, and testing of the software. Software in Progress is not amortized until placed in service.

All other property and equipment acquisitions are expensed upon receipt. Fully depreciated assets purchased prior to October 1, 1996 may be written off against accumulated depreciation. The buildings in which the PTO operates are leased from private concerns by the General Services Administration (GSA). Long-term leases are negotiated by the GSA and rent charges approximate to commercial rental rates are levied by the GSA and paid by the PTO. The lease arrangements with the GSA are considered operating leases.

Postemployment Compensation

Claims brought by employees of the PTO for on-the-job injuries fall under the Federal Employees Compensation Act (FECA) administered by the U.S. Department of Labor (DOL). The DOL bills each agency annually as its claims are paid, but payment on these bills is deferred two years to allow for funding through the budget process. As of September 30, 1999, the PTO recorded a $789 thousand liability for claims paid on its behalf during the benefit period July 1, 1997 through September 30, 1999. At September 30, 1998, the PTO recorded a $889 thousand liability for claims paid on its behalf during the benefit period July 1, 1996 through September 30, 1998.

Employees of the PTO who lose their jobs through no fault of their own may receive unemployment compensation benefits under the unemployment insurance program administered by the DOL. The DOL bills each agency quarterly as its claims are paid. As of September 30, 1999, the PTO recorded a $17 thousand liability for the quarter ended September for claims paid by the DOL on the PTO's behalf. At September 30, 1998, the PTO recorded a $28 thousand liability for the quarters ended June and September.

Annual, Sick, and Other Leave

Annual leave and compensatory time are accrued as earned, with the accrual being reduced as leave is taken. An adjustment is made each fiscal year to ensure that the balances in the accrued leave accounts reflect current pay rates. No portion of this liability has been obligated. To the extent current or prior year funding is not available to pay for 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.

Employee Retirement Systems and Benefits

Employees of the PTO participate in either 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, the FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees who had five years of federal civilian service prior to 1984 and who are rehired after a break in service of more than one year may be able to elect to join the FERS and Social Security system or be placed in the CSRS offset retirement system.

The financial statements of the PTO do not report CSRS or FERS assets or accumulated plan benefits that may be applicable to its employees. The reporting of such liabilities is the responsibility of the U.S. Office of Personnel Management. While the PTO reports no liability for future payments to employees under these programs, the Federal government is liable for future payments to employees through the various agencies administering these programs. The PTO does not fund post-retirement benefits such as the Federal Employees Health Benefit (FEHB) Program and the Federal Employees Group Life Insurance (FEGLI) Program. The PTO also is not required to fully fund the CSRS pension liabilities. The financial statements of the PTO recognize an imputed financing source and corresponding expense that represents the PTO's share of the cost to the Federal government of providing pension and post-retirement health and life insurance benefits to all eligible PTO employees.

For those employees covered by the CSRS and the FERS, the PTO made contributions equivalent to approximately 8.5 percent and 10.7 percent, respectively, of the employee's basic pay during both fiscal years 1999 and 1998.

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, the 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 for employees participating in the CSRS. Employees participating in the FERS are covered under the Federal Insurance Contributions Act (FICA), for which the PTO contributes a matching amount to the Social Security Administration.

For the years ended September 30, 1999 and 1998, the PTO's retirement plan contributions for CSRS and FERS participants were $32,544 thousand and $28,157 thousand, respectively. The PTO also contributed $15,187 and $11,931 thousand for the years ended September 30, 1999 and 1998, respectively, to the Social Security Administration for FICA benefits.

Deferred Revenue

Deferred revenue represents fees that have been received by the PTO for requested services but will not be fully earned until the related service has been substantially completed. Two types of deferred revenue are recorded. The first type results from checks received with a request for service that were not yet deposited due to the lag time between receipt and initial review. The second type of deferred revenue relates primarily to fees for applications that have been partially processed, and to collected issue fees for which the patent has not been issued.

Application fees that have undergone the initial processing phase but have not been reviewed by a patent examiner or trademark attorney are deferred, and revenue are recognized to the extent costs are incurred in the initial processing phase. The balance of application fees received is considered unearned. Issue fees are earned over an eight-week processing cycle. Revenue is earned to the extent costs are incurred in the processing cycle, with the remaining issue fees considered unearned.

Comparative Data

The display of programs on the Statement of Net Cost was modified to conform to revised Department of Commerce mission areas. The fiscal year 1998 Statement of Cash Flows was not audited; however, the supporting data was audited with the fiscal year 1998 financial statements. In addition, certain fiscal year 1998 statement and footnote amounts were reclassified to conform to the fiscal year 1999 presentation.

Note 2.
Fund Balance with Treasury

Non-entity funds consist of amounts held in trust by the PTO on deposit for the convenience of PTO customers. Customers have the option of maintaining a deposit account at the PTO to facilitate the order process. Customers can draw from their deposit account when they place an order and can replenish their deposit account as desired. Funds maintained in customer deposit accounts are not available for PTO use until an order has been placed. Once an order has been placed, the funds are reclassified to entity funds.

As of September 30, 1999 and 1998, the Fund Balance with Treasury consisted of the following:

	1999			1998
(Dollars in Thousands)	**Unrestricted Funds**	**Restricted Funds**	**Total**	**Total**
Appropriated Funds (Obligated)	$245,253	$ –	$245,253	$292,940
Appropriated Funds (Unobligated)	144,913	–	144,913	121,564
Revenue Withheld	–	233,529	233,529	233,529
Subtotal Entity Funds	390,166	233,529	623,695	648,033
Customer Deposit Accounts	–	50,207	50,207	46,921
Subtotal Non-Entity Funds	–	50,207	50,207	46,921
Total Fund Balance with Treasury	$390,166	$283,736	$673,902	$694,954

Note 3.
Advances and Prepayments

The PTO has authority to enter into joint projects under 15 U.S.C. section 1525 and has authority to engage in programs and exchanges to recognize technology of patented inventions under 35 U.S.C. Section 6. During fiscal year 1999, in accordance with the report language accompanying P.L. 105-277, the PTO entered into memorandums of understanding (MOU) with the National Inventors Hall of Fame (NIHF), a non-profit organization, and provided $5,000 thousand to expand its partnership with the NIHF. The PTO prepaid the NIHF to begin work on the four cooperative efforts outlined in the MOUs. A total of $1,713 thousand remains prepaid as of September 30, 1999. The PTO expects to fully expend this amount by March 31, 2000.

During fiscal year 1999 the PTO also prepaid five years of subscriptions for certain software. In addition, the PTO maintains deposit accounts with the Government Printing Office and the Department of Commerce to facilitate transactions of a recurring nature.

As of September 30, 1999 and 1998 advances and prepayments consisted of the following:

(Dollars in Thousands)	**1999**	**1998**
Intragovernmental		
Department of Commerce Goods and Services	$ 550	$ 174
Deposit Accounts	169	53
ADP Services	34	1,236
Total Intragovernmental	753	1,463
National Inventors Hall of Fame	1,713	–
Software Maintenance	609	–
Travel Advances	16	7
Total Advances and Prepayments	$3,091	$1,470

Note 4.
Property and Equipment

As of September 30, 1999, property and equipment consisted of the following:

			(Dollars in Thousands)		
Class of Fixed Asset	**Depreciation Method**	**Service Life (Years)**	**Acquisition Value**	**Accumulated Depreciation**	**Net Book Value**
ADP Equipment	SL	3-7	$166,991	$108,953	$ 58,038
Software	SL	3-11	70,428	42,919	27,509
Software in Progress	–	–	30,701	–	30,701
Furniture	SL	5	16,969	8,349	8,620
Equipment	SL	3-5	9,895	5,583	4,312
Total			$294,984	$165,804	$129,180

As of September 30, 1998, property and equipment consisted of the following:

			(Dollars in Thousands)		
Class of Fixed Asset	**Depreciation Method**	**Service Life (Years)**	**Acquisition Value**	**Accumulated Depreciation**	**Net Book Value**
ADP Equipment	SL	3-7	$153,643	$ 82,149	$ 71,494
Software	SL	3-11	56,087	38,940	17,147
Software in Progress	–	–	13,466	–	13,466
Furniture	SL	5	14,973	6,500	8,473
Equipment	SL	3-5	10,293	5,714	4,579
Total			$248,462	$133,303	$115,159

Note 5. Liabilities

The PTO records as liabilities all amounts that are likely to be paid as the direct result of events that have already occurred. The PTO considers liabilities covered by three types of resources: (1) realized budgetary resources, (2) unrealized budgetary resources, and (3) cash and Fund Balance with Treasury. Realized Budgetary Resources include obligated balances directly funding existing liabilities and unobligated balances available for spending as of September 30, 1999. Unrealized Budgetary Resources represent collections in excess of amounts appropriated for current fiscal year spending that become available for spending in subsequent fiscal years. Although these resources are not yet realized due to a time constraint, they become available in future periods to cover liabilities existing as of the Balance Sheet date. The amount of unrealized budgetary resources considered available to cover liabilities as of September 30, 1998 was reduced due to subsequent information concerning a fiscal year 1999 rescission of these funds.

A portion of cash and Fund Balance with Treasury cover liabilities that will never require the use of a budgetary resource. These liabilities consist of deposit accounts, refunds payable to customers for fee overpayments, undeposited collections and amounts collected by the PTO on behalf of other organizations.

Due to the funding structure of the PTO, budgetary resources do not cover a portion of unearned fees. The PTO's fees that were withheld and deposited into a restricted special fund receipt account are not considered a resource until appropriated and made available by the issuance of a Treasury warrant, although the PTO incurred costs to generate these fees. Therefore, budgetary resources from current operations that normally would be used to cover a portion of unearned fees have been used to cover prior year costs associated with restricted fees. In addition, the current patent fee structure sets low initial application fees following later with income from maintenance fees as a supplement to cover the full cost of the patent examination and issuance process. The combination of these funding circumstances requires the PTO to obtain additional budgetary resources to cover its liability for unearned revenue as of September 30, 1999.

As of September 30, 1999 and 1998, the following liabilities are covered by budgetary resources with the remainder not covered as follows:

(Dollars in Thousands)	**9/30/1999**	**9/30/1998**
Liabilities Covered by Resources		
Intragovernmental		
Accounts Payable	$ 4,189	$ 4,541
Accrued Payroll and Benefits	4,563	2,745
Accrued Postemployment Compensation	17	28
Customer Deposit Accounts	2,784	1,497
Total Intragovernmental	11,553	8,811
Accounts Payable	55,728	50,800
Accrued Payroll and Benefits	33,255	26,497
Customer Deposit Accounts	47,423	45,424
Deferred Revenue	141,002	54,454
Total Liabilities Covered by Resources	288,961	185,986
Liabilities Not Covered by Resources		
Intragovernmental		
Accrued Postemployment Compensation	789	889
Total Intragovernmental	789	889
Accrued Leave	21,981	20,352
Deferred Revenue	138,355	252,677
Actuarial Liability	3,699	3,797
Total Liabilities Not Covered by Resources	164,824	277,715
Total Liabilities	$453,785	$463,701

Note 6.
Deferred Revenue

As of September 30, 1999, deferred revenue consisted of the following:

(Dollars in Thousands)	**Patents**	**Trademarks**	**Information Dissemination**	**Total**
Unearned Fees	$237,208	$31,644	$1,328	$270,180
Undeposited Checks	7,688	1,330	159	9,177
Total Deferred Revenue	$244,896	$32,974	$1,487	$279,357

As of September 30, 1998, deferred revenue consisted of the following:

(Dollars in Thousands)	**Patents**	**Trademarks**	**Information Dissemination**	**Total**
Unearned Fees	$259,937	$29,435	$2,680	$292,052
Undeposited Checks	12,732	2,125	222	15,079
Total Deferred Revenue	$272,669	$31,560	$2,902	$307,131

Note 7.
Actuarial Liability

The FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have contracted 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 under the FECA for the PTO's employees are administered by the DOL and are ultimately paid by the PTO.

The DOL estimated future workers compensation (FWC) liability by applying actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, and medical and miscellaneous costs for approved compensation cases.

The DOL method of determining liability uses historical benefit payment patterns for a specific incurred period to predict the ultimate payments for that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the OMB's economic assumptions for ten-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

1999	**1998**
5.50% in year 1, 5.50% in year 2, 5.55% in year 3, 5.60% in year 4, and thereafter	5.60% in year 1, and thereafter

Based on information provided by the DOL, the DOC determined that the estimated liability of the PTO as of September 30, 1999 and 1998 was $3,699 thousand and $3,797 thousand, respectively.

Note 8.
Leases

The operating lease agreements negotiated by the GSA for the PTO's office buildings expire at various dates between fiscal year 1999 and fiscal year 2007. During fiscal years 1999 and 1998, rent expense was $60,099 thousand and $50,042 thousand, respectively.

Under existing commitments as of September 30, 1999, the minimum lease payments through fiscal year 2004 are as follows:

(Dollars in Thousands) **Fiscal Year**	
2000	$ 60,657
2001	56,944
2002	40,787
2003	38,125
2004	35,126
Total Future Minimum Lease Payments	$231,639

Note 9.
Imputed Financing

The PTO recognizes an imputed financing source and corresponding expense to represent its share of the cost to the Federal government of providing pension and post-retirement health and life insurance benefits (Pension/ORB) to all eligible PTO employees.

As of September 30, 1999 and 1998, the components of the imputed financing sources and corresponding expenses are:

(Dollars in Thousands)	**1999**	**1998**
CSRS/FERS	$ 7,840	$ 8,717
FEHB	14,540	12,139
FEGLI	52	45
Total Pension/ORB	$22,432	$20,901

Note 10.
Program or Operating Expenses

Program or operating expenses consists of both those costs that are directly charged to the business activities and those costs that are allocated to the business activities. The costs that are allocated to the business activities can be further distinguished by those costs that are centrally managed for efficiency, but can be directly controlled within the management structure of the business activities, and those costs that are indirect charges in support of the business activities that are controlled at a PTO-wide level. The designation of the allocated costs between those directly allocated to the business activities and those considered indirect are displayed in Note 11.

Total program or operating expenses as of September 30, 1999 and 1998 by expense category are as follows:

	1999			1998
(Dollars in Thousands)	**Direct**	**Allocated**	**Total**	**Total**
Personal Services and Benefits	$390,943	$ 47,187	$438,130	$379,850
Unfunded Personal Services and Benefits	24,650	2,837	27,487	22,997
Travel and Transportation	1,128	2,173	3,301	2,535
Rental, Communication and Utilities	1,498	72,052	73,550	60,505
Printing and Reproduction	46,150	1,266	47,416	42,426
Contractual Services	55,315	92,197	147,512	130,525
Training	1,676	3,846	5,522	4,812
Maintenance and Repairs	4,269	31,372	35,641	25,402
Supplies and Materials	6,289	1,501	7,790	11,259
Equipment not Capitalized	3,381	4,634	8,015	7,542
Insurance Claims and Indemnities	61	28	89	190
Other Services	372	3,601	3,973	405
Depreciation	45,597	17,822	63,419	62,136
Total Program or Operating Expenses	$581,329	$280,516	$861,845	$750,584

Note 11.
Program or Operating Expenses by Category and Responsibility Segment

The program or operating expenses as of September 30, 1999 and 1998 by expense category and responsibility segment are as follows:

	1999					1998
(Dollars in Thousands)	**Patents**	**Trademarks**	**Information Dissemination**	**Intellectual Property Policy**	**Total**	**Total**
Direct Expenses						
Personal Services and Benefits	$329,187	$45,060	$10,212	$6,484	$390,943	$337,054
Unfunded Personal Services and Benefits	20,615	2,802	748	485	24,650	20,213
Travel and Transportation	406	57	183	482	1,128	904
Rental, Communication and Utilities	83	62	1,322	31	1,498	1,555
Printing and Reproduction	41,751	2,557	1,829	13	46,150	40,928
Contractual Services	37,570	6,425	9,986	1,334	55,315	48,509
Training	1,403	116	131	26	1,676	1,175
Maintenance and Repairs	1,395	1,108	1,726	40	4,269	5,647
Supplies and Materials	4,915	512	695	167	6,289	9,211
Equipment not Capitalized	1,899	279	1,052	151	3,381	4,474
Insurance Claims and Indemnities	61	–	–	–	61	160
Other Services	128	203	39	2	372	229
Depreciation	34,711	5,777	3,956	1,153	45,597	46,079
Subtotal Direct Expenses	474,124	64,958	31,879	10,368	581,329	516,138
Allocated Expenses						
Rent	40,423	6,120	3,740	932	51,215	42,673
Telecommunications	8,344	1,424	3,955	185	13,908	8,531
Program Automation	56,234	11,672	6,237	995	75,138	42,744
Subtotal Allocated Expenses	105,001	19,216	13,932	2,112	140,261	93,948
Allocated Indirect Expenses						
Allocated Automation	36,009	11,939	3,038	1,156	52,142	58,476
Resource Management	65,399	13,277	7,822	1,615	88,113	82,022
Subtotal Allocated Indirect Expenses	101,408	25,216	10,860	2,771	140,255	140,498
Total Program or Operating Expenses	$680,533	$109,390	$56,671	$15,251	$861,845	$750,584

Note 12.
Adjustments to Budgetary Resources

As of September 30, 1999 and 1998, the components of adjustments to budgetary resources are:

(Dollars in Thousands)	**1999**	**1998**
Available Recoveries	$ 10,756	$3,719
Unavailable Collections and Recoveries	(142,683)	–
Rescission of Prior Year Funds	(71,000)	–
Total Adjustments	$(202,927)	$3,719

Note 13.
Commitments and Contingencies

Commitments

In addition to the future lease commitments discussed in Note 8, the PTO is obligated for the purchase of goods and services that had been ordered but not yet received at fiscal year-end. Total undelivered orders for all of the PTO's activities were $165,959 thousand and $224,242 thousand as of September 30, 1999 and 1998, respectively. Of these amounts $162,867 thousand and $222,772 thousand were unpaid.

Contingencies

The PTO is a party to various routine administrative proceedings, legal actions, and claims brought by or against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the Federal government. Management expects that as of September 30, 1999 it is reasonably possible that from $750 thousand to $7,500 thousand may be owed for awards or damages involving labor relations claims. Approximately $2,555 thousand may be owed for awards or damages involving labor relations claims as of September 30, 1998.

Judgment Fund

Certain legal matters to which the PTO is named a party may be administered and in some instances litigated and paid by other Federal agencies. These primarily relate to tort claims and contract disputes. Generally, amounts paid in excess of $2.5 thousand for Federal Tort Claims Act settlements or awards pertaining to these litigations are funded from a special appropriation called the Judgment Fund. During fiscal years 1999 and 1998 there were no payments from the Judgment Fund on behalf of the PTO. Although the ultimate disposition of any potential Judgment Fund proceedings cannot be determined, management does not expect that any liability or imputed costs that might ensue would be material to the PTO's financial statements.

United States Patent and Trademark Office

Required Supplemental Information

As of September 30, 1999

Intragovernmental Assets

(Dollars in Thousands)

Agency	Fund Balance with Treasury	Accounts Receivable	Prepayments
13-Department of Commerce	$ –	$1,543	$587
20-Department of Treasury	673,902	–	–
Other	–	2	167
Total	$673,902	$1,545	$754

Intragovernmental Liabilities

(Dollars in Thousands)

Agency	Accounts Payable	Accrued Payroll and Benefits	Accrued Postemployment Compensation	Customer Deposit Accounts
04-U.S. Government Printing Office	$1,755	$ –	$ –	$ –
13-Department of Commerce	1,804	–	–	89
20-Department of Treasury	–	1,183	–	–
24-Office of Personnel Management	143	2,854	–	–
89-Department of Energy	–	–	–	1,082
Other	487	526	806	1,613
Total	$4,189	$4,563	$806	$2,784